Trinity Industries, Inc. and Subsidiaries v. Commissioner of Internal Revenue, 132 T. C. 6 (U. S. Tax Court 2009)

In Trinity Industries, Inc. v. Commissioner, the U. S. Tax Court ruled that deferred payments for barges delivered in 2002 must be accrued as income in that year despite customers' claims of offset for alleged defects in previously sold barges. The court also denied deductions for these withheld payments under Section 461(f), clarifying the timing and control necessary for a deductible transfer. This decision underscores the strict application of the all-events test for income accrual and the narrow scope of the contested liabilities deduction.

Parties

Trinity Industries, Inc. and its subsidiaries, as the petitioner, contested a deficiency determination by the Commissioner of Internal Revenue, the respondent, regarding the tax year ending December 31, 2002.

Facts

Trinity Industries, Inc. , through its subsidiary Trinity Marine Products, Inc. , entered into contracts to build barges for J. Russell Flowers, Inc. (Flowers) and Florida Marine Transporters, Inc. (Florida Marine). The contracts included deferred payment terms, with payments due 18 months after delivery. After delivery, Flowers and Florida Marine claimed defects in barges sold under earlier contracts and withheld the deferred payments, asserting a right of offset. Trinity accrued income from the barges delivered in 2001 but excluded the deferred payments from 2002 income due to the offset claims. The Commissioner challenged this exclusion, asserting that the deferred payments should have been accrued in 2002.

Procedural History

The Commissioner issued a notice of deficiency to Trinity Industries, Inc. , asserting a deficiency in tax for the year ending March 31, 1999, due to the carryback of a 2002 net operating loss that was affected by the exclusion of the deferred payments from 2002 income. Trinity petitioned the U. S. Tax Court for a redetermination of the deficiency. The court reviewed the case de novo, focusing on the issues of income accrual and the deductibility of the withheld payments under Section 461(f).

Issue(s)

Whether Trinity Industries, Inc. was required to accrue the deferred payments for barges delivered in 2002 as income in that year despite the customers' claims of offset for alleged defects in previously sold barges?

Whether Trinity Industries, Inc. could deduct the withheld deferred payments in 2002 under Section 461(f) of the Internal Revenue Code?

Rule(s) of Law

Under the accrual method of accounting, income is recognized when all events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy. See 26 C. F. R. 1. 446-1(c)(1)(ii)(A), 1. 451-1(a). An accrual basis taxpayer must report income in the year the last event occurs which unconditionally fixes the right to receive the income and there is a reasonable expectancy that the right will be converted to money. See *Schlumberger Technology Co. v. United States*, 195 F. 3d 216, 219 (5th Cir. 1999).

Section 461(f) of the Internal Revenue Code allows a deduction for a contested liability in the year money or other property is transferred to satisfy the liability, provided certain conditions are met, including that the transfer occurs while the contest is ongoing and the liability would otherwise be deductible in the transfer year.

Holding

The U. S. Tax Court held that Trinity Industries, Inc. was required to accrue the deferred payments for barges delivered in 2002 as income in that year, notwithstanding the offset claims by Flowers and Florida Marine. The court further held that Trinity was not entitled to deduct the withheld payments under Section 461(f) because no transfer occurred in 2002.

Reasoning

The court reasoned that Trinity's right to receive the deferred payments was fixed upon delivery of the barges, satisfying the all-events test for income accrual. The offset claims did not negate this right but rather affected only the timing of receipt. The court distinguished cases where income accrual was postponed due to disputes over the validity or amount of the claim, noting that Flowers and Florida Marine did not dispute their obligations under the second contract but merely withheld payment pending resolution of their claims.

The court rejected Trinity's argument that the offset claims justified postponing accrual, citing *Commissioner v. Hansen*, 360 U. S. 446 (1959), which held that income must be accrued when the right to receive it is fixed, even if the funds are withheld or used to satisfy other obligations. The court also noted that doubts about collectibility do not justify postponing accrual unless the debtor is insolvent or bankrupt, which was not the case here.

Regarding the deductibility of the withheld payments under Section 461(f), the court held that no transfer occurred in 2002 because the deferred payments were not within Trinity's control to transfer. The court emphasized that a transfer requires relinquishing control over funds or property, which did not occur until the settlement agreements in 2004 and 2005. The court distinguished *Chernin v. United*

States, 149 F. 3d 805 (8th Cir. 1998), noting that a court-issued writ of garnishment, as in *Chernin*, was necessary to effect a transfer, which was absent in this case.

Disposition

The court ruled in favor of the Commissioner, requiring Trinity to accrue the deferred payments as income in 2002 and denying the deductions claimed under Section 461(f). The case was decided under Rule 155 of the Tax Court Rules of Practice and Procedure.

Significance/Impact

The *Trinity Industries* decision reinforces the strict application of the all-events test for income accrual under the accrual method of accounting, clarifying that offset claims do not negate the fixed right to income. It also narrows the scope of Section 461(f) deductions, requiring a clear transfer of funds or property under the taxpayer's control to satisfy a contested liability. This ruling impacts how taxpayers must account for income and deductions in situations involving disputed claims and deferred payments, emphasizing the importance of the timing and control of transfers.

