Harmont Plaza, Inc. v. Commissioner, 56 T. C. 640 (1971)

Income must be accrued under section 451(a) when a taxpayer has a fixed right to receive it, even if payment is contingent upon future events.

Summary

Harmont Plaza, Inc. sought to avoid accruing rental income from Sears, which had vacated its property, arguing that its right to receive indemnification from Southern Park, Inc. was contingent on Southern Park's cash flow. The Tax Court held that Harmont had a fixed right to receive the income, as the cash flow condition did not vitiate the right to receive but merely delayed payment. The court determined that neither the cash flow deficit nor the priority schedule established doubtful collectibility, requiring Harmont to accrue the income in the years it became fixed, despite the uncertainty of when payment might be received.

Facts

Sears vacated Harmont Plaza's property in 1969 to move to Southern Park Mall. Harmont entered into agreements with Southern Park, Inc. , and others, which provided for indemnification against rental loss from Sears' vacating. The indemnification was subject to Southern Park's cash flow and a priority schedule. Southern Park had a deficit cash flow from inception, and the indemnification obligation was subordinated to other claims. Harmont did not report the rental loss as income in 1970 and 1971, the years in question.

Procedural History

The IRS assessed deficiencies against Harmont for the fiscal years ending November 30, 1970, and November 30, 1971, based on unreported rental income. Harmont filed a petition with the Tax Court to contest these deficiencies. The court's decision focused on whether the income should be accrued under section 451(a) of the Internal Revenue Code.

Issue(s)

1. Whether Harmont Plaza, Inc. had a fixed right to receive the indemnification payments from Southern Park, Inc. , in the fiscal years ending November 30, 1970, and November 30, 1971.
2. Whether the cash flow and priority schedule provisions of the indemnification agreement rendered the payments sufficiently doubtful to preclude accrual.

Holding

1. Yes, because the court determined that the cash flow and priority schedule conditions did not negate Harmont's fixed right to receive the indemnification payments but only affected the timing of payment.

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2. No, because the court found that neither the cash flow deficit nor the priority schedule established sufficient doubt about collectibility to justify non-accrual.

Court’s Reasoning

The court applied the rule that income must be accrued when all events have occurred that fix the right to receive such income and the amount can be determined with reasonable accuracy. It rejected Harmont’s argument that the cash flow and priority schedule conditions made the right contingent, analogizing these to the general subordination in corporate capital structures which do not preclude a fixed right. The court also found that the financial difficulties of Southern Park did not rise to the level of insolvency or bankruptcy that would justify non-accrual due to doubtful collectibility. The court cited cases like Commissioner v. Hansen and Georgia School-Book Depository, Inc. , to support its conclusion that delay in payment does not defer accrual, and that initial cash flow deficits in leveraged real estate transactions are not reliable indicators of financial viability.

Practical Implications

This decision clarifies that taxpayers must accrue income when they have a fixed right to receive it, even if payment is contingent upon future events like cash flow. Legal practitioners should advise clients to accrue income in the year it becomes fixed, regardless of payment uncertainties, unless the debtor’s financial condition suggests true insolvency. The ruling impacts how income from contingent payment arrangements is treated for tax purposes, potentially affecting business planning and financial reporting in real estate and other industries where such arrangements are common. Subsequent cases, such as Jones Lumber Co. v. Commissioner, have further explored the concept of doubtful collectibility, but Harmont Plaza remains a key precedent for understanding the accrual of income under section 451(a).

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