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Taxation -- Disallowance of Deduction for Unreasonable Salary Paid Unrelated Non-Partner by Partnership

of assignments, is the court following its action in regulating the activities of an associated news organization? [22]

It has been suggested that our anti-trust tradition, swinging as it has from remedies against abuse of power to a clearer recognition of the danger of the potential abuse of power as such, has become so confused that the relief necessary to cover all cases, regardless of the nature of the plaintiff and the cause of the violation, would better be vested in a federal administrative agency.[23] It is submitted, however, that the recent flexibility of judicial regulation to reach a pragmatic result, together with the cogent judicial recognition of the dangers inherent in the mere possession of a relative excess of power, even though in an unincorporated organization marketing restricted rights in an intangible commodity, are indicative of an affirmation of the broad principles of public policy underlying the anti-trust laws,[24] and of an intent to give relief commensurate with the extent of possible injury to the complainant.

TAXATION—DISALLOWANCE OF DEDUCTION FOR UNREASONABLE SALARY PAID UNRELATED NON-PARTNER BY PARTNERSHIP

A partnership contracted in writing in 1941 to pay its bookkeeper a $2,400 minimum salary plus 10% of the net sales but not to exceed 22½% of the net profits. The employee, originally hired in 1937, had worked faithfully with the firm in its formative years for very little compensation. Near the end of 1940 the partnership signed a contract with General Motors Corporation which resulted in a boom in business. In 1943 the bookkeeper's total salary under the contingent compensation contract was $46,049.41. The Commissioner, sustained by the Tax Court,[1] held that since the inflated salary was due to the war boom, rather than to the employee's capabilities and services, that only $13,000 was reasonable and disallowed the remainder. *Held*, affirmed, under I. R. C. Sec. 23 (a) 1,[2] the Commissioner and the Tax Court

22. Continuing jurisdiction was retained in the District Court in the *Associated Press* case in an attempt to solve in the most practicable manner the monopoly caused by the membership by-laws. In both the *Associated Press* and the *Ascap* cases, the courts damaged the structure of the organization only insofar as was necessary to solve the problem immediately at hand.

23. Levi, *supra* note 6.

24. See Note, 54 YALE L. J. 860 (1945).

1. 16 P-H TC MEM. DEC. ¶ 47, 119 (1947).

2. "Sec. 23. Deductions from gross income.

"In computing net income there shall be allowed as deductions:

"(a) [As amended by Section 121 of the Revenue Act of 1942, c. 619, 56 STAT. 798 (26 U. S. C. § 23 [1946])].

"Expenses,—

"(1) Trade or business expenses.—

"(A) In General. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, *including a reasonable allowance*

may disallow unreasonable deductions for salary. *Patton v. Commissioner of Internal Revenue*, 168 F. 2d 28 (C. C. A. 6th 1948).

This case appears to be the first in which a circuit court of appeals has held that a non-partner employee, in the absence of some special relationship with the partners, was paid an unreasonable salary under I. R. C. 23 (a) 1.[3] In the past, the inquiry into reasonableness of salary has been confined to those cases where a special relationship existed in corporate, partnership, and proprietorship situations. The special relationship of stockholder-officer to a corporation has caused a close scrutiny of the officer's salary.[4] Salary deduction has not been allowed when based on an individual's relation to the corporation rather than on his services.[5] In the leading case,[6] cited as authority for the holding in the *Patton* case, compensation to stockholder-officers of a corporation was disallowed because such compensation was not in reality payment for services, but a distribution of the net profits.[7] Note the close "relationship of the parties" as compared with an "ordinary" employee.

Partnerships and proprietorships frequently produce special relationships, and ties of blood and marriage replace the officer-stockholder association of the corporation. In the partnership and proprietorship situations also, ostensible salary payments have been disallowed when found to be other than remuneration for services rendered.[8] Here, also, there is not the "ordinary employee" relationship and there is usually involved a relative who is either not actually an employee, or whose work is not commensurate with the pay. In all these situations, even when the "special relationship" exists, if the work done is commensurate with the pay, the deduction for salary will be allowed.[9]

The Commissioner's authority, under I. R. C. 23 (a) 1,[10] to hold a contingent salary unreasonable cannot be denied. The innovation of holding a portion of the salary of an "ordinary employee" non-deductible may be considered an enlargement of a post war trend for ". . . the Bureau and the courts . . . to restrict contingent compensation which is greatly increased as a result of war profits, especially where those profits are not directly attributable

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for salaries or other compensation for personal services actually rendered; . . ." (Italics ours.)

