R. A. Stewart & Co. , Inc. v. Commissioner, 61 T. C. 315 (1973)

An advance payment received under a claim of right in an involuntary conversion triggers the start of the replacement period for nonrecognition of gain under Section 1033.

Summary

In R. A. Stewart & Co. , Inc. v. Commissioner, the Tax Court ruled that the taxpayer must recognize gain in the year it received an unrestricted advance payment from the City of New York for condemned property, as this payment triggered the start of the replacement period under Section 1033. The court applied the claim-of-right doctrine, holding that the advance payment was taxable income in the year received, despite the possibility of future adjustments to the final award. The taxpayer's failure to replace the property within the statutory period or to request an extension meant it did not qualify for nonrecognition treatment.

Facts

R. A. Stewart & Co. , Inc. owned property at 80 Duane Street, New York, used for its business. In 1965, the City of New York condemned this property and made an advance payment of $70,000 to the company, which was unrestricted in use. The adjusted basis of the property was $55,005. 53 at the time of payment. In 1968, a final award of $104,570. 95 was determined. The company replaced the property in 1969 but did not file for an extension of the replacement period under Section 1033.

Procedural History

The IRS determined deficiencies in the company's 1965 and 1966 federal income taxes, leading to a dispute over whether the company should recognize gain from the 1965 payment. The Tax Court heard the case and ruled in favor of the IRS, determining that the advance payment triggered gain recognition in 1965.

Issue(s)

1. Whether the advance payment received by the taxpayer in 1965 from the City of New York for condemned property triggered the start of the replacement period under Section 1033, requiring gain recognition in that year.

Holding

1. Yes, because the advance payment was received under a claim of right without restriction, triggering the start of the replacement period for nonrecognition of gain under Section 1033.

Court's Reasoning

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The court applied the claim-of-right doctrine, stating that income received without restriction must be recognized in the year received, even if it may later be subject to repayment. The court cited North American Oil Consolidated v. Burnet and Whitaker v. Commissioner to support this principle. The court distinguished this case from others where payments were contingent on final determinations, noting that the taxpayer here received and used the funds freely. The court also referenced Section 1033, which requires replacement of converted property within one year of realizing gain or within an extended period if approved by the IRS. Since the taxpayer received the advance payment in 1965 and did not replace the property until 1969 without requesting an extension, it failed to meet the statutory requirements for nonrecognition of gain.

Practical Implications

This decision clarifies that advance payments in condemnation cases, if unrestricted, trigger the start of the replacement period under Section 1033. Taxpayers must be aware that such payments can result in immediate tax liabilities, even if the final award is still pending. In practice, taxpayers should consider filing for an extension if they anticipate needing more time to replace the property. This case also reinforces the application of the claim-of-right doctrine in tax law, impacting how taxpayers report income from uncertain or contingent sources. Subsequent cases have followed this principle, affecting how similar involuntary conversion scenarios are analyzed and reported for tax purposes.

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