T.C. Memo. 1953-204

Under the accrual method of accounting, a business expense is deductible only when (1) all events have occurred that establish the fact of the liability and (2) the amount of the liability can be determined with reasonable accuracy.

Summary

Patsch Brothers Coal Co., a strip-mining partnership using the accrual method of accounting, sought to deduct estimated backfilling costs for mined land in 1946-1948. The Tax Court disallowed the deductions, holding that the liability to backfill wasn't fixed and the amount wasn't determinable with reasonable certainty during those years. The court distinguished the case from *Harrold v. Commissioner*, emphasizing the uncertainty created by the use of independent contractors for backfilling and the delayed completion of backfilling on several tracts.

Facts

Patsch Brothers Coal Company mined coal in Pennsylvania via strip-mining, operating under leases that required compliance with Pennsylvania strip-mining laws and, in some cases, restoration of the land to its original contour. The partnership accrued reserves on its books, based on tonnage mined, to cover backfilling costs. These reserves were deducted on the partnership's income tax returns. The IRS disallowed the deductions, allowing only deductions for actual backfilling expenses in 1947 and 1948.

Procedural History

The Commissioner of Internal Revenue disallowed the partnership's deductions for accrued backfilling expenses. The partnership petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether Patsch Brothers Coal Company could deduct, as accrued expenses, the estimated costs of backfilling land from which it strip-mined coal in 1946, 1947, and 1948, under the accrual method of accounting.

Holding

No, because the mining of coal did not definitively fix the partnership's liability to pay for backfilling within the tax year, and the amount of the liability was not established with sufficient certainty to support accrual.

Court's Reasoning

The court applied the "all events" test, stating that deductions are permissible under the accrual method when all events have occurred to (a) establish a definite liability of the taxpayer to pay and (b) fix the amount of such liability. The court found that the partnership's liability wasn't fixed because contractors sometimes performed the backfilling, creating uncertainty about the partnership's direct obligation. Also, backfilling was not promptly completed, indicating the partnership didn't treat the obligation as fixed or determinable. The court distinguished *Harrold v. Commissioner* because, in that case, the obligation to backfill was solely the partnership's, and backfilling commenced promptly. The court also noted that the estimates of backfilling costs were not reasonable, considering the lack of expenditures on some tracts and the low cost per ton on others. The court quoted *Spencer, White & Prentis v. Commissioner*, emphasizing that "the only thing which had accrued was the obligation to do the work which might result in the estimated indebtedness after the work was performed." The court also cited *Brown v. Helvering*, reiterating that contingent liabilities are not accruable as deductions.

Practical Implications

This case reinforces the stringent requirements of the "all events" test for accrual accounting. It clarifies that a mere obligation to perform work in the future is insufficient to justify a current deduction. To deduct future expenses, businesses must demonstrate a fixed and unconditional liability, and the amount must be reasonably ascertainable. The case highlights the importance of demonstrating consistent treatment of liabilities and providing evidence to support the reasonableness of cost estimates. It shows how the use of independent contractors can complicate the determination of liability. It has influenced how courts evaluate the deductibility of environmental remediation costs and other future obligations.