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COMMENTS

UPDATING THE *McCANDLESS* DOCTRINE: TAXING OF REASONABLE COMPENSATION PAID BY CLOSELY-HELD CORPORATIONS

INTRODUCTION

When two legitimate interests of society confront each other, the extent to which the law permits one to intrude upon the other is often determined by resorting to a judicial definition of the word "reasonable." Because this term is abstract, its function in adjudication, essentially a concrete fact-finding process, is not to avoid disputes but to identify the boundaries within which such disputes should be decided. Federal income tax controversies are among those decided in this manner. Thus the provision that a "reasonable allowance"¹ for compensation is deductible from taxable income does not prevent conflicts between corporations and the federal government; it merely establishes the limits within which they can be resolved.

A corporation is, of course, subject to federal tax on its income.² In calculating this income, section 162 of the Internal Revenue Code provides that a corporation can deduct "a reasonable allowance for salaries or other compensation for personal services actually rendered."³ This section thus provides that a corporation can reduce its taxable income by maximizing its allowable compensation payments.⁴

1. I.R.C. § 162 provides in pertinent part:

(a) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered. . . .

2. I.R.C. § 11 (a) provides in pertinent part that "[a] tax is hereby imposed for each taxable year on the taxable income of every corporation."

3. I.R.C. § 162, quoted in part at note 1 *supra*.

4. Following the first use of the term "reasonable compensation," in the Revenue Act of 1918, ch. 18, § 234 (a), 40 Stat. 1077 (1919) (current version at I.R.C. § 162), an interesting argument was advanced that, under the statute, a corporation could deduct a reasonable allowance for compensation *even if it had not paid it*. Griswald, *New Light on "A Reasonable Allowance for Salaries,"* 59 HARV. L. REV. 286 (1945). The argument used legislative history to advocate that the statute was intended to incorporate

After taxes are paid at the corporate level, the remaining income again becomes subject to taxation at the individual level when it is distributed to the shareholders as dividends.⁵ If the shareholder is also an employee of the corporation, he can receive payments from it of both compensation and dividends. Hence, like the corporation, he has the incentive to have the compensation payments maximized. To the extent that payments to the shareholder-employee are deemed compensation, he avoids the so-called "double taxation of dividends";⁶ the corporation, in which he has an ownership interest, is not taxed on the payment and in fact receives the benefit of a deduction for it. Furthermore, payments of compensation are classified as personal service income and are generally subject to a maximum tax rate of fifty percent,⁷ whereas payments of dividends can be taxed at a maximum rate of seventy percent.⁸ Thus the advantages to the corporation and the shareholder-employee coincide in having the payments treated as compensation; conversely, these advantages inure to the government if the payments are treated as dividends.

A straightforward reading of section 162 suggests that a finding that a given compensation payment was reasonable should

the methodology then used by the IRS in calculating income for sole proprietors and partnerships for purposes of computing the post-war excess profits tax. *Id.* at 287. Under that methodology, sole proprietors and partners were allowed a deduction for a hypothetical salary if they had not formally paid themselves one. *Id.* The IRS, however, took the position that the compensation must be paid in order to be deducted. This view was bolstered by dictum of the Supreme Court in *Lucas v. Ox Fibre Brush Co.*, 281 U.S. 115 (1930), wherein the Court stated:

On the contrary, the payments fell directly within the provisions of section 234(a) as a reasonable allowance for compensation for personal services actually rendered. The statute does not require that the services should be actually rendered during the taxable year, but that the payments therefor shall be proper expenses *paid* or *incurred* during the taxable year.

Id. at 119 (emphasis added). The IRS interpretation has, of course, prevailed.

5. I.R.C. § 301 provides:

(a) In General.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

.....

(c) Amount Taxable.—In the case of a distribution to which subsection (a) applies—

(1) Amount Constituting Dividends.—that portion which is a dividend (as defined in section 316) shall be included in gross income.

6. See generally Swift, *Reasonable Compensation, A Question of Fact*, 52 A.B.A.J. 384 (1966).

7. I.R.C. § 1348; see [1978] Index, STAN. FED. TAX REP. (CCH) ¶ 201.13.

8. *Id.* ¶ 414.

be dispositive of the issue of whether or not a deduction will be allowed. A survey of the decisional law reveals that the preponderance of authority is in accord with this position.⁹ The Court of Claims, however, has identified one factual situation in which it has refused to apply the prevailing viewpoint. Where a closely-held corporation had paid its shareholder-employees compensation but not dividends, the absence of dividends has been a fact which, of itself, has compelled the Court of Claims to invalidate a portion of the otherwise reasonable deduction.¹⁰

The Court of Claims' position represents a novel variation with regard to the ultimate question of taxation, since previously a finding of reasonableness would automatically dictate that the deduction be allowed.¹¹ Thus this doctrine¹² merits examination because it departs from the standard statutory analysis. In addition, because the Court of Claims is only one of several courts in which this issue can be litigated, the response of other courts to the interpretation of the Court of Claims must also be considered. Finally, this doctrine should be evaluated in terms of its possible effect on all reasonable compensation cases, since it could result in the dividend history of the corporation becoming the central focus in determining the propriety of any given deduction. Before these matters are considered, however, the general context in which reasonable compensation disputes occur will first be described.

BACKGROUND OF REASONABLE COMPENSATION LITIGATION

Publicly-held v. Closely-held Corporations

It is not uncommon to find individuals who enjoy the dual status of shareholder and employee in both publicly-held and closely-held corporations.¹³ However, the deductibility of com-

9. McLean and Martin, *Is "Reasonable" Enough? The McCandless Doctrine*, 54 TAXES 642, 642 (1976).

A comprehensive listing of cases on the issue can be found at *Chart of "Reasonable Compensation" Decisions*, [1978] 1 STAN. FED. TAX REP. (CCH) ¶ 1372.0127. See also 10 A.L.R.3d 125 (1966). There is also a substantial amount of commentary on the subject of what constitutes reasonable compensation. A bibliography of articles on the topic can be found at [1974] 202 TAX MNGM'T (BNA) C-7-C-8 (3d ed.).

10. *Charles McCandless Tile Service v. United States*, 422 F.2d 1336 (Ct. Cl. 1970).

