National Bank of Olney v. Commissioner, T.C. Memo. 1954-237

Unclaimed bank deposits that are transferred from a deposit liability account to surplus are considered taxable income to the bank in the year of transfer, as this action signifies the bank's dominion and control over the funds, making the likelihood of repayment to depositors sufficiently remote.

Summary

National Bank of Olney acquired assets and liabilities from a predecessor bank, including unclaimed depositors' accounts. In 1948, after unsuccessful attempts to locate depositors, the bank transferred $6,780.64 from deposit liability to surplus and did not report it as income. The Commissioner determined a tax deficiency, arguing this amount was income. The Tax Court held that the transfer of unclaimed deposits to surplus constituted taxable income in 1948 because it signified the bank's assertion of control over the funds, making future payment to depositors improbable, even though the bank technically remained liable under state law.

Facts

Taxpayer, National Bank of Olney, was incorporated in 1934, acquiring assets and liabilities from a liquidated predecessor bank of a similar name, including certain depositors' accounts from the predecessor bank.

During 1948, the taxpayer attempted to locate certain depositors of these older accounts through mail and advertising but was unsuccessful.

In 1948, the taxpayer transferred $6,780.64 from unclaimed, dormant, and inactive deposit accounts to its Undivided Profits or Surplus Account, closing out the unclaimed deposit accounts in that amount on its books.

The taxpayer did not include this $6,780.64 as income in its 1948 tax return, though it was noted as a "Sundry Credit to Earned Surplus."

The Commonwealth of Pennsylvania did not examine the taxpayer's books, nor did the taxpayer report unclaimed deposits to the state during 1948 or prior years.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the taxpayer's 1948 income tax.

The National Bank of Olney petitioned the Tax Court to contest the Commissioner's determination.

Prior to the hearing, the National Bank of Olney merged into Fidelity-Philadelphia Trust Company, which continued the case.

Issue(s)

1. Whether unclaimed deposits in a bank constitute taxable income when the bank transfers these deposits from a deposit liability account to surplus.

2. Whether Pennsylvania escheat laws prevent unclaimed deposits from being considered income to the bank.

3. Whether the gain from unclaimed deposits should be treated as a reduction in the purchase price of assets acquired from the predecessor bank, rather than as taxable income.

Holding

1. Yes, because the transfer to surplus signifies the bank's dominion and control over the funds, making the likelihood of repayment to depositors remote enough to warrant income recognition.

2. No, because Pennsylvania escheat laws are not self-executing and do not automatically negate the bank's claim of right to the deposits in the absence of state action.

3. No, because the discharge of indebtedness principle applies, and the circumstances do not qualify as a reduction in purchase price of assets; the deposits are considered income from the discharge of a liability.

Court's Reasoning

Unclaimed Deposits as Income: The court relied on precedent cases like *Boston Consol. Gas Co. v. Commissioner*, noting that unclaimed deposits become income when transferred to surplus as it's practically unlikely they will be claimed. The court emphasized that book entries, while not conclusive, signify a point when it is reasonable to conclude deposits won't be paid and represent the bank's assertion of dominion. Quoting *Wichita Coca Cola Bottling Co. v. United States*, the court stated, "If the balance was an aggregate of old deposits, the book entry closing them out and putting the money to free surplus funds was not mere bookkeeping, but a financial act, as though a bank could and did transfer to its surplus old deposit accounts as barred or abandoned. Such a financial act creates income in the year in which it is done."

While Pennsylvania law might not start the statute of limitations until a demand for payment is refused, meaning the bank technically remains liable, the court reasoned, "The important consideration is that it was unlikely as a matter of fact that the bank would have to honor its obligation to the depositors in question." The court acknowledged that if deposits are later claimed and paid, a deduction would be available then.

Escheat Laws: The court rejected the argument that Pennsylvania escheat laws prevent income recognition. It stated that escheat is not self-executing, requiring state action. Since no escheat proceedings were initiated, the bank's dominion over the deposits in 1948 was sufficient for income recognition. The court compared the bank's claim to the deposits to an extortionist's claim to ill-gotten gains, referencing *Rutkin v. United States*, and distinguished *Commissioner v. Wilcox*.

Reduction of Purchase Price: The court dismissed the argument that this was a reduction in purchase price. It cited *United States v. Kirby Lumber Co.* and *Helvering v. American Chicle Co.* to establish that discharge of indebtedness can be income. The court distinguished cases cited by the petitioner (*Hirsch v. Commissioner*, etc.) as involving specific property purchases where debt reduction by the original creditor was deemed a purchase price adjustment. In this case, the unclaimed deposits were not tied to a specific asset purchase and the 'creditor' (depositor) was not reducing a sale price but rather the bank was unilaterally recognizing income from dormant liabilities.

Practical Implications

This case provides a clear rule for banks and similar institutions regarding unclaimed deposits: when a bank transfers long-dormant deposit liabilities to surplus, it triggers taxable income in that year. This is not negated by the bank's continuing legal liability to depositors or potential future escheat to the state. Financial institutions should regularly review dormant accounts and recognize income when they effectively treat these funds as their own by transferring them to surplus. This case highlights the importance of book entries as evidence of dominion and control in tax law and clarifies that the mere possibility of future claims or escheat does not defer income recognition. It emphasizes a practical, rather than strictly legalistic, approach to determining when income is realized in situations involving unclaimed funds.

