33 T.C. 640 (1960)

For an expense to be accrued and deducted for tax purposes, the liability must be fixed and uncontested at the end of the tax year.

Summary

General Communication Company (GCC) sought to deduct a $75,000 royalty payment to Radio Corporation of America (RCA) for the taxable year ending September 30, 1954, based on a patent license agreement. The U.S. Tax Court ruled against GCC, finding the liability was not sufficiently fixed or definite to warrant a deduction. The court determined that GCC contested the liability, as evidenced by its actions and legal strategies, preventing the accrual of the expense for tax purposes.

Facts

GCC, an accrual-method taxpayer, had a patent license agreement with RCA. RCA claimed GCC owed royalties based on certain equipment manufactured by GCC. GCC initially denied utilizing RCA patents. Later, GCC's general counsel advised the company to set up a reserve for potential royalties after RCA identified specific patents. GCC's engineers and patent counsel analyzed the patents. GCC's patent counsel investigated the validity of RCA's patents, prepared a memorandum, and suggested compromise or defense strategies. The company did not pay the royalties. GCC accrued the $75,000 royalty liability on its books for its fiscal year ending September 30, 1954.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in GCC's income and excess profits tax for the fiscal year ending September 30, 1954, disallowing the deduction for accrued royalties. The U.S. Tax Court heard the case.

Issue(s)

Whether GCC was entitled to accrue a $75,000 deduction for royalties allegedly owed to RCA for the taxable year ending September 30, 1954.

Holding

No, because GCC's liability for the royalties was neither fixed nor uncontested at the end of the taxable year.

Court's Reasoning

The court cited *Dixie Pine Products Co. v. Commissioner*, holding that to reflect income correctly, all events fixing the amount and fact of liability must occur during

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the tax year. The court also referenced *Lucas v. American Code Co.*, which stated an accrued liability requires a "definite admission of liability, negotiations for settlement are begun, and a reasonable estimate of the amount of the loss is accrued on the books." The court found that GCC's actions indicated a clear intent to resist paying the royalties, thus contesting the liability. Key factors were GCC's initial denials of patent use, consultations with patent counsel, strategies for compromise or defense, and lack of any actual royalty payments. Although the company booked the expense, the court determined that GCC had not admitted its liability. The court noted, "a taxpayer may resist payment of an asserted claim in more subtle ways than express denial of liability or adoption of a litigious attitude."

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