11. McLean and Martin, *Is "Reasonable" Enough? The McCandless Doctrine*, 54 TAXES 642, 642 (1976).

12. The doctrine is generally called the *McCandless* doctrine after the principal Court of Claims case espousing it. *Id.* However, it is also known as the "automatic dividend rule." Holden, *Has the Court of Claims Adopted an Automatic Dividend Rule in Compensation Cases?*, 32 J. TAXATION 331 (1970).

13. There is no universal definition for the term "closely-held corpora-

pensation payments by publicly-held corporations is seldom questioned.¹⁴ The rationale behind this hands off policy of the IRS and the courts is that it is felt that forces of the marketplace complement the fiduciary duty of those who fix the compensation amounts to keep them at as low a figure as possible. Compensation payments are expenses, which the corporation ordinarily wishes to minimize because of the pressures of competition. Moreover, directors who allow inordinately high salaries and bonuses will, it is thought, find themselves answerable to non-employee shareholders who can express their dissatisfaction by removing the directors, filing derivative suits, or selling their stock.¹⁵

These additional constraints of the marketplace do not apply to closely-held corporations for the simple reason that the shareholder-employees control the corporation. There exists no competitive pressure to reduce expenses by minimizing compensation; on the contrary, maximizing compensation is the least expensive way to distribute the corporation's earnings. Furthermore, the internal constraints on the directors are almost negligible. At a minimum, the shareholders who chose the directors are the employees who receive the compensation; more commonly, these shareholder-employees are the directors themselves. This absence of an arm's-length relationship has led the IRS to assume an aggressive posture in contesting what has been referred to as "disguised dividends"¹⁶ paid by closely-held corporations.¹⁷

tion." Definitions range from any corporation whose shares are not traded on the over-the-counter securities market to a corporation in which the ownership and management are identical. F.H. O'NEAL, 1 CLOSE CORPORATIONS § 1.02 (2d ed. 1971). A distinction has also been drawn between the terms "close" and "closely-held." The former relates to the situation where the corporation's shares are not available to outsiders; the latter to situations where the shareholders are numerically few. *Id.* § 1.04. However, the terms are generally considered synonymous. *Id.* For purposes of the discussion herein, the term will be used to describe the type of corporation normally challenged by the IRS as to the reasonableness of its compensation. A synthesis of the cases in this area indicates that this type of corporation could be described as one in which both the management and ownership are to a substantial degree vested in a small group of persons, and in which there is a high frequency of overlapping of the roles of shareholder, director, and officer by these persons or members of their immediate families.

A publicly-held corporation can be described as one in which the shares are issued to or traded by the public. H. HENN, *Handbook of the Law of Corporations* § 257 (2d ed. 1970).

14. *See* [1974] 202 TAX MNGM'T (BNA) A-5 (3d ed.).

15. *Id.*

16. *E.g.*, *Nor-Cal Adjusters v. Comm'r*, 503 F.2d 359, 362 (9th Cir. 1974).

17. For an illustration of the detail with which the IRS will investigate the compensation payments of a corporation, see *AUDIT TECHNIQUES HAND-*

Judicial Analysis: The Amount and Purpose Tests

Answering the question of whether a given deduction is a "reasonable allowance . . . for personal services actually rendered"¹⁸ involves two separate determinations.¹⁹ The *amount* of the payment must be ascertained to determine whether it meets the statutory requirement of reasonableness, and the *purpose* of the payment must be identified to determine whether it was to compensate for the employee's performance of personal services. In applying the amount test, a court will typically weigh such factors as compensation scales of competing corporations,²⁰ compensation of other employees within the corporation,²¹ the financial condition of the corporation,²² the

BOOK FOR INTERNAL REVENUE AGENTS ¶ 672-73 (1976), reprinted in [1974] 202 TAX MNGM'T (BNA) B-9 (3d ed.), which contains such statements as:

One of the first steps is to assemble the salaries. [T]hese salaries may at times also be shown as manufacturing salaries. . . , or selling salaries, or as bonuses among other deductions. Items not usually thought of as salaries, such as . . . payment of his/her personal expenses should also be considered.

.
[Determine] if salaries are being paid to wives, children, relatives, or domestic servants. The use of initials is often adopted to conceal the fact that the employees involved are such persons.

.
[Establish] whether they perform any services for the business. Have they a desk? Are there on hand any cancelled checks or papers signed by them? . . . If the employee is a wife, how many children is she raising that would occupy her at home? . . . The examiner should attempt to get answers to these and to any other pertinent questions not only by talking directly with the employee but also in some cases through discrete questioning of the other employees of the taxpayer.

18. I.R.C. § 162, quoted at note 1 *supra*.

19. [1978] 1 STAN. FED. TAX REP. (CCH) ¶ 1370.01; [1974] 202 TAX MNGM'T (BNA) A-2 (3d ed.). This two step analysis was probably developed more in response to the Treasury regulations accompanying the statute than to the statutory language itself. Treas. Reg. § 1.162.7 (1958) provides in part: "The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services."

20. *E.g.*, *Builders Steel Co. v. Comm'r*, 197 F.2d 263 (8th Cir. 1952) (salaries of four shareholder-employees, three of them officers, compared with salaries of defendant corporation's largest competitor and found excessive; decision of Tax Court to reduce salary allowance to amount approximating salaries of competitor affirmed).

21. *E.g.*, *Pinkham Med. Co. v. Comm'r*, 128 F.2d 986 (1st Cir. 1942) (compensation of \$21,000 paid to shareholder-employee who served as treasurer held unreasonable in light of fact that president of corporation received compensation of \$15,000 for same period).

22. *E.g.*, *Austin v. United States*, 28 F.2d 677 (5th Cir. 1928) (inordinately high salaries paid to shareholder-employees for one year held reasonable based on explanation that they also reflected payment for services rendered in prior year when corporation was financially unable to pay salaries due to cash shortage caused by coal strike and government controls).

salary history of the employee,²³ the nature of services performed,²⁴ and the general state of the economy.²⁵ In applying the purpose test, a court will look to factors such as the extent of control of the corporation by the employee,²⁶ the method used to calculate the compensation,²⁷ the salary history of the employee,²⁸ the nature of services performed,²⁹ and the amount of dividends paid.³⁰

It can be seen that the proof needed to satisfy the amount test might also be relevant to the purpose test, and vice versa. However, the tests relate to different segments of the statutory language, and thus properly entail independent examinations. Because the typical challenge to a payment can be categorized

23. *E.g.*, *Pacific Grains, Inc. v. Comm'r*, 399 F.2d 603 (9th Cir. 1968) (after a prior year's compensation payment to a shareholder-employee of \$29,000, payments of \$41,250 and \$55,200 for two subsequent years held unreasonable after corporation failed to demonstrate any material change in the employee's duties; deductions of \$30,000 for each year allowed).

