

Thriftmart, Inc. v. Commissioner, 59 T. C. 598 (1973)

An accrual basis taxpayer cannot deduct reserves for future liabilities unless all events fixing the liability have occurred and the amount is reasonably ascertainable.

Summary

Thriftmart, Inc. , an accrual basis taxpayer and self-insurer under California's Workmen's Compensation law, sought to deduct reserves for estimated future liabilities. The U. S. Tax Court held that such reserves were not deductible as they were contingent and not reasonably ascertainable at year-end. The court allowed deductions for nonforfeitable sick pay accrued under a union contract but disallowed deductions for forfeitable sick pay and charitable lease deductions for unused leased space to the Salvation Army, emphasizing that only the actual use of leased space for charitable purposes is deductible.

Facts

Thriftmart, Inc. , a California corporation operating grocery businesses, was a self-insurer under California's Workmen's Compensation law and maintained reserves for estimated future liabilities. It also had a union contract providing for sick leave pay, with some amounts being nonforfeitable upon an employee's anniversary date and others forfeitable if the employee voluntarily resigned or was discharged for dishonesty. Thriftmart leased parts of its building to the Salvation Army, claiming a charitable deduction based on the fair rental value of the entire leased space, despite the Salvation Army only using part of it.

Procedural History

The Commissioner of Internal Revenue disallowed Thriftmart's deductions for reserves for workmen's compensation and sick pay, as well as the charitable deduction for the unused leased space. Thriftmart appealed to the U. S. Tax Court, which upheld the Commissioner's disallowance of the deductions for reserves and the charitable lease but allowed the deduction for nonforfeitable sick pay.

Issue(s)

1. Whether an accrual basis taxpayer may deduct a reserve for estimated future liabilities under workmen's compensation when all events fixing liability have not occurred and the amount is not reasonably ascertainable at year-end.
2. Whether Thriftmart is entitled to deduct an accrual for nonforfeitable sick pay and forfeitable sick pay under its union contract.
3. Whether Thriftmart is entitled to a charitable deduction for the fair rental value of leased space to the Salvation Army, including unused space.
4. Whether Thriftmart may deduct depreciation on the portion of property leased to the Salvation Army for which it claims a charitable deduction.

Holding

1. No, because the all-events test was not satisfied; liability was contingent and the amount not reasonably ascertainable.
2. Yes for nonforfeitable sick pay, because liability was fixed by the end of the taxable year; No for forfeitable sick pay, because liability was contingent on future events.
3. No for the unused leased space, because the Salvation Army did not use it for charitable purposes; Yes for the used space, but only on an annual basis due to the revocable nature of the lease.
4. No, because the property was not used in Thriftmart's trade or business or held for the production of income while leased to the Salvation Army.

Court's Reasoning

The court applied the all-events test for accrual method taxpayers, requiring that all events fixing liability occur and the amount be reasonably ascertainable by year-end. For workmen's compensation reserves, the court found that Thriftmart's liability was contingent and the amounts not reasonably ascertainable due to various factors like preexisting conditions and potential negotiations or disputes. The court distinguished Thriftmart from cases involving insurance companies, which have specific statutory provisions allowing for reserves. For sick pay, the court allowed deductions for nonforfeitable amounts under the union contract, as these were fixed liabilities by year-end, but disallowed deductions for forfeitable amounts due to their contingent nature. Regarding the charitable lease, the court held that only the fair rental value of the space actually used by the Salvation Army was deductible and only on an annual basis due to the lease's revocable nature. The court also disallowed depreciation deductions on the leased property, as it was not used for business or income production during the lease. The court cited several precedents, including *Dixie Pine Co. v. Commissioner* and *Simplified Tax Records, Inc.* , to support its reasoning.

Practical Implications

This decision clarifies that accrual basis taxpayers cannot deduct reserves for future liabilities unless all events fixing the liability have occurred and the amount is reasonably ascertainable. Businesses should carefully evaluate their accrual practices, especially for self-insurance reserves, ensuring that they meet the all-events test. The ruling also affects how companies structure charitable leases, emphasizing that only the actual use of the leased space for charitable purposes can be deducted, and such deductions must be annualized if the lease is revocable. This case has been cited in subsequent cases dealing with similar issues, such as *John G. Allen* and *Lukens Steel Co.* , reinforcing its significance in tax law regarding accruals and charitable contributions.