16 T.C. 1084 (1951)

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A taxpayer using the accrual method of accounting need not recognize income when the right to receive payment is contingent upon the outcome of a substantial legal controversy, making the ultimate amount uncertain.

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Summary

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Boston Elevated Railway Co. sought review of tax deficiencies determined by the Commissioner. The Tax Court addressed whether the railway should have accrued income from cost-of-service deficits when reimbursement from the Commonwealth of Massachusetts was contested, when a loss occurred on an elevated railway structure, if depreciation deductions were allowable, and if pro rata deductions were permitted for payments to extend public control. The court held that the contested deficits were not accruable as income, the loss occurred when the structure was demolished per a court decision, depreciation was allowable until the loss, and the payments for extending public control could be amortized over the life of the extension.

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Facts

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Boston Elevated Railway Co. (the “Railway”) operated under a public control act guaranteeing sufficient income to cover operating costs and dividends. In 1941, the city challenged the Railway’s accounting methods, leading the state to withhold deficit payments. The state Attorney General initiated legal proceedings questioning the Railway’s cost-of-service calculations. The Railway ceased passenger service on its Atlantic Avenue elevated line in 1938 but maintained it as a standby facility. In 1931, the Railway paid a sum to extend public control, which included a guaranteed income.

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Procedural History

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The Commissioner determined deficiencies in the Railway's income taxes. The Railway disputed these deficiencies in Tax Court. The Commissioner then amended the answer to argue that deductions initially allowed were in fact not allowable.

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Issue(s)

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1. Whether the Railway, using the accrual method, should have accrued income for cost-of-service deficits when the Commonwealth of Massachusetts disputed the amounts?

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2. Whether the Railway's loss regarding the Atlantic Avenue elevated railway structure occurred in 1941 or 1942?

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3. Whether the Railway is entitled to depreciation deductions on the Atlantic Avenue elevated railway structure?

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4. Whether the Railway is entitled to pro rata deductions for amounts paid to extend the period of public control?

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Holding

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1. No, because the Commonwealth contested the legality of the Railway's accounting procedures, and the amount, if any, that the Railway would receive was uncertain.

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2. The loss occurred in 1942 because the Railway intended to keep the option of using the structure until a court decision forced its demolition.

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3. Yes, because the Railway is entitled to depreciation until the loss occurred.

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4. Yes, because the payment was for the 28-year extension, and the Railway is entitled to amortize it over the life of the extension.

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Court’s Reasoning

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Regarding the accrual of income, the court stated,

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