24. *E.g.*, *Doernbecher Mfg. Co. v. Comm'r*, 95 F.2d 296 (9th Cir. 1938) (court affirmed the propriety of the Board of Tax Appeals use of expert testimony as to the actual value of services rendered as a method of establishing the reasonable compensation deduction).

25. *E.g.*, *Baltimore Dairy Lunch v. United States*, 231 F.2d 870 (8th Cir. 1956) (increase in salary from \$9,974 to \$16,621 for tax year 1943 held reasonable on theory that acute manpower shortages during this year increased the value and extent of services performed by shareholder-employee).

26. *E.g.*, *San Marco Shop, Inc. v. Comm'r*, 223 F.2d 702 (5th Cir. 1955) (compensation of \$10,000 annually for menial tasks paid to two shareholder-employees who owned 50% and 49% of the corporation's shares held unreasonable by virtue of fact that the remaining 1% shareholder-employee, who performed more extensive services, received substantially less compensation).

27. *E.g.*, *Am-Plus Storage Battery Co. v. Comm'r*, 35 F.2d 167 (7th Cir. 1929) (portions of compensation payments to shareholder-employees held unreasonable by virtue of fact that commissions were calculated according to percentage of stock ownership rather than sales made by the shareholder-employees).

28. *E.g.*, *Heatbath Corp. v. Comm'r*, 14 T.C. 332 (1950) (portions of compensation held unreasonable based on fact that salaries were increased dramatically after employees became shareholders, with shareholder-employees failing to prove that they had been underpaid before they acquired ownership).

29. *E.g.*, *J.D. Van Hooser & Co. v. Glenn*, 50 F. Supp. 279 (W.D. Ky. 1943) (compensation consisting of base salary and comparatively large bonuses held reasonable after finding that shareholder-employees devoted full time to the corporation and possessed valuable skills which were indispensable to the success of the enterprise).

30. *E.g.*, *R.H. Oswald Co., Inc. v. Comm'r*, 185 F.2d 6 (7th Cir. 1950) (affirmation of Tax Court finding that the inference of unreasonableness created by a corporation's payment of large compensation amount to shareholder-employee coupled with failure to pay dividends for same period was sufficient to overcome testimony of expert witness that the compensation was reasonable).

For an often-cited case which lists the factors commonly considered in reasonable compensation cases, see *Mayson Mfg. Co. v. Comm'r*, 178 F.2d 115, 119 (6th Cir. 1949).

as a challenge to either the amount or the purpose, but not both, this conceptual distinction has usually been maintained.³¹

*The Forums of Litigation:
The Search for Favorable Precedents*

The Tax Court, the Court of Claims, and the federal district courts exercise concurrent original jurisdiction over disputes involving allowable tax deductions by a corporation,³² and it is the corporation that selects the court in which the issue will be litigated.³³ Although there are many factors which may influence the corporation's decision,³⁴ one which may be critical is the precedents extant in the alternative forums. Basically, the eleven federal circuits, the Tax Court and the Court of Claims each regards itself as comprising a separate independent jurisdiction, bound technically by only its own precedents and those

31. See [1974] 202 TAX MNGM'T (BNA) A-2 (3d ed.).

32. [1974] 202 TAX MNGM'T (BNA) A-18 (3d ed.).

The Tax Court, initially called the Board of Tax Appeals, was created in 1924. By virtue of the Tax Reform Act of 1969, it was rechristened the United States Tax Court and moved from the Executive Branch to the Legislative Branch. [1978] 152 TAX MNGM'T (BNA) A-16 (3d ed.). The Tax Court consists of 16 one-judge divisions. [1978] 152 TAX MNGM'T (BNA) A-20 (3d ed.). Its jurisdiction is limited to claimed deficiencies in federal income, estate, gift and excise taxes, and the interest on these deficiencies. I.R.C. §§ 6213, 6659, 7441-42.

The Court of Claims is the special court which has jurisdiction over certain types of claims against the United States. See generally 36A C.J.S. *Federal Courts* §§ 327-54 (1961).

33. [1974] 202 TAX MNGM'T (BNA) A-18 (3d ed.). Upon receipt of a notice of deficiency from the Commissioner of the Internal Revenue Service, the corporation can challenge the deficiency and thereby invoke the jurisdiction of the Tax Court. I.R.C. §§ 7441, 7442. If the corporation does not wish to litigate in Tax Court, it can pay the amount of the deficiency and then file a claim for a refund. It can file this claim in either the Court of Claims or federal district court. [1978] 152 TAX MNGM'T (BNA) A-18 (3d ed.).

34. Two key elements which must be evaluated are the fact that the corporation can retain the amount of the disputed tax only if it litigates in the Tax Court, and that the corporation can obtain a jury trial only if it litigates in the district court. Other considerations which may be pertinent are the place where the litigation may occur, the length of docket, the cost of filing, and the possibility of avoiding publicity. For a discussion of these and other factors see [1978] 152 TAX MNGM'T (BNA) A-12-A-15 (3d ed.).

One aspect of that is common among all the courts is their allocation of the burden of proof. In all jurisdictions, the burden of proving reasonableness rests with the taxpayer, who must come forward with evidence to show both that the Commissioner's claimed amount of deficiency was incorrect and establish what the corrected amount should be. [1978] 1 STAN. FED. TAX REP. (CCH) ¶ 1372. In all three forums, the Commissioner has the right to counterclaim that its initial calculation was too low, and thereby seek a further disallowance of the deduction. The burden of proving the further disallowance rests with the Commissioner. *Id.*

of the Supreme Court.³⁵ Only the Tax Court does not claim complete autonomy; it will defer to the precedent of the circuit to which the case is appealable if the precedent is directly on point, and even if the decision is contrary to the Tax Court's own prior decisions.³⁶ In the usual case, however, a corporation has the opportunity to select from among these three jurisdictions the one it believes has the most favorable precedent.

