12 T.C. 977 (1949)

A taxpayer on the accrual basis can only deduct contested tax liabilities in the year the litigation is terminated, either by court decision or abandonment of the appeal.

Summary

Lehigh Valley Railroad disputed property taxes assessed by New Jersey from 1932-1940, paying the undisputed portion but contesting the balance in court. The Tax Court addressed the proper year to accrue these contested taxes, related interest, and a Mixed Claims Commission award. The court held that contested taxes accrued when the litigation ended, amounts paid under protest accrued when paid, interest accrued when tax liability was fixed, and the Black Tom award accrued in 1939 when certified. This decision clarifies the accrual method for disputed liabilities and the timing of income recognition from awards.

Facts

Lehigh Valley Railroad (Lehigh) contested New Jersey property taxes from 1932-1940, arguing illegal valuation methods and discriminatory assessment. Lehigh paid the undisputed portion of the tax each year, while litigating the remaining balance. During litigation, court orders required Lehigh to pay additional amounts toward the tax. Lehigh also received an award from the Mixed Claims Commission related to the "Black Tom" explosion.

Procedural History

Lehigh appealed the tax assessments to the New Jersey Board of Tax Appeals, then filed suits in federal court to enjoin collection. These suits were consolidated. The District Court granted injunctions conditioned upon increased payments. The Third Circuit Court of Appeals reversed, and the Supreme Court denied certiorari in 1941. Lehigh discontinued remaining appeals in August 1941. The IRS determined deficiencies in Lehigh's income tax for 1941-1944, leading to this case before the Tax Court.

Issue(s)

1. Whether the 1932-1940 New Jersey state taxes should be accrued and deducted in the years the tax was imposed, or in the years the related litigation was terminated?
2. Whether interest on the unpaid portion of those taxes should be accrued ratably over the years the taxes were due, or in the year the underlying tax liability was determined?
3. Whether income from the Black Tom award should be accrued when the award was made by the Mixed Claims Commission, or when it was actually received?

Holding

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1. No, because the unpaid balance of the tax imposed in each taxable year was accruable only as and when paid, or upon the termination of the litigation between it and the state, either by a final decision of the courts or by the discontinuance of the appeals.
2. No, because interest on the unpaid balance of the tax imposed became accruable when the liability for the unpaid taxes was determined.
3. The income from the Black Tom award was accruable for income tax purposes in 1939, when the award was made and certified to the Secretary of the Treasury by the Secretary of State.

Court’s Reasoning

The court applied the principle that a liability accrues when all events have occurred that fix the amount and the taxpayer’s liability to pay it. The Court stated,

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