12 T.C. 806 (1949)

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Income is accruable under the accrual method of accounting only when the right to receive it becomes fixed and determinable, not when it’s merely a disputed claim in litigation.

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Summary

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Paul Redcay, a former school principal, was dismissed from his position. He continued to report his expected salary as income for several years while contesting his dismissal. After losing his legal battle, he attempted to deduct these amounts as losses or bad debts. The Tax Court disallowed these deductions, holding that because his right to the income was never fixed due to ongoing litigation, it was never properly accruable as income in the first place. The court also held that the deficiency was properly calculated without regard to the credit for tax withheld.

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Facts

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Paul Redcay was dismissed from his position as a high school principal in 1939. Redcay contested his dismissal through various legal channels. From 1940 to 1942, Redcay reported his expected salary from the school as income, believing he would win his case and receive back pay. After losing his final appeal in 1943, he stopped reporting the salary as income. In 1944 and 1945, Redcay attempted to deduct portions of the previously reported income as a loss or bad debt.

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Procedural History

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Redcay was initially dismissed by the local school board, a decision upheld by the state commissioner of education and the state board of education. The New Jersey

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Supreme Court initially remanded the case for reconsideration, but ultimately dismissed Redcay's writ of certiorari in 1943. The New Jersey Court of Errors and Appeals affirmed this judgment in 1944. Redcay then sought to deduct the claimed losses on his federal income tax returns, which the Commissioner of Internal Revenue disallowed, leading to this case before the Tax Court.

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Issue(s)

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1. Whether the petitioners are entitled to deductions for losses or bad debts in the amount of $5,250 for 1944 and $5,200 for 1945.

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2. Whether the respondent committed error in determining the deficiency for the taxable year 1945, by reason of his failure to allow a credit for the amount of tax withheld from wages.

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Holding

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1. No, because Redcay's right to receive the salary was never fixed during the years he reported it as income, as the claim was continuously in dispute. Thus, there was no actual debt that became worthless or a loss incurred during the taxable years 1944 and 1945.

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2. No, because the calculation of a deficiency is determined without regard to credits for tax withheld as specified under Section 271 of the Internal Revenue Code.

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Court's Reasoning

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The court reasoned that Redcay's claim for compensation was disputed throughout

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1940-1942. Applying the accrual method, the court cited *Dixie-Pine Products Co. v. Commissioner, 320 U.S. 516 (1944)* and *Security Flour Mills Co. v. Commissioner, 321 U.S. 281 (1944)*, emphasizing that a taxpayer cannot accrue income when the right to receive it is not fixed. As Redcay only had a disputed claim, the school board was never indebted to him. Therefore, he had no indebtedness that became worthless, and sustained no actual loss during 1944 or 1945. The court stated, "Under the accrual method, income is accruable when the right to receive it becomes fixed." Regarding the tax withholding credit, the court looked to the statutory definition of

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