However, courts are frequently persuaded by authority from other jurisdictions. Thus the Court of Claims' precedent cannot be discounted merely because a corporation can choose to avoid litigating in that forum. Faced with the identical factual situation, the Tax Court and other federal courts must also decide whether the absence of dividend payments mandates disallowing part of a corporation's compensation deduction. Since this fact situation has proven to be recurring, it is necessary to examine the cogency of the Court of Claims position, hereinafter referred to as the *McCandless* doctrine.³⁷

THE McCANDLESS DOCTRINE AND THE COURT OF CLAIMS

The Principal Case

In *Charles McCandless Tile Service v. United States*,³⁸ the plaintiff corporation filed an action in the Court of Claims to obtain a refund of a deficiency claimed by the Commissioner. Mc-

35. See 36 C.J.S. *Federal Courts* §§ 235, 289 (1960); [1978] 152 TAX MNGM'T (BNA) A-12 (3d ed.).

36. *Id.* It can be seen that a detailed analysis of the precedents on a given issue is an essential element in planning the corporation's strategy. If, for example, it appears that the Tax Court precedents are unfavorable, but its circuit court has a clear precedent favoring its position, the corporation can nevertheless litigate in the Tax Court and expect to prevail. *Cf.* *Schanchrist Foods, Inc. v. Comm'r, T.C. Memo 1977-129*, 36 T.C.M. 555 (CCH 1977), discussed at note 95 *infra*. If, however, the circuit court's precedent is only arguably favorable, it may choose to take the dispute to district court, thus maximizing the chances for a trial court victory and minimizing the possibilities of having to appeal. If both the Tax Court and circuit court precedents are unfavorable, the corporation can still turn to the Court of Claims, which may not have ruled on the issue.

To assist in planning this strategy, several studies have been undertaken in an attempt to identify patterns of holdings in the various forums. Studies reveal, for example, that taxpayers seeking a refund in reasonable compensation cases have prevailed for the full amount sought in 55% of the cases in Tax Court, 60% of the cases in the Court of Claims, and 73% of the cases in district court. Conversely, the Commissioner has justified the full amount of the deficiency in 22%, 10%, and 7% of the cases respectively. The remaining cases were resolved by compromise solutions. [1974] 202 TAX MNGM'T (BNA) A-19 (3d ed.). Perhaps the most significant aspect of the compilations is the highlighting of the infrequency of the IRS' initial determination of a deficiency being upheld when challenged.

37. See note 12 *supra*.

38. 422 F.2d 1336 (Ct. Cl. 1970).

Candless, incorporated in 1960, had assumed the assets of a partnership consisting of Charles S. McCandless and his son, Charles L. McCandless. These two men were the officers, directors, and principal shareholders of the corporation, which was engaged in the business of ceramic tile contracting.³⁹ During the years 1963-1965, the corporation paid the father and son salaries of \$58,500, \$79,200 and \$86,000 each, and deducted these amounts on its tax return. The Commissioner assessed a deficiency on each salary of \$7,500, \$29,200 and \$37,500 for each year respectively, thereby disallowing the deduction of these amounts.⁴⁰ The corporation had not paid dividends during the three years in question, nor in the three years of its prior existence.⁴¹ The corporation sought to justify the entire deduction.

The Court of Claims began its analysis by defining the issue as the typical one of reasonableness of compensation, and recited the usual factors considered by courts in resolving this issue.⁴² Referring to the evidence of competitive salaries, the court rejected the Commissioner's contention that the salaries paid the McCandlesses were unreasonable simply because they were higher than those paid by a competitor.⁴³ The court stated:

If a comparison of the two companies indicated anything, however, it is that the McCandlesses *were* entitled to compensation substantially in excess of that received by their Hawthorne [the competitor] counterpart. Accordingly, after examining the record in its entirety, with particular emphasis upon the elements discussed above, we consider the compensation paid by plaintiff to the McCandlesses during the pertinent period, in and of itself, to have been within the realm of reasonableness.⁴⁴

Under the conventional amount and purpose tests, the foregoing statement might be interpreted as a clear finding of reasonableness only as to amount. However, the matter of whether there was a legitimate purpose, that is, whether there were "personal services actually rendered"⁴⁵ justifying the payments, was not disputed by the Commissioner. In fact, the court noted that "plaintiff's impressive net profit during the years in question has been due in large measure to the long experience, outstanding executive abilities, and hard work of Charles S. and Charles L. McCandless."⁴⁶ The court thus con-

39. *Id.* at 1337-38.

40. *Id.* at 1338 n.1.

41. *Id.* at 1339.

42. *Id.* at 1338-39.

43. *Id.* at 1339.

44. *Id.*

45. I.R.C. § 162, quoted in part at note 1 *supra*.

46. 422 F.2d at 1339.

ceded that the corporation had sustained its burden of proving reasonableness of amount and purpose.

The *McCandless* court, though, did not end its analysis at this point. In deciding whether the deduction should be allowed, the court identified what it called two "operative facts":⁴⁷ 1) that the corporation had never paid dividends since its formation, and 2) that the payments to the father and son during the three years were equal to approximately fifty percent of the corporation's profits before paying salaries and federal income taxes. From these facts the court reasoned that "it [is] clear that any return on equity capital is so conspicuous by its absence as to indicate, given all the facts, that the purported compensation payments necessarily contained a distribution of corporate earnings within."⁴⁸

After ruling that a portion of the deduction could not be allowed, the *McCandless* court then faced the task of determining what amount should properly be disallowed. Candidly conceding that "[n]o precise formula . . . commends itself to us,"⁴⁹ the court decided the matter should be resolved by balancing the amount the father and son should have received as employees against the amount they were entitled to as shareholders.⁵⁰ Since the corporation was a successful enterprise, the court felt that they deserved to be substantially rewarded in both capacities.⁵¹ Without further analysis, the Court of Claims held that "an examination of the entire record leads us to conclude that a return on equity capital equal to 15 percent of net [sic] profits (before salaries and Federal income tax) would have been reasonable and justified in each of the years under review."⁵² The court recalculated the amount of the deduction accordingly. The corporation, which had sought a refund of the taxes paid on \$62,590, was thus permitted to recover the taxes paid on \$11,610.⁵³

47. *Id.*

48. *Id.* at 1339-40.

49. *Id.* at 1340.

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.* at 1340 n.4. The court did not explain how it arrived at the 15% figure. The results did not correlate with the IRS' calculation of the deficiencies: the Commissioner received more than he sought for one year and less than he sought for two. *Id.* at 1338 n.1, 1340 n.4. The results were also contrary to the recommendations of the Trial Commissioner who had made the preliminary findings of fact. *Id.* at 1337.

