5 T.C. 263 (1945)

Income accrues to a taxpayer when there arises a fixed or unconditional right to receive it, with a reasonable expectation that the right will be converted into money or its equivalent; however, income should be accrued and reported only when its collectibility is assured.

Summary

E. T. Slider, Inc. received proceeds from life insurance policies after the death of its president. A dispute arose regarding the rightful recipient of the funds, leading the insurance company to withhold payment pending resolution. The Tax Court addressed whether the insurance proceeds were taxable income in 1939 or 1940, and if the proceeds constituted abnormal income attributable to other years for excess profits tax purposes. The court held that the proceeds were properly included in income for 1940 because their collectibility was not assured in 1939, and that the proceeds were not attributable to other years for excess profits tax purposes.

Facts

E.T. Slider transferred his business assets and life insurance policies to E.T. Slider, Inc. Slider died on October 4, 1939. His widow, Rose B. Slider, made a claim against the insurance proceeds, disputing the validity of the policy assignments. The Penn Mutual Life Insurance Co. (Penn Mutual) withheld payment on three policies due to the widow's claim. Slider, Inc. did not include the proceeds from these policies in its 1939 tax return.

Procedural History

The Commissioner determined deficiencies in E.T. Slider, Inc.'s income, declared value excess profits, and excess profits taxes for 1940 and 1941. The company initially excluded certain insurance proceeds from its 1939 income, then filed an amended return including them. The Commissioner determined the proceeds were accruable in 1940 and did not constitute abnormal income attributable to other years for excess profits tax purposes. E.T. Slider, Inc. petitioned the Tax Court, contesting the Commissioner's determinations. The Tax Court upheld the Commissioner's assessment.

Issue(s)

1. Were the taxable proceeds of insurance policies on the life of E.T. Slider accruable as income to E.T. Slider, Inc. in 1939 or 1940?
2. Do the insurance proceeds constitute abnormal income attributable to other years for excess profits tax purposes, so as not to be includible in E.T. Slider, Inc.'s excess profits net income for 1940?

Holding

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1. No, because a fixed and unconditional right to receive the proceeds did not exist in 1939 due to the widow's claim and Penn Mutual's refusal to pay without a bond.
2. No, because the proceeds were not accruable as income until 1940, making them attributable only to that year for excess profits tax purposes.

Court's Reasoning

The court applied the principle that income accrues when there is a fixed right to receive it and a reasonable expectation that the right will be converted into money. Citing *Security Flour Mills Co. v. Commissioner, 321 U.S. 281 (1944)*, the court emphasized that a taxpayer may not accrue an expense or income, the amount of which is unsettled or the liability for which is contingent. The court found that the widow's claim, even if without legal foundation, prevented E.T. Slider, Inc. from having a fixed right to the insurance proceeds in 1939 because Penn Mutual withheld payment. The court noted the corporation's resolution stating that the widow compelled Penn Mutual to withhold the premiums and interest. This indicated the corporation's good faith doubt about receiving the funds in 1939. Regarding the excess profits tax issue, the court followed *Premier Products Co., 2 T.C. 445 (1943)*, holding that the proceeds were not attributable to other years because they were not accruable until 1940. The court referenced Section 721 of the Internal Revenue Code, noting that abnormal income must also be attributable to other years to be excluded.

Practical Implications

This case clarifies the application of the accrual method of accounting, especially when the right to receive income is disputed or uncertain. Attorneys should advise clients that a mere expectation of receiving income is insufficient for accrual; there must be a fixed and unconditional right. When assessing tax implications, consider potential legal challenges or contingencies that may delay or prevent the receipt of funds. This case also highlights the importance of contemporaneous documentation reflecting a company's assessment of collectibility. For excess profits tax purposes, the timing of accrual determines the tax year to which the income is attributable.

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