Conlorez Corp. v. Commissioner, 51 T. C. 467 (1968)

Gain from involuntary conversion must be recognized in the year of receipt if not reinvested within the statutory period.

Summary

In Conlorez Corp. v. Commissioner, the Tax Court ruled that Conlorez must recognize gain in 1961 from a partial payment received for property appropriated by New York State, as the property was not replaced within the time allowed by IRC Section 1033 for nonrecognition of gain. The court also upheld additions to tax for late filing of returns for 1961 and 1964 but found no negligence in the underpayment of taxes. The decision underscores the importance of timely reinvestment following an involuntary conversion to defer tax on the gain.

Facts

Conlorez Corporation owned real property in Niagara Falls, NY, which was appropriated by the State of New York on September 24, 1959. In 1961, Conlorez received a partial payment of $81,900, exceeding its adjusted basis in the property. In 1964, the New York Court of Claims awarded Conlorez an additional $84,675 plus interest. Conlorez replaced the property in 1965 and filed its 1961 and 1964 tax returns late.

Procedural History

The Commissioner of Internal Revenue determined deficiencies and additions to tax for Conlorez's 1961 and 1964 tax years. Conlorez petitioned the U. S. Tax Court for a redetermination. The court upheld the deficiencies and additions to tax for late filing but rejected the addition for negligence.

Issue(s)

1. Whether Conlorez realized gain in 1961 from the partial payment for its appropriated property.
2. Whether Conlorez filed timely income tax returns for 1961 and 1964, and if not, whether the failure was due to reasonable cause and not willful neglect.
3. Whether any part of the underpayment of income taxes for 1961 and 1964 was due to negligence or intentional disregard of rules and regulations.

Holding

1. Yes, because Conlorez received the partial payment under a claim of right and the payment exceeded its basis in the property, thus triggering recognition of gain in 1961.
2. No, because Conlorez did not establish that it timely mailed its 1961 return or that its failure to file timely for both years was due to reasonable cause and not

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willful neglect.
3. No, because Conlorez relied in good faith on its accountant's advice, and thus the underpayment was not due to negligence or intentional disregard of rules and regulations.

Court's Reasoning

The court applied IRC Section 1033, which requires recognition of gain from involuntary conversions unless the proceeds are reinvested within a specified period. Conlorez received the partial payment under a claim of right, as it believed it was entitled to the funds and used them freely. The court rejected Conlorez's arguments that the payment was a loan or that its contingent liability to repay the State or its tenant prevented gain recognition in 1961. The court also found that Conlorez did not replace the property within the statutory period, thus failing to qualify for nonrecognition under Section 1033. On the issue of late filing, the court found that Conlorez did not establish timely mailing of its 1961 return or reasonable cause for late filing of both returns. However, the court found no negligence in the underpayment of taxes, as Conlorez relied on its experienced accountant. The court quoted, "Earnings received under a claim of right, not subject to any limitation on use, are taxable in the year received, even though at the time of receipt conditions exist which might require the taxpayer to return part or all of such earnings. "

Practical Implications

This decision clarifies that gain from involuntary conversions must be recognized in the year of receipt unless the property is replaced within the statutory period under IRC Section 1033. Taxpayers must carefully track the timing of payments and reinvestments to ensure eligibility for nonrecognition. The ruling also emphasizes the importance of timely filing tax returns and maintaining clear records of mailing. For legal practitioners, this case underscores the need to advise clients on the tax implications of partial payments and the strict requirements for nonrecognition of gain. Subsequent cases have applied this ruling to similar scenarios, reinforcing the necessity of timely reinvestment to defer tax on involuntary conversion gains.

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