The Precedent Basis of the Decision

The decision in *McCandless* that fifteen percent of the reasonable compensation deduction must be disallowed by virtue of the fact that dividends were not paid was premised on a preliminary holding that a finding of reasonableness does not in itself justify the deduction. The Court of Claims cited three cases as authority for this proposition: *Irby Construction Co. v. United States*,⁵⁴ *Northlich, Stolley, Inc. v. United States*,⁵⁵ and *Klamath Medical Services Bureau v. Commissioner*.⁵⁶ In both *Irby* and *Northlich*, however, the compensation amounts had been found unreasonable, and coincidentally in both cases the corporation had paid dividends for the taxable years in question. Both courts discussed the matter only in dicta, referring to *Klamath*.⁵⁷ Thus, the cornerstone of the *McCandless* doctrine is *Klamath*, "the only case prior to *McCandless* in which compensation was found to be reasonable but a deduction was disallowed."⁵⁸

The Klamath Medical Service Bureau was a corporation engaged in the business of selling medical, surgical, and hospital services.⁵⁹ Its shareholders were doctors who were also employed by the corporation to perform the medical services sold. The doctors billed the corporation for services performed according to a fixed fee schedule established by contract. The cor-

54. 290 F.2d 824 (Ct. Cl. 1961). The Irby corporation was managed by a father and son, who, together with members of their immediate family, owned 70% of the corporation's shares. During the taxable years in question, the corporation had discontinued regular salary payments to the father and son and instead, paid them 60% of all the corporation's profits over \$30,000. Under this formula, some \$300,000 was paid out in a span of two years. The court upheld a portion of the disallowance based on unreasonableness of amount. Then, citing *Klamath Medical Services Bureau v. Comm'r.*, 261 F.2d 842 (9th Cir. 1958), it noted that the amounts could also be disallowed if they were found to be an attempt to distribute earnings. 290 F.2d at 827.

55. 368 F.2d 272 (Ct. Cl. 1966). The Northlich corporation, which had paid dividends, also paid year-end bonuses to its employees. The bonuses of the four shareholder-employees were substantially higher than those of the non-shareholder-employees, and the corporation did not introduce evidence to justify this difference in terms of services performed. Despite its assertion that its payments were competitive, the corporation failed to introduce evidence of compensation among comparable firms. The court affirmed the disallowance of a portion of the deductions, then cited *Irby's* use of the language from *Klamath Medical Services Bureau v. Comm'r.*, 261 F.2d 842 (9th Cir. 1958) in noting that it was proper for the court to guard against disguised dividends. 368 F.2d at 278.

56. 261 F.2d 842 (9th Cir. 1958).

57. See notes 54 & 55 *supra*.

58. O'Neill, *Reasonable, but Nondeductible, "Compensation"?*, 57 A.B.A.J. 82, 82 (1971).

59. 261 F.2d at 844.

poration would make an immediate payment to the doctors of fifty percent of the fixed fee. Then, at six month intervals, the corporation would calculate the remaining revenue after expenses, and pay it all to the doctors, dividing it pro rata based on the amount of fees billed.⁶⁰ The corporation also owned a separate hospital at which none of the doctors performed services; revenue from this operation was included in the semiannual calculation.⁶¹ During the three years in question payments averaged 122% of the fees billed the corporation by the doctors.⁶² On its return, the corporation had deducted all payments to the doctor-shareholders as reasonable compensation. The corporation did not pay dividends,⁶³ under the compensation formula it had devised it could not make a profit from which to pay them.

The Tax Court ruled that, despite a finding that the payments in total were reasonable in amount, the portion in excess of 100% of the billable amount could not be allowed as a deductible expense.⁶⁴ The Ninth Circuit agreed.⁶⁵ Although the court was obviously influenced by the fact that a certain amount of the payments were attributable to the independent operations of the hospital and that the corporation could function indefinitely without showing a profit,⁶⁶ the *Klamath* court based its holding on the express language of the Code requiring that deductions be for "necessary" expenses.⁶⁷ It was not necessary for the corporation to pay its employees in excess of the amounts required by their contracts. Thus the court reasoned that excess payments were not deductible.⁶⁸

It can be seen that the two cases are readily distinguishable. Technically, the holding in *Klamath* is based on the requirement of section 162 that expenses, to be deductible, must be necessary; this requirement was not at issue in *McCandless*. Moreover, *Klamath* involved a rather transparent scheme to avoid all taxes at the corporate level: the corporation's formula precluded it from ever having taxable earnings. The *McCandless* corporation, on the other hand, utilized no scheme or formula. It paid straight salaries, found to be reasonable, and if it continued to earn a profit and not pay dividends, it would have

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 847.

64. 29 T.C. 339 (1957).

65. 261 F.2d at 848.

66. 261 F.2d at 847.

67. I.R.C. § 162, quoted in part at note 1 *supra*.

68. 261 F.2d at 848.

become liable for taxes on its accumulated earnings.⁶⁹

Klamath can be explained by the conventional amount and purpose analysis, whereas *McCandless* cannot. Part of the purported compensation in *Klamath*, that derived from the revenue of the independent hospital, was not for services rendered. Also, the semiannual distribution of all corporate earnings regardless of fee costs incurred had the unmistakable earmarks of disguised dividend payments. In short, while the amount test was satisfied, there was a clear failure of the purpose test, and the deduction could have been disallowed on that basis. In *McCandless*, however, both the amount and purpose tests were satisfied, and applying these two criteria, the deduction should have been allowed. Thus the *McCandless* court, in justifying a disallowance where the purpose test was satisfied, relied on a case where this same test had not been satisfied. This constituted an unwarranted extension of the earlier precedent.⁷⁰

Statutory Interpretation and Policy Considerations

The general precept derived from *McCandless* is that a compensation payment can be reasonable in amount and purpose and yet, under certain circumstances, not be deductible. This interpretation does more than go beyond the statutory language; it is in direct conflict with it. Section 162 is unambiguous in stating that the sole test of deductibility of compensation shall be its reasonableness in relation to services performed.⁷¹ The accompanying Treasury regulations, often given as much weight as the Code itself,⁷² are equally explicit.⁷³ The *McCandless* decision

69. I.R.C. § 531.

70. It should also be observed that, in relying exclusively on *Klamath*, the *McCandless* court overlooked precedent within its own jurisdiction which stated that a lack of dividends was only probative, not conclusive, of the reasonableness of compensation. In *Armiger v. United States*, 339 F.2d 625 (Ct. Cl. 1964), the IRS had assessed a deficiency against the closely-held corporation, arguing that it had made excessive deductions for automobile expenses, salaries, and bonuses paid to five shareholder-employees in years in which the corporation had not paid dividends. The court agreed as to the automobile expenses, but disagreed as to the salaries and bonuses. All compensation payments except those made to one shareholder-employee for a partial year while he was in the army were found to be reasonable. *Id.* at 625. Thus these payments were held to be deductible in their entirety despite a complete absence of dividends. Theoretically, this case should have been controlling in *McCandless*.

