Robert Reis & Co. v. Commissioner, 20 T.C. 297 (1953)

For accrual basis taxpayers, contested taxes do not accrue for deduction purposes until the contest is resolved and the liability is determined with reasonable certainty, typically upon settlement or final adjudication.

Summary

Robert Reis & Co., an accrual basis taxpayer, contested proposed deficiencies in excess profits taxes for 1943 and 1944. The dispute was settled in March 1949, and Reis paid the taxes in June 1949. Reis sustained a net operating loss in 1949 and sought to increase this loss carry-back to 1947 by deducting the settled excess profits taxes for 1943 and 1944 in 1949, the year of settlement and payment. The Tax Court held that because Reis contested the taxes and the liability was not fixed until the 1949 settlement, the excess profits taxes accrued and were deductible in 1949 for purposes of calculating the net operating loss carry-back.

Facts

1. Robert Reis & Co. used the accrual method of accounting and filed tax returns on a calendar year basis.
2. In 1948, the IRS proposed adjustments for 1943 and 1944 income and excess profits taxes, resulting in a proposed deficiency.
3. The proposed deficiency stemmed from disallowing an excess profits credit carry-over from 1942, which was linked to a contested 1942 loss deduction.
4. Reis contested the proposed deficiencies for 1943 and 1944 and did not agree to pay or accrue the taxes on its books.
5. In March 1949, Reis settled the dispute, agreeing to pay deficiencies in income and excess profits taxes for 1943 and 1944.
6. Reis paid the settled excess profits taxes in June 1949.
7. Reis incurred a net operating loss in 1949 and sought to carry it back to 1947, including the 1949 excess profits tax payment in the 1949 loss calculation.

Procedural History

1. The IRS determined deficiencies in income tax for 1946 and 1947, disallowing the increase in the 1949 net operating loss carry-back due to the 1943-44 excess profits tax payment.
2. Robert Reis & Co. petitioned the Tax Court to contest the IRS’s determination.
3. The Tax Court considered the propriety of the IRS’s failure to increase the 1949 net operating loss by the contested and settled excess profits taxes.

Issue(s)

1. Whether, for an accrual basis taxpayer, contested excess profits taxes for prior years accrue and are deductible for net operating loss purposes in the year the contest is settled and the taxes are paid, rather than the year to which the taxes

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originally relate.

Holding

1. Yes, because for an accrual basis taxpayer, contested taxes accrue and are deductible in the taxable year when the contest is resolved and the liability becomes fixed and determinable, which in this case was 1949, the year of settlement and payment.

Court's Reasoning

– The court relied on the principle established in *Dixie Pine Products Co. v. Commissioner* and *Security Flour Mills Co. v. Commissioner*, which held that for accrual basis taxpayers, contested tax liabilities do not accrue until the contest is resolved.
– The court emphasized that prior to the 1949 settlement, Robert Reis & Co. contested the 1943 and 1944 excess profits taxes and did not agree to pay or accrue them. Therefore, the liability was contingent and not fixed.
– The court stated, "It is agreed that the taxes in question were contested, that the contest ended with a settlement in 1949, and that the taxes were paid in that year. We think the petitioner is thus brought within the ambit of *Dixie Pine Products Co. v. Commissioner*, 320 U. S. 516, and *Security Flour Mills Co. v. Commissioner*, 321 U. S. 281."
– The court rejected the IRS's argument that even under accrual accounting, a special rule should apply to federal income and excess profits taxes, causing them to accrue in the year the income was earned, regardless of a contest. The court distinguished *Stern Brothers Co.*, cited by the IRS, as dealing with accumulated earnings and profits, not deductions.
– The court clarified that while Section 122(d)(6) deduction for excess profits taxes is disallowed in certain excess profits tax computations under Section 711, those sections were not applicable here. The general limitation formula under Section 710(a)(1)(B) does not override the plain language of Section 122(d)(6) allowing the deduction.
– The court dismissed the IRS's concern about distorting the excess profits picture, noting that the same distortion would occur for cash basis taxpayers who would deduct the taxes in the year of payment, which the IRS did not dispute as permissible.
– The court concluded that the statute plainly provides for the deduction in 1949, the year the contested liability was resolved and paid, aligning with accrual accounting principles for contested liabilities.

Practical Implications

– This case clarifies that for accrual basis taxpayers, the deductibility of contested taxes for net operating loss calculations is determined by the year the contest is resolved, not the year the tax liability relates to. This provides certainty in tax

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planning for businesses contesting tax assessments.
– Legal practitioners should advise accrual basis clients that if they are contesting a tax liability, the deduction for that tax will generally be recognized in the year the contest is settled or finally adjudicated, impacting net operating loss carry-backs or carry-forwards in that later year.
– This ruling emphasizes the importance of consistent application of accrual accounting principles, even for tax liabilities, particularly regarding the

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