20 T.C. 280 (1953)

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A cash-basis taxpayer cannot deduct an estimated reserve for renegotiation expenses in the year the income subject to renegotiation was earned, even if the taxpayer anticipates contesting the renegotiation.

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Summary

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Albert Miller, a cash-basis taxpayer, sought to deduct $7,000 as a "reserve for renegotiation expense" in 1944, anticipating that his income from sales to Huse-Liberty Mica Company would be subject to renegotiation under the Renegotiation Act of 1943. Miller argued that Section 3806(a)(3) of the Internal Revenue Code allowed him to deduct these anticipated expenses in the year the income was earned. The Tax Court disagreed, holding that Section 3806 is limited to excessive profits and does not permit the deduction of estimated, unpaid expenses in a prior year, even if related to renegotiation. The Court emphasized that deductions are generally taken in the year paid or incurred, and Section 3806 doesn't create an exception for estimated expenses.

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Facts

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In 1944, Albert Miller worked as a salesman for Huse-Liberty Mica Company and earned $77,313.83, all of which was subject to renegotiation under the Renegotiation Act of 1943. Anticipating renegotiation and planning to contest it, Miller set up a "Reserve for renegotiation expense" of $7,000, which he deducted as a business expense on his 1944 income tax return. This amount was an estimate of the costs to be incurred. Although Miller retained an attorney in 1944, no significant services were performed, and no part of the reserve was actually paid during that year. Miller kept his books and filed his return on a cash receipts and disbursements basis.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Miller's 1944 income tax liability, disallowing the $7,000 deduction for the reserve for renegotiation expense. Miller petitioned the Tax Court for a redetermination of the deficiency.

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Issue(s)

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Whether a cash-basis taxpayer can deduct an estimated reserve for renegotiation expenses in the year the income subject to renegotiation was earned, under Section 3806(a)(3) of the Internal Revenue Code, when no part of the reserve was actually paid during that year.

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Holding

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No, because Section 3806 is limited to the treatment of excessive profits and does not create an exception to the general rule that cash-basis taxpayers can only deduct expenses in the year they are actually paid.

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Court's Reasoning

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The Tax Court reasoned that Section 3806 provides a mechanism for adjusting income and tax liability when excessive profits are eliminated through renegotiation, focusing on crediting prior-year tax overpayments against the amount of excessive profits repaid. The court emphasized that this section does not create new deductions beyond those already permitted under Section 23 of the Internal Revenue Code. The Court cited *National Builders, Inc., 12 T.C. 852, 860*, stating that Section 3806 relates to an administrative function of the Commissioner. Since Miller was a cash-basis taxpayer, he could only deduct expenses actually paid during the

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year. The Court also cited *Cramp Shipbuilding Co., 17 T.C. 516, 532*, affd. 202 F.2d 280, stating that "Had Congress desired to keep the renegotiation years open for adjustment of subsequent renegotiable items of income and expense it would have so provided." Since the $7,000 reserve was an estimate and not actually paid in 1944, it was not deductible. The court concluded that to allow the deduction would be contrary to the established principle that deductions are taken in the year

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