71. I.R.C. § 162, quoted in part at note 1 *supra*.

72. *E.g.*, *Bingler v. Johnson*, 394 U.S. 741 (1969), wherein the Court stated that "the Regulations 'must be sustained unless unreasonable and plainly inconsistent with the revenue statutes,' and 'should not be overruled except for weighty reasons.'" *Id.* at 750, quoting from *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948).

73. *Treas. Reg. § 1.162-7* (1958), quoted in note 19 *supra*.

simply cannot be reconciled with the statute which it interpreted.

The tone of the court's opinion indicates that it may be applying some rudimentary policy principle, in effect saying that shareholder-employees shouldn't be allowed to circumvent the IRS by refusing to pay themselves doubly-taxed dividends. However, the Internal Revenue Code has provisions addressing this very situation. Besides placing limits on allowable compensation payments, the Code provides for taxes on earnings should the corporation choose to accumulate them rather than pay dividends.⁷⁴ Other provisions for allowable expense deductions⁷⁵ and capital expenditures⁷⁶ restrict the ways a corporation can spend its revenues without incurring income taxes. Any attempt by the court to supplement this comprehensive taxing scheme seems improper. Moreover, the underlying premise of such a policy argument, that a corporation which is able to stay in business and meet its payroll must necessarily be making a taxable profit, is not theoretically sound.⁷⁷

Since *McCandless*, the Court of Claims has not had occasion to apply its holding; corporations which have not paid dividends understandably now choose to litigate in other forums. In a subsequent case involving a similar but distinguishable fact situation, however, the court implicitly reaffirmed in dictum its adherence to the doctrine.⁷⁸

74. I.R.C. § 531.

75. I.R.C. § 162.

76. I.R.C. § 263.

77. According to classic, widely-accepted micro-economic theory, it should be the normal occurrence for a business enterprise to be able to meet all its expenses, including salaries, but have no profits left over to distribute as dividends. Under theoretical pure competition conditions, an equilibrium condition would be reached at which all products demanded by society would be produced; and each producer would be able to meet all its costs but not make a profit. Thus zero profits for all producing firms is considered the norm. In fact, "real world" profits are explainable in economic theory only by pointing to deviations from the concept of static pure competition, e.g., changes in demand, variance of production costs among firms, restrictions on market entry, or incomplete access to information. See generally P. SAMUELSON, *ECONOMICS* 627-31 (9th ed. 1973); R. LEFTWICH, *THE PRICE SYSTEM AND RESOURCE ALLOCATION* 199-226 (5th ed. 1973).

An implicit assumption of the *McCandless* court, then, that a firm should be expected to show a profit, is contrary to basic economic principles.

78. *Giles Indus., Inc. v. United States*, 496 F.2d 556 (Ct. Cl. 1974). The IRS had advocated a disallowance equal to the 15% formula utilized in *McCandless*. The court distinguished *McCandless* noting in the instant case that: 1) it had previously ruled that certain unpaid loans, separate from the questionable compensation payments, were in fact dividends, thus giving the corporation dividends for the years in question; 2) some of the questionable compensation was to non-shareholder employees who could not receive dividends; 3) the corporation had a satisfactory dividend history. *Id.* at 221. Though it did not question the validity of the basic tenet of

While the absence of dividends in compensation cases has always been an important evidentiary fact in determining the reasonableness of compensation payments, the Court of Claims has now made it a dispositive fact. In essence, the court has taken what was a rule of thumb and converted it into a rule of law.

THE TREATMENT OF THE DOCTRINE IN OTHER FORUMS

The Tax Court

The Tax Court, where *Klamath* originated, has noted *McCandless* in several of its decisions. However, it remains unclear whether the Tax Court has rejected the doctrine, adopted it in modified form, or has used the case to develop yet another approach to the reasonable compensation issue.

In *Electric & Neon, Inc. v. Commissioner*,⁷⁹ the corporation made only nominal⁸⁰ salary payments to its president, who owned ninety-seven percent of the shares. During the six years in question, however, the corporation had made loans to the president totaling \$109,000.⁸¹ In opposing the deficiency assessed by the IRS, the corporation argued that the loans should not be considered distributions of the corporation's income because the president was obligated to repay them. The Tax Court found any such obligation illusory.⁸² It then had to decide whether the \$109,000 should be treated as compensation or dividends. The court engaged in the standard amount and purpose analysis, but then stated:

The test of deductibility of alleged compensation is, as we mentioned, two-pronged. However, in this case the respondent [IRS] does not contend that the amounts . . . constituted unreasonable compensation for his services. Rather, the respondent's position is that the amounts . . . were not *intended* to be paid as compensation. It is settled law that such intent must be shown as a condition precedent to the allowability of a deduction to the corporation. [citing *McCandless*, *Northlich*, *Irby* and *Klamath*]⁸³

Because the corporation had initially contended that the amounts were loans, the court ruled that it was estopped from claiming they were compensation. Hence, though the payments

McCandless, the court did note that the 15% figure was derived more from the facts of the case than a "precise formula." *Id.* This may indicate that the court does not consider itself bound to use only one specific percentage should it have occasion to again apply its doctrine.

79. 56 T.C. 1324 (1971).

80. The payments ranged from \$9,000-\$12,000 annually. *Id.* at 1339.

81. *Id.*

82. *Id.* at 1340.

