16 T.C. 732 (1951)

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A taxpayer using the accrual method of accounting must deduct expenses when all events have occurred that establish the liability and the amount can be determined with reasonable accuracy, and must recognize income when all events have occurred that fix the right to receive it and the amount can be determined with reasonable accuracy.

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Summary

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Kenyon Instrument Co. was a subcontractor during World War II. In 1943, Kenyon agreed with the Navy to refund overcharges from 1942. Kenyon made the refunds in 1943 and 1944. Kenyon also overpaid New York franchise taxes in 1944. In 1945, formal renegotiation agreements led to further refunds of excessive profits. These renegotiations led to state franchise tax refunds in 1947. The Tax Court addressed whether the refunds to customers were deductible in the year paid, whether the overpayment of state franchise taxes was deductible, and when the state franchise tax refunds should be included as income. The court held that the customer refunds were accruable in 1943, the overpayment of franchise taxes was not deductible, and the state franchise tax refunds were includible in 1945 when all factors were known.

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Facts

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Kenyon Instrument Co. manufactured aircraft instruments during World War II. In 1943, Kenyon agreed with the Supervisory Cost Inspector of the U.S. Navy to refund $393,359.50 in overcharges to customers for work done in 1942. Kenyon made these refunds in quarterly payments, with $197,952.03 paid in 1943 and $195,407.47 paid in 1944. Kenyon computed and paid its New York State franchise taxes in 1944 based on its 1943 and 1944 income, unadjusted for these refunds. In 1945, Kenyon signed formal renegotiation agreements with the Navy for 1943 and 1944, resulting in further refunds of excessive profits. These renegotiations led to New York State franchise tax refunds, which Kenyon received in 1947.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in Kenyon's tax liabilities for 1942, 1944, and 1945. Kenyon contested adjustments related to 1944 and 1945. Kenyon appealed the Commissioner's determination to the Tax Court.

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Issue(s)

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1. Whether Kenyon is entitled to a deduction in 1944 for repayments made in that year as price adjustments on war contracts.

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2. Whether the Commissioner erred in disallowing a deduction for part of a payment in 1944 for New York State franchise taxes.

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3. Whether Kenyon's income in 1945 should include certain refunds of New York State franchise taxes.

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Holding

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1. No, because the obligation to make the refunds was fixed and determinable in 1943, making them accruable in that year.

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2. No, because the overpayment of state franchise taxes was due to Kenyon's own error, and there was no actual or apparent liability for that portion of the tax.

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3. Yes, because all the factors necessary to determine the amount of the state

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franchise tax refunds were known to Kenyon in 1945.

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Court’s Reasoning

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Regarding the customer refunds, the court emphasized that under the accrual method, expenses are deductible when the liability becomes fixed and determinable. The court found that the

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