23 T.C. 652 (1955)

Compensation received under a claim of right is taxable income in the year received, even if a portion of the compensation is voluntarily returned to the payor in a subsequent year.

Summary

The Tax Court addressed whether a taxpayer could exclude from his gross income amounts voluntarily returned to his employer in a later year, where the compensation had been received without restriction in a prior year. The court held that because the taxpayer had received the income under a claim of right in the prior year, the subsequent repayment did not alter the income's taxability in the year of receipt. The court emphasized that the initial receipt of funds established their character as taxable income, irrespective of later voluntary actions by the taxpayer.

Facts

The petitioner, Pike, received compensation from his employer in a particular year. Subsequently, in a later tax year, Pike voluntarily returned a portion of that compensation to the corporation. At the time Pike received the compensation, there were no restrictions or conditions attached to his receipt of the funds. The repayment was not mandated by any legal obligation or prior agreement.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Pike, arguing that the compensation initially received was taxable income in the year of receipt, and the subsequent voluntary repayment did not change its character. Pike petitioned the Tax Court for a redetermination of the deficiency. The Tax Court reviewed the Commissioner's determination based on the established facts.

Issue(s)

Whether compensation received by a taxpayer without restriction under a claim of right is excludable from the taxpayer's gross income in the year of receipt if the taxpayer voluntarily returns a portion of that compensation to the payor in a subsequent year.

Holding

No, because the compensation was received under a claim of right in the initial year, making it taxable income regardless of the taxpayer's subsequent voluntary repayment in a later year.

Court's Reasoning

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The Tax Court based its decision on the established “claim of right” doctrine, which provides that income received under a claim of right is taxable in the year received, even if there is a possibility that the recipient may have to return the funds in the future. The court distinguished this case from situations where salary adjustments are made within the same year or before the services are fully completed. Here, the services were completed, the compensation was paid without conditions, and the taxpayer had full control over the funds. The court cited North American Oil Consolidated v. Burnet, 286 U.S. 417, emphasizing that once income is received under a claim of right, it is taxable, and the subsequent voluntary return does not change its character. Judge Turner, in dissent, argued that the majority was misapplying precedent by failing to recognize that the repayment occurred after the completion of services and without any prior obligation. The dissent contended that the compensation should be considered income because Pike had received it

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