83. *Id.* at 1341.

could readily be justified in terms of amount, the *Electric* court ruled that they had to be treated as dividends.⁸⁴

In *Paula Construction Co. v. Commissioner*,⁸⁵ the Tax Court reached an identical result under different circumstances. On the advice of its accountant, who believed that it qualified for subchapter-S treatment,⁸⁶ the corporation had not paid its three shareholder-employees any compensation but had distributed all its earnings to them.⁸⁷ When the subchapter-S status was terminated retroactively, the corporation sought to have a portion of the distributions recategorized as compensation. Relying on the same language used in *Electric*, the *Paula* court held that the corporation's initial categorization of the payments as distributions of earnings precluded it from later asserting that the payments were intended as compensation.⁸⁸

In a factual situation similar to *McCandless*, the Tax Court found for the corporation without mentioning the doctrine. In *Osborne Motors, Inc. v. Commissioner*,⁸⁹ the corporation paid its president, who owned ninety-six percent of the company, compensation totalling \$41,500. Although it had not paid dividends, the corporation had spent \$75,500 for capital improvements.⁹⁰ Apparently satisfied that the absence of dividends was not attributable to a shareholder-employee attempt to avoid double taxation,⁹¹ the *Osborne* court concluded that the payments were both reasonable and deductible.⁹²

One view of the foregoing cases is that the Tax Court has developed a new "intent test"⁹³ whereby a corporation now has the additional burden of showing that the payments in question were intended to be compensation. The corporation, according to this view, can easily protect itself by using appropriate labels for payments, and by expressing the requisite intent in board

84. *Id.* at 1345-46.

85. 58 T.C. 1055 (1972).

86. "Subchapter-S" refers to the I.R.C. provisions whereby a corporation which meets strictly construed conditions does not pay taxes at the corporate level, but all its profits, whether or not distributed, are deemed to be the income of its shareholders. The chief advantage of electing subchapter-S status is the avoidance of double taxation of dividends. See *generally* [1976] 178 TAX MNGM'T (BNA) (3d ed.).

87. It is not known why the corporation did not pay salaries, because even under subchapter-S, these payments would have been deductible, and the total tax billed reduced. *Id.*

88. 58 T.C. at 1060.

89. T.C. Memo 1976-153, 35 T.C.M. 691 (CCH 1976).

90. *Id.* at 693.

91. *Id.* at 694.

92. *Id.*

93. [1974] 202 TAX MNGM'T (BNA) A-2 (3d ed.).

resolutions.⁹⁴ This conclusion explains *Electric* and *Paula* in particular, and is not contradicted by *Osborne*.

Another possible view is that the Tax Court has adopted the *McCandless* doctrine in a modified form: the absence of dividends, previously only probative, is now a dispositive fact unless the corporation can come forward with evidence specifically justifying the nonpayment. This appears particularly pertinent to *Osborne*.

In considering the various rationales proffered to explain the Tax Court decisions, an equally valid thesis is that the court's manipulation of the doctrine is tantamount to a rejection of it.⁹⁵ At the very least, *Osborne* illustrates that the court will not apply the doctrine by rote. If the modified approach is accepted as the explanation for the Tax Court decisions, it should be noted that this approach has the court balancing one evidentiary fact against another. In fact, this is exactly what the courts were doing prior to *McCandless*, and conflicts with the automatic results that would otherwise be reached under the doctrine. If credence is given to the theory that a new "intent test" exists, then a corporation is not precluded from making payments to a shareholder-employee intended exclusively as compensation. Nothing in the Tax Court decisions indicates that this view would inevitably result in a disallowance. Moreover, the "intent test" is nothing more than the conventional purpose test. Just as intent is supposedly now necessary, a valid purpose has always been a requirement for an allowable deduction. Considering that a corporation's existence is incorporeal to begin with, an attempt to differentiate between its "intent" and its "purpose" is, at best, a purely tautological exercise.

The Circuit Courts

Only a few circuits have had occasion to consider the principle of *McCandless*. While decisions in certain jurisdictions are clear, there are not yet enough cases emerging from these eleven courts to reveal a consistent pattern.

94. *Id.* at A-9.

95. In *Schanchrist Foods, Inc. v. Comm'r.*, T.C. Memo 1977-129, 36 T.C.M. 555 (CCH 1977), the Tax Court found for the corporation and stated that the absence of dividends was not conclusive evidence of unreasonableness. *Id.* at 563. Despite this holding, the case cannot be interpreted as a disavowal of the *McCandless* doctrine. The case was appealable to the Seventh Circuit, which had previously rejected the doctrine. *Edwin's, Inc. v. United States*, 501 F.2d 675 (7th Cir. 1974); see text accompanying notes 99-101 *infra*. The Tax Court was thus constrained to follow the appellate court decision, which it cited as controlling authority. 36 T.C.M. at 536. It cannot safely be said, therefore, that this acquiescence to the Seventh Circuit's position represents adoption of it.

The Tenth Circuit has embraced the basic principle of *McCandless*, but it has not restricted itself to a percentage disallowance formula. In *Pepsi Cola Bottling Company of Salina, Inc. v. Commissioner*,⁹⁶ the corporation's payments to its president, who owned ninety-nine percent of the company, consisted almost entirely of substantial bonuses. The corporation, which had not paid dividends, introduced considerable evidence, such as salary surveys and documentation of long hours worked to support its contention of reasonableness. The district court disallowed a portion, approximately forty percent, of the deduction due to unreasonableness.⁹⁷ In affirming, the Court of Appeals, relying on *McCandless*, held that even if it accepted the corporation's contention that the evidence conclusively established reasonableness, the absence of dividends was sufficient to justify the lower court results.⁹⁸

The Seventh Circuit has been the only court to expressly reject the *McCandless* doctrine. In *Edwin's, Inc. v. United States*,⁹⁹ the IRS appealed the lower court's finding of reasonableness.¹⁰⁰ The corporation had not paid dividends, and on appeal the IRS's argument was primarily based on *McCandless*. In affirming the deductions in their entirety, the Seventh Circuit stated that "[w]hile the absence of dividends might be a red flag, it should not deprive compensation demonstrated to be reasonable under all the circumstances of the status of reasonableness."¹⁰¹

The Eighth Circuit, while not directly ruling on the doctrine, has been influenced by *McCandless*. In *Schneider & Company v. United States*,¹⁰² the corporation had a complex bonus formula, similar to the one in *Klamath*, whereby all revenues except for two percent of sales were paid to the shareholder-employees under the label of compensation. The lower court disallowed as a deduction that portion which was in excess of what the court determined to be a reasonable amount.¹⁰³ The Court of Appeals affirmed based on a finding that the lower court decision was not clearly erroneous. In dictum, the Eighth Circuit cited *McCandless* for the principle that the absence of dividends creates an *inference* of unreasonableness. The *Schneider* court then cited *Irby* in holding the deduction might be disallowed

96. 528 F.2d 176 (10th Cir. 1975).

