



WHEN RESULTS COUNT

TAX VALUATION E-FLASH

Special Edition

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Law Offices – Richard Ashare, P.C. v. Commissioner, T.C. Memo. 199-282, August 24, 1999

The taxpayer is a corporate law firm with one shareholder who is also the only professional employee. The firm had won a large lawsuit, resulting in the taxpayer being awarded \$12,567,623 in legal fees. This case concerns \$1,750,000 of compensation claimed for 1993. The taxpayer had previously been audited through 1992, with the following result:

Year	Reported Compensation	Agreed Compensation	Constructive Dividend
1989	\$ 2,151,666	\$ 2,151,666	\$ -
1990	\$ 1,690,834	\$ 1,563,447	\$ 127,387
1991	\$ 2,000,000	\$ 1,947,042	\$ 52,958
1992	\$ <u>4,650,000</u>	\$ <u>4,602,596</u>	\$ <u>47,404</u>
	\$ <u>10,492,500</u>	\$ <u>10,264,751</u>	\$ <u>227,749</u>

The law firm had three directors, Mr. Ashare, his wife Marlene, and his longtime tax advisor Barry Bess. The corporation's compensation policy was to pay to Mr. Ashare annually all legal fees received during the year less an amount equal to the sum of its corporate expenses plus any funds retained for future operations.

In order to be deductible, compensation must be (1) reasonable in amount and (2) for service actually rendered to the payor in or before the year of payment. In Judge Laro's analysis, he said:

We have no doubt that the \$ 1,750,000 paid to Mr. Ashare meets the first test for

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Value measurement is used for many purposes, including:

- Business Planning
- Succession Planning
- Purchase Price Allocations
- ESOP Values
- Economic Damages
- Corporate Dissolutions
- Shareholder/Partner Disputes
- Marital Dissolutions
- Estate and Gift

deductibility; i.e., it is reasonable in amount as to the compensation that a personal service corporation such as petitioner could pay its key employee in a year for his services. Mr. Ashare's qualifications for his position with petitioner justify high compensation, as does the fact that he is vital and indispensable in petitioner's operation and success. Petitioner's business also is complex and highly specialized, and it demands a person of Mr. Ashare's expertise. See Alpha Med., Inc. v. Commissioner, supra at 945; Mayson Manufacturing Co. v. Commissioner, 178 F.2d 115, 119 (6th Cir. 1949), revg. and remanding a Memorandum Opinion of this Court dated Nov. 16, 1948; see also Pulsar Components Intl., Inc. v. Commissioner, supra; Mad Auto Wrecking, Inc. v. Commissioner, supra.

There is significant discussion of the period of time for which the compensation is paid which is not presented here, but to which the reader is commended in the full text of the case.

Judge Laro also noted,

The dispositive fact of this case is that petitioner's board, through an exercise of unwritten corporate policy, set Mr. Ashare's compensation for 1993 at \$1,750,000... In this regard, the board resolved that Mr. Ashare was entitled to receive compensation of \$ 1,750,000 during 1993 for his past and present services. The board, through the exercise of its sound business judgment, resolved that Mr. Ashare was entitled to that amount

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of compensation, and we decline to second-guess the board's wisdom..... The fact that Mr. Ashare is the one who lent the funds to petitioner is of no consequence. It is a legitimate managerial function to ascertain the amount of employee compensation that will be paid in a year, and, absent abuse, which is not present here, we decline to second-guess management's decision on the amount and timing of that compensation or on the manner in which management goes about obtaining the underlying funds

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