

# Income Tax--Basis of Loss in Case of Anticipated Damages (Ewing-Thomas Converting Co. v. McCaughn (3rd Cir. 1930))

St. John's Law Review

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### Recommended Citation

St. John's Law Review (1930) "Income Tax--Basis of Loss in Case of Anticipated Damages (Ewing-Thomas Converting Co. v. McCaughn (3rd Cir. 1930))," *St. John's Law Review*: Vol. 5 : No. 1 , Article 35.  
Available at: <https://scholarship.law.stjohns.edu/lawreview/vol5/iss1/35>

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**INCOME TAX—BASIS OF LOSS IN CASE OF ANTICIPATED DAMAGES.**—The Ewing-Thomas Converting Company contracted to deliver a specified quantity of yarn during the year 1919, to one Myers. At the close of the year prices were steadily advancing and Myers was demanding delivery in accordance with the contract. Delivery was finally made in May, 1920. The taxpayer then deducted as a loss sustained in 1919, a sum equal to the loss which it estimated would be sustained in the performance of such similar contracts. The Collector of Internal Revenue under section 214 (a) of the Revenue Act of 1918 contended that the loss was not such as might be deducted in 1919. The District Court for the Eastern District of Pennsylvania sustained the collector. The appellant petitioned for a review. *Held*, to justify deduction in 1919 of anticipated damages because of a breach, the contract must be performed within a short time after the close of the year, the amount of damages must be reasonably predictable, negotiations for settlement must be commenced within the year and completed soon after its close. Here liability could not be reasonably determined on December 31, 1919, and so no deduction was allowed. *Ewing-Thomas Converting Co. v. McCaughn* (C. C. A., 3rd, Sept. 11, 1930).

The deduction for loss of a taxpayer's breach of contract is not allowed<sup>1</sup> except under special circumstances.<sup>2</sup> Since it could not be said that the loss was in 1919 and since the taxpayer did not in that year accrue an estimated amount of the loss on its books rejection of the deduction for the year should be sustained. Article 144 of the statute does not contemplate the deduction of losses resulting in the mere fluctuation of the value of property.<sup>4</sup> A liability incurred through a breach of contract is a deductible loss for the year in which the breach occurred, where liability was admitted, an offer in compromise made, and an amount representing the estimated liability was accrued on the books.<sup>5</sup> Though the amount of the loss was undetermined until the compromised settlement was affected during the succeeding year.<sup>6</sup> But not as to a deduction prior to the year in which the settlement was agreed to, and the liability was entered upon the books.<sup>7</sup> However, loss from mere cancellation of contract is not allowed.<sup>8</sup> Since the Income Tax Law is concerned only with realized losses as well as with realized gains,<sup>9</sup> the decision disallowing the deduction in the instant case was in line with the rule

<sup>1</sup> Appeal of Brighton Mills, 1 B. T. A. 392 (1925).

<sup>2</sup> Nice Ballbearing Company, 5 B. T. A. 484 (1926).

<sup>3</sup> Sec. 234 (a), Rev. Act of 1918; Lucas American Code Co., Inc., 280 U. S. 445 (C. C. A., 2nd, 1930).

<sup>4</sup> Art. 144, Rev. Act of 1918, *New York Ins. Co. v. Edwards*, 271 U. S. 109 (C. C. A., 2nd, 1926).

<sup>5</sup> *New Process Cork*, 3 B. T. A. 1339 (1926).

<sup>6</sup> *Raleigh Smokeless Fuel*, 6 B. T. A. 381 (1927).

<sup>7</sup> *Lynchburg Colliery Co., Inc.*, 7 B. T. A. (1927).

<sup>8</sup> *Ledbetter Mfg. Co.*, 12 B. T. A. 145 (1928).

<sup>9</sup> *Weiss v. Weinert*, 279 U. S. 333, 49 Sup. Ct. 337 (1929); Klein, Federal Income Taxation (1929), par. 6:31 (a), 21:48 (d).

as laid by the court in past decisions.<sup>10</sup> Although it has been held that the taxpayer's liability for damages on account of a breach of contract in 1920, was a loss sustained and deductible in that year, and though the amount of damages was negotiated, agreed upon and paid the following year,<sup>11</sup> this decision has been limited to cases in which the taxpayer admits liability by offer of settlement immediately after the breach.<sup>12</sup>

R. D. F.

**INCOME TAX—TRUST SITUS—INTANGIBLES—DOUBLE TAXATION.**—These are three cases, decided together, involving three complaints for the abatement of certain income taxes assessed by the Commonwealth of Massachusetts<sup>1</sup> and paid by the complainants, residents of Massachusetts, as trustees under three wills, two being administered in New York and one in the District of Columbia. The trust property, consisting of intangibles, had previously been taxed by New York and the District of Columbia respectively. Plaintiffs allege that, the trustees having been appointed by the courts of New York and the District of Columbia, and the trusts being administered in those jurisdictions, these trusts are liable to the state of New York and the District of Columbia for an income tax on the gains and profits here sought to be taxed. *Held*, that the fact that trustees were residents of Massachusetts did not authorize that State to impose income taxes on the trust, since, the property having already been taxed in New York and the District of Columbia respectively, such action would render them liable to double taxation. *Edward W. Hutchins et al., Trustees v. Commissioner of Corporations and Taxation, Massachusetts Supreme Judicial Court (U. S. Daily 2361, Oct. 2, 1930).*

The Court states that the taxing section indicates an intention on the part of the General Court to tax all the income there described which is within its power to tax. "It is as broad as the jurisdiction of the Commonwealth." The question of jurisdiction is disposed of not as an original problem, but on the theory enunciated in *Farmers' Loan and Trust Company v. Minnesota*,<sup>2</sup> that the courts of New York and the District of Columbia have already settled the *situs* of the trusts, and that such *situs* for the purpose of taxation having been established in New York and the District of Columbia, the Commonwealth is powerless, under the due process clause of the Fourteenth

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<sup>10</sup> *Empire Printing & Box Company*, 5 B. T. A. 303 (1926); *Hidalgo Steel Company*, 8 B. T. A. 76 (1927).

<sup>11</sup> *Producers Fuel*, 1 B. T. A. 202 (1925).

<sup>12</sup> *Hamler Coal Company*, 4 B. T. A. 947 (1926).

<sup>1</sup> Under Mass. Gen. Laws, ch. 62, sec. 10.

<sup>2</sup> 280 U. S. 204, 50 Sup. Ct. 98 (1930).