97. *Pepsi Cola Bottling Co., Inc. v. Comm'r*, 61 T.C. 564 (1974).

98. 528 F.2d at 183.

99. 501 F.2d 675 (7th Cir. 1974).

100. *Edwin's, Inc. v. Comm'r*, 355 F. Supp. 773 (W.D. Wis. 1972).

101. 501 F.2d at 677 n.5.

102. 500 F.2d 148 (8th Cir. 1974).

103. *Schneider & Co. v. United States*, 32 T.C.M. 553 (1973).

even if the compensation proved reasonable.¹⁰⁴ Despite this juxtaposition of precedents, the Eighth Circuit has apparently accepted the underlying rationale of *McCandless*.

It should be noted that the Ninth Circuit, although it has not considered the matter, was the court which affirmed *Klamath*.¹⁰⁵ Since it has been illustrated that *McCandless* is an extension of the *Klamath* holding, it cannot be said that the Ninth Circuit has accepted the doctrine.

Summary

In considering the impact of the *McCandless* doctrine, it is worthwhile to note that the issue it addresses remains unresolved in most jurisdictions. Admittedly, this status stems from the fact that few federal courts have yet faced the precise factual situation of *McCandless* and not from the fact that the doctrine has generally been found unpersuasive. However, in Tax Court cases involving substantially similar situations, there has been no adoption of the doctrine in either results or dicta.¹⁰⁶ The fact that this important forum has not directly addressed the issue might indicate that it at least has some doubt as to the doctrine's rationale, if it has not in fact tacitly rejected it.

A court confronting the issue as one of first impression will not find a voluminous body of authority supporting the doctrine. Rather, it will find a scattering of sometimes inapposite decisions. As a result, a court will be able to evaluate the cogency of the *McCandless* doctrine unfettered by the presence of a marked trend among its sister jurisdictions.

CONCLUSION: THE IMPLICATIONS OF WIDESPREAD ADOPTION

It has been advanced that the *McCandless* decision is neither well founded on precedent nor proper in its statutory interpretation. While these factors alone are sufficient reasons for not following the doctrine, additional considerations militate against its adoption.

It should be first noted that the doctrine need not be limited to cases where the corporation has not paid dividends. To illustrate, consider a variant of the *McCandless* fact situation where the corporation has paid its shareholder-employees dividends equal to ten percent of the amount it paid them as compensation. Since the Court in *McCandless* held that the shareholder-employees were entitled to a fifteen percent return on their in-

104. 500 F.2d at 153.

105. 261 F.2d 842 (9th Cir. 1948).

106. See text accompanying notes 79-95 *supra*.

vestment capital, five percent of the deduction would still not be allowed. This logic has not escaped the IRS, which has urged that the doctrine be applied in cases where dividends have been paid,¹⁰⁷ nor has it escaped corporate tax advisers, who point out that nominal dividend payments, though recommended for their cosmetic value, do not necessarily protect against a disallowance under the *McCandless* principle.¹⁰⁸

Widespread use of the doctrine would shift the principal focus of reasonable compensation disputes away from an evaluation of amounts paid and services performed to an examination of the return on equity capital. Instead of evaluating the payments in relation to the work performed by the employees, courts would be evaluating the payments in terms of the return that these employees are entitled to as shareholders. Besides being a further digression from the Code provisions, this would impose an additional burden on the owners of closely-held corporations. Investment decisions in a free society are made for a myriad of reasons, and the anticipated and actual return on such investments varies concomitantly. The *McCandless* doctrine penalizes the shareholder investor for any decisions which deviate from the norm established by the court. This interference by the judiciary would result in rigidities pertinent to only one business form, thus reducing the value to society of the closely-held corporation.

The *McCandless* doctrine also represents an unjustifiable difference in the tax treatment afforded the publicly-held versus the closely-held corporation. A publicly-held corporation's failure to pay dividends would not trigger even an inspection of its compensation deductions. Yet the amounts paid by a public corporation to its top employees, who usually are directors and officers and invariably are shareholders, are often beyond the wildest conjecture of those establishing compensation for the closely-held corporation.¹⁰⁹ Perhaps closer scrutiny in applying

107. *Giles Indus., Inc. v. United States*, 496 F.2d 556 (Ct. Cl. 1974), discussed at note 78 *supra*. Prior to appeal, the corporation conceded that "loans" made to its president, which were equal to a 6.85% return on investment, were in fact dividends. *Id.* at 567. Though it agreed that these payments were dividends, the IRS urged a further disallowance equal to the 15% return on investment utilized in *McCandless*. *Id.* Also, in *Schanchrist Foods, Inc. v. Comm'r*, T.C. Memo 1977-129, 36 T.C.M. 555 (1977), discussed at note 95 *supra*, the corporation made dividend payments of \$100 to each of its two shareholders for one of the years in dispute. *Id.* at 561. The Commissioner nevertheless urged the imposition of *McCandless*, probably arguing that these payments were inconsequential.

108. *E.g.*, McLean and Martin, *Is "Reasonable" Enough? The McCandless Doctrine*, 54 TAXES 642, 644 (1976).

109. Consider, for example, the 1977 salaries and bonuses paid the following key executives of major public corporations. Harold S. Geneen (ITT)

the rules to closely-held corporations is appropriate; a judicial changing of those rules is not.

The *McCandless* doctrine is neither supported by law nor by policy and should be disavowed by all courts that decide reasonable compensation cases. Because of its prominent position in this area, the Tax Court in particular should take the earliest possible opportunity to unequivocally repudiate the doctrine. More fundamentally, the Internal Revenue Service should discontinue its advocacy of a pro-*McCandless* position. The continued utilization of *McCandless* will only result in the receipt of a few more tax dollars in exchange for greater uncertainty and potential disruption in an area already heavily litigated. The return on an investment in the *McCandless* doctrine is very poor indeed.

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received \$986,000; Steven J. Ross (Warner Communications) \$905,000; Charles D. Tandy (Tandy) \$790,000; Rawleigh Warner, Jr. (Mobil) \$725,000; John D. deButts (ATT) \$722,000; Clifton C. Garvin (Exxon) \$696,000; Henry Ford II (Ford) \$682,000; Thomas A. Murphy (GM) \$475,000. *FORBES*, May 29, 1978 at 87. Presumably, the IRS will not challenge the reasonableness of these compensation payments.

