T.C. Memo. 1954-283

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When a corporation using the completed contract method of accounting dissolves in a tax-free reorganization with long-term contracts still in progress, the Commissioner has the authority to allocate income earned under those contracts to the dissolved corporation to clearly reflect income.

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Summary

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Oklahoma Contracting Company (Oklahoma Standard) dissolved in a tax-free reorganization, with Delaware Standard succeeding it. Oklahoma Standard used the completed contract method of accounting. The Tax Court addressed whether income from incomplete contracts at the time of reorganization could be allocated to Oklahoma Standard. The court held that the Commissioner could allocate a portion of the income from those contracts to Oklahoma Standard, as the reorganization prevented the consistent application of the completed contract method, and such allocation was necessary to clearly reflect Oklahoma Standard's income. Additionally, the court held that a net operating loss sustained by Delaware Standard in a subsequent year could not be carried back and deducted by Oklahoma Standard, and that additional state income taxes assessed and paid by Oklahoma Standard in the taxable period, but related to a prior year, were not deductible.

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Facts

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Oklahoma Standard was on an accrual basis and used the completed contract method. On September 20, 1942, Delaware Standard succeeded Oklahoma Standard in a tax-free reorganization. At that time, several long-term construction contracts undertaken by Oklahoma Standard were incomplete. Oklahoma Standard's final return did not accurately reflect income from these contracts. Delaware Standard reported income from these contracts in its subsequent return. The Commissioner allocated a portion of the income from the in-progress contracts to Oklahoma Standard.

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Procedural History

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The Commissioner determined deficiencies against Oklahoma Standard, allocating income from the in-progress contracts. Oklahoma Standard challenged the Commissioner's determination in the Tax Court.

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Issue(s)

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1. Whether the Commissioner was authorized to allocate income from incomplete construction contracts to Oklahoma Standard, despite its use of the completed contract method and the tax-free reorganization.

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2. Whether a net operating loss sustained by Delaware Standard after the reorganization could be carried back and deducted by Oklahoma Standard.

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3. Whether additional Oklahoma income taxes assessed and paid by Oklahoma Standard in the taxable period, but related to a prior year, were deductible in the taxable period.

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Holding

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1. Yes, because the completed contract method of accounting no longer clearly reflected income due to the dissolution, and the Commissioner has broad discretion under Section 41 of the Internal Revenue Code to ensure income is

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clearly reflected.

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2. No, because net operating losses can only be carried back by the same taxpayer who sustained them, and Oklahoma Standard ceased to exist after the reorganization.

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3. No, because the taxes accrued in the prior year when all events fixing the amount and liability occurred, regardless of when the additional tax was discovered or paid.

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Court’s Reasoning

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The court relied on Section 41 of the Internal Revenue Code, which allows the Commissioner to compute income using a method that clearly reflects it if the taxpayer’s method does not. The court found that Oklahoma Standard’s dissolution prevented it from continuing its completed contract method. Citing *Jud Plumbing & Heating, Inc. v. Commissioner*, the court stated that when a corporation voluntarily acts to prevent the completion of a long-term contract, it cannot insist its income is free of tax or measured only at completion. The court also determined the reorganization did not alter the taxability of income earned by Oklahoma Standard prior to the reorganization. Regarding the net operating loss, the court followed *New Colonial Ice Co. v. Helvering*, emphasizing that deductions are generally confined to the taxpayer sustaining them. The court also cited *United States v. Anderson*, stating that taxes accrue when all events occur to fix the amount and determine liability.

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Regarding joint ventures, the court stated,

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