18 T.C. 1245 (1952)

The phrase “paid or accrued” in Section 122(d)(6) of the Internal Revenue Code, concerning net operating loss deductions, is construed according to the taxpayer’s method of accounting (cash or accrual).

Summary

Lewyt Corporation, an accrual-basis taxpayer, sought to increase its net operating loss carry-backs by including excess profits taxes paid in 1946 and amounts tendered in 1947 for prior years. The Tax Court held that “paid or accrued” refers to the taxpayer’s accounting method. Since Lewyt used the accrual method, it could only deduct taxes that had properly accrued during the relevant tax year, not merely taxes paid or amounts tendered. The court further determined that amounts tendered as payment did not constitute taxes actually paid during the year.

Facts

Lewyt Corporation, a manufacturer, filed its tax returns using the accrual method with a fiscal year ending September 30. It incurred net operating losses in 1946 and 1947. A dispute arose regarding the amortization of customer orders received from predecessor corporations, leading to asserted deficiencies for 1943. In 1947, Lewyt tendered payments to the IRS for additional taxes for 1943, 1944, and 1945, based on a potential settlement. However, the settlement was not finalized immediately, and the IRS placed the funds in a suspense account. Lewyt deducted these amounts on its 1947 return.

Procedural History

The Commissioner determined deficiencies for 1944 and 1945. Lewyt petitioned the Tax Court contesting the deficiencies. The Commissioner also sought an increased deficiency for 1945. The case centered around the proper calculation of net operating loss carry-backs and the deductibility of tendered tax payments. A stipulation of settlement regarding the 1943 tax year was filed with the Tax Court, and a decision was entered accordingly.

Issue(s)

1. Whether excess profits taxes paid in 1946 and amounts tendered in 1947 could be added to net operating losses for 1946 and 1947 when computing net operating loss carry-backs.

2. Whether amounts tendered to the IRS in 1947 constituted payments of additional excess profits taxes for 1943, 1944, and 1945 within the 1947 fiscal year.

3. Whether Lewyt was entitled to deduct interest paid or accrued during the 1947 fiscal year.

4. Whether excess profits tax paid or accrued within the 1944 taxable year could reduce net income for said year when computing the net operating loss carry-back from 1946 to 1945.

Holding

1. No, because the phrase "paid or accrued" should be interpreted based on the taxpayer's accounting method; Lewyt used the accrual method.

2. No, because the amounts tendered did not constitute actual tax payments within the fiscal year 1947.

3. The court did not specifically address the interest deduction because the parties agreed that the decision regarding the principal amounts would govern the interest payments.

4. The court held that this issue turned on the interpretation of "paid or accrued," and its interpretation of the phrase disposed of this question.

Court's Reasoning

The court reasoned that the phrase "paid or accrued" in Section 122(d)(6) should be construed according to the taxpayer's method of accounting, citing Section 48(c) of the Code. Since Lewyt used the accrual method, it could only deduct taxes that had properly accrued during the relevant tax year. The court distinguished Commissioner v. Clarion Oil Co., stating that case was specific to determining undistributed income. It cited Estate of Julius I. Byrne, which confirmed that an accrual basis taxpayer cannot increase its net operating loss carry-back for a particular year by adding in the amount of excess profits taxes paid in that year for the previous year. The court further reasoned that the amounts tendered in 1947 were not "tax payments" because the liabilities were still contested, and the IRS had placed the funds in a suspense account. The court referenced Dixie Pine Products Co. v. Commissioner, which established that a contested liability cannot be accrued.

Practical Implications

This case clarifies that the deductibility of taxes for net operating loss purposes hinges on the taxpayer's accounting method. Accrual-basis taxpayers cannot simply deduct taxes paid during the year; the tax liability must have properly accrued. The case also highlights that a mere tender of payment, especially when the underlying tax liability is still in dispute, does not constitute a "tax payment" for deduction purposes. Attorneys should advise clients to carefully consider their accounting methods and the status of any tax disputes when planning for net operating loss carry-backs. The case serves as a reminder that estimated tax payments or amounts held in suspense by the IRS may not be immediately deductible. Subsequent cases have cited this case to determine the proper timing of deductions based on accounting methods.

