6 T.C. 183 (1946)

A taxpayer using the accrual method can deduct accrued interest expense even if there's uncertainty about its payment, unless disallowed under specific provisions like related-party rules.

Summary

Butler Consolidated Coal Co., in receivership, disputed the Commissioner's deficiency assessment for 1941. Key issues included the nature of losses from property sales ("Erico" and "Argentine" properties) and the deductibility of accrued interest from 1939 and 1940. The Tax Court held that the loss from the sale of the Erico property was a long-term capital loss. The court also determined that Butler Consolidated could deduct accrued interest on its debts, except for interest owed to related parties, when calculating net operating loss carryovers from 1939 and 1940, which impacted the 1941 tax liability. The court emphasized the company's improved financial condition and the nature of the debt as secured by mortgages.

Facts

Butler Consolidated Coal Co. was in receivership for a decade before August 1941. The company used the accrual method of accounting. It had discontinued mining operations on its "Argentine" property in 1931 and on its "Erico" property in 1930. In 1940, the mortgage on the Argentine property was foreclosed. In 1941, the Erico property was sold at public auction for $2,000. During 1939 and 1940, the company had substantial outstanding interest-bearing debt, including mortgages and notes, upon which interest accrued but was not paid. A reorganization plan in 1941 involved creditors waiving accrued interest in exchange for new obligations.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency in Butler Consolidated Coal Company's income tax for 1941. Butler Consolidated petitioned the Tax Court for a redetermination of the deficiency. The Tax Court addressed multiple issues related to loss deductions and interest accruals to determine the correct tax liability for 1941.

Issue(s)

1. Whether the loss from the sale of the "Erico" property in 1941 was an ordinary loss or a long-term capital loss?

2. Whether the loss from the foreclosure of the mortgage on the "Argentine" property in 1940 was an ordinary loss or a long-term capital loss?

3. Whether Butler Consolidated could deduct accrued interest on its outstanding debt in 1939 and 1940 when calculating net operating loss carryovers to 1941,

despite the uncertainty of payment and later cancellation of the debt?

Holding

1. No, because the coal in place was not held primarily for sale to customers in the ordinary course of business, nor was it property subject to depreciation.

2. No, because the facts with regard to the loss on the Argentine property are in all essential respects the same as those with reference to the claimed loss with respect to the sale of its Erico property in 1941.

3. Yes, but only for the interest owed to parties other than B.D. Phillips and his family, because a taxpayer using the accrual method can deduct accrued interest even if payment is uncertain, unless related-party rules apply.

Court's Reasoning

Regarding the Erico property, the court reasoned that the "coal in place" was not inventory or property held primarily for sale in the ordinary course of business. Citing 26 U.S.C. § 117, the court determined the loss was a long-term capital loss because the company's business was mining and selling coal, not real estate. The court also noted the petitioner did not show or attempt to show that any part of the Erico property was subject to an allowance for depreciation. Regarding the accrued interest, the court relied on <span id=

