1 T.C. 482 (1943)

A taxpayer's consistent use of an accounting method for long-term contracts will be upheld if it clearly reflects income, even if it requires adjustments in the year of contract completion.

Summary

W.F. Trimble and Sons Co., a construction contractor, consistently used a method of accounting for long-term contracts based on engineers' estimations of work completion, billing clients accordingly, and deducting expenses. The Commissioner challenged this method, arguing it didn't clearly reflect income and adjusted the company's income for 1935 and 1936. The Tax Court held that Trimble's method did clearly reflect income because compensating adjustments were made at the end of each contract, and that the statute of limitations barred assessment for 1935. The court also found Trimble hadn't demonstrated error in the Commissioner's depreciation computation.

Facts

Trimble, a construction company, accounted for long-term contracts by creating separate accounts for each project, recording costs and billings. Billings were primarily based on engineers' percentage of completion estimates. The company deducted total cost entries from total billing entries at year-end to compute gross profit or loss. Unbilled charges were entered for the year the charges arose. Trimble consistently used this method since 1920.

Procedural History

The Commissioner determined deficiencies in Trimble's income tax for 1935 and 1936, arguing that Trimble's method of reporting profits on long-term contracts didn't accurately reflect income. Trimble petitioned the Tax Court, contesting the deficiencies and arguing that the statute of limitations barred assessment for 1935.

Issue(s)

1. Whether the statute of limitations barred assessment of the deficiency for the year 1935.

2. Whether the Commissioner erred in determining that Trimble's method of computing income from long-term contracts did not clearly reflect income.

3. Whether the Commissioner erred in denying the depreciation claimed by Trimble.

Holding

1. No, because Trimble's accounting method clearly reflected income, the

Commissioner has not shown that Trimble omitted more than 25% of properly includible gross income. Thus, the statute of limitations had run.

2. No, because Trimble's method of accounting for long-term contracts did clearly reflect income as adjustments were made at the end of the contracts.

3. No, because Trimble did not provide sufficient evidence to show that the Commissioner's depreciation determination was erroneous.

Court's Reasoning

The court addressed the statute of limitations issue first. Section 275(c) allows assessment within five years if the taxpayer omits over 25% of gross income stated in the return. The court determined that the relevant figure was the $94,256.77 stated as gross income on the return, and not the total gross receipts. However, because Trimble's accounting method clearly reflected income, the court found that there was no omission of income and that the statute of limitations barred assessment for 1935.

Regarding the accounting method, the court relied on *Hegeman-Harris Co. v. U.S.*, noting the similarity in accounting methods where actual expenses were deducted from bills sent to clients, and overhead expenses were separately deducted. "Where the profits or losses under the foregoing method differed from the correct profits and losses determined on the completion of a contract, compensating adjustments were made upon completion of the work." The court emphasized that adjustments at the end of the contract reconciled any yearly inaccuracies.

On depreciation, the court found Trimble's evidence insufficient to prove the Commissioner's determination was erroneous. A civil engineer's testimony that the claimed depreciation was reasonable was insufficient.

Practical Implications

This case reinforces the principle that consistent accounting methods, especially for long-term contracts, will be respected if they clearly reflect income. The court emphasized the importance of adjustments made at the end of a contract to reconcile any discrepancies from earlier estimations. This highlights that the Tax Court is willing to look at the overall picture of a taxpayer's accounting practices when determining whether the method clearly reflects income.

This decision informs legal practice by requiring the Commissioner to demonstrate that a taxpayer's consistent accounting method distorts income, considering end-of-contract adjustments. It also cautions taxpayers that generalized testimony is insufficient to overcome a depreciation determination made by the Commissioner. Subsequent cases would likely cite this to show that consistent application of an accounting method coupled with contract reconciliations supports a clear reflection of income.

