1180 East 63rd Street Bldg. Corp. v. Commissioner, 12 T.C. 437 (1949)

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When a taxpayer deducts accrued expenses (like property taxes) and later experiences a practical extinguishment of the liability to pay those expenses, the taxpayer must include the previously deducted amount in income to the extent a tax benefit was received.

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Summary

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1180 East 63rd Street Building Corporation accrued and deducted real estate taxes on its property, resulting in a tax benefit. Subsequently, through a foreclosure sale and related legal proceedings, the corporation effectively eliminated its liability for a significant portion of those taxes. The Commissioner of Internal Revenue increased the corporation's gross income to reflect the tax benefit previously obtained. The Tax Court upheld the Commissioner's determination, finding a practical extinguishment of the tax liability, triggering the tax benefit rule. The court reasoned that the corporation's actions and the circumstances surrounding the tax settlement indicated that the liability was effectively resolved, not gratuitously forgiven.

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Facts

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The 1180 East 63rd Street Building Corporation acquired a building and part of the land it occupied in 1936. The property had pre-existing delinquent real estate taxes. The corporation accrued and deducted real estate taxes on its returns for 1939 and 1940. By 1942, the delinquent taxes, penalties, and interest exceeded $55,000. The corporation reached an agreement with the state's attorney, resulting in a tax foreclosure suit. The property was sold to the corporation's nominee for $24,000, and the corporation redeemed the property at that price. Separately, the corporation obtained an injunction preventing the county from collecting the remaining balance of the taxes.

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Procedural History

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The Commissioner of Internal Revenue increased the corporation's gross income for 1942 by $6,340.42, reflecting the portion of unpaid taxes and interest deducted in 1939 and 1940 that had provided a tax benefit. The Tax Court reviewed the Commissioner's determination, focusing on whether the tax liability had been extinguished and if the extinguishment was a gratuitous cancellation of debt.

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Issue(s)

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Whether the Commissioner erred in increasing the petitioner's gross income for 1942 by $6,340.42, representing the portion of unpaid taxes and interest deducted in prior years that resulted in a tax benefit, given the foreclosure proceedings and subsequent actions.

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Holding

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Yes, the Commissioner's action was approved because there was a practical extinguishment of the petitioner's liability for delinquent taxes due to the court proceedings and the prevailing practice, and this extinguishment was not a voluntary or gratuitous cancellation of indebtedness.

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Court's Reasoning

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The Tax Court considered whether the foreclosure proceedings fully extinguished the corporation's tax liability. While acknowledging the uncertainty under Illinois law regarding personal liability for taxes after foreclosure and redemption, the court emphasized that the

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