3. *Ibid.*

4. Taylor & Co. v. Glenn, 62 F. Supp. 495 (W. D. Ky. 1945).

5. Lydia E. Pinkham Medicine Co. v. Comm'r of Int. Rev., 128 F. 2d 986 (C. C. A. 1st 1942), *cert. denied*, 317 U. S. 675 (1942); Botany Worsted Mills v. United States, 278 U. S. 282 (1929).

6. Botany Worsted Mills v. United States, *supra.*

7. In the case Lydia E. Pinkham Medicine Co. v. Comm'r of Int. Rev., *supra,* officers' salaries were disallowed because the officers were away for long periods and in fact rendered little or no service to the corporation.

8. Brown v. Comm'r of Int. Rev., 63 F. 2d. 66 (C. C. A. 9th 1933) (Payment to sister in absence of proof of service to partnership disallowed), *cert. denied on this point,* 290 U. S. 607 (1933); Hecht v. United States, 54 F. 2d 968 (Ct. Cl. 1932) (Above average payment to son set aside), *cert. denied,* 286 U. S. 560 (1932).

9. Weinstein v. Comm'r of Int. Rev., 166 F. 2d 81 (C. C. A. 6th 1948).

10. See note 2 *supra.*

to the *officer's* (Italics ours) services." [11] The cases indicative of the trend, however, appear to be limited to the "special relationship" situation.[12] This is apparently the first case in which such action has been taken regarding the salary paid to an unrelated employee. A possible reason for the Commissioner's holding may be found in the Tax Court report on this case.[13] The questioning of the bookkeeper indicated that the Commissioner may have suspected fraud;[14] however, fraud was not acknowledged as the reason for the decision. The use of the general term "unreasonable" in this situation, although apparently proper under 23 (a) 1,[15] indicates a wide area of control over compensation by the Commissioner. In the absence of a special relationship, and where there is arm's length bargaining between employer and employee, it is submitted that the Commissioner should act with extreme caution in substituting his opinion for that of the parties as to what is a reasonable allowance for salary.

TORTS—SLANDER OF TITLE—ADOPTION OF RESTATEMENT VIEW IN FLORIDA

Plaintiffs, owners of real property, alleged that the defendants had falsely and maliciously altered a letter (by adding a legal description over the letterhead, a jurat, and by subscribing as witnesses) from a third party concerning construction of a house on plaintiff's land, so as to make it appear to be a contract of sale. It was also alleged that the defendants then recorded the letter, thereby slandering the title of the plaintiff; and that as a result the plaintiffs lost an opportunity of sale and profit. *Held,* that the declaration was sufficient to maintain an action for slander of title. *Lehman v. Goldin,* 36 So. 2d 259 (Fla. 1948).

The case, one of first impression in Florida, relied heavily on the *Restatement of Torts,*[1] which is in accord with the majority view.[2] The rule is

11. 1 RABKIN AND JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION 726 (1947 ed.).

12. Locke Machine Co. v. Comm'r of Int. Rev., 168 F. 2d 21 (C. C. A. 6th 1948) (Director-executive officers); Taylor & Co. v. Glenn, 62 F. Supp. 495 (W. D. Ky. 1945) (Stockholder-officers).

13. See note 1 *supra.*

14. *Supra* note 1, at 411—"Q. How were the moneys that were paid to you under this agreement paid? Were they paid to you by check or cash? . . . A. It was paid to me by check and I turned around and cashed them. Q. As a matter of fact, many of them were paid in cash out of large checks that were drawn and used to pay various expenses, and to pay some money to you and some to either or both of the Pattons? A. Yes. . . . Q. What did you do with the moneys that were paid to you . . . did you invest them in anything? A. Why, no. . . . Q. Did you deposit it in any bank? A. No. . . . Q. Did you have some war bonds? A. Yes . . . I don't know how much. Q. What did you do with the balance? A. I got it. Q. What did you do with it? Where did you keep it? A. I kept it at home."

15. See note 2 *supra;* see Note, 56 HARV. L. REV. 997 (1943).

1. RESTATEMENT, TORTS §§ 624, 625, 626 (1938).

2. Gudger v. Manton, 21 Cal. 2d. 537, 134 P. 2d 217 (1943); Greenlake Investment Co. v. Swarthout, 349 Mo. 232, 161 S. W. 2d 697 (1942); Dwelle v. Home Realty and