2 T.C. 25 (1943)

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For tax purposes, income from long-term contracts is recognized in the year the contract is both finally completed and accepted, with ‘completion’ referring to substantial completion, not necessarily absolute perfection, and acceptance determined by the actions of the parties and any contractual terms regarding acceptance.

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Summary

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Ehret-Day Co., a construction company, disputed the Commissioner’s assessment of income tax deficiencies for 1938. The deficiencies stemmed from the inclusion of profits from two construction contracts and the disallowance of a portion of salary deductions claimed for the company’s officers. The Tax Court addressed whether the contracts were completed and accepted in 1938 and whether the officer’s salaries were reasonable. The court ultimately found that both contracts were completed and accepted in 1938, and adjusted the amount of reasonable salary deductions.

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Facts

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Ehret-Day Co. entered into two construction contracts: one for a store and office building with Ruth Keator Fredericks and another for the reconstruction of the North End Hotel. For the Fredericks contract, the architect issued a certificate authorizing final payment, despite some minor defects remaining. The hotel was occupied and operated after the work was seemingly finished. The company reported income on the completed contract method. The IRS argued both projects were finished and accepted in 1938, leading to a tax deficiency.

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Procedural History

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The Commissioner determined deficiencies in Ehret-Day's income and excess profits taxes for 1938. Ehret-Day Co. petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court reviewed the facts, applicable regulations, and relevant case law to reach its decision.

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Issue(s)

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1. Whether the construction contract with Fredericks was completed and accepted in 1938 for tax purposes?

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2. Whether the North End Hotel contract was accepted in 1938 for tax purposes?

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3. Whether the salaries paid to the company's officers were reasonable and properly deductible for tax purposes?

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Holding

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1. Yes, the Fredericks contract was completed and accepted in 1938 because the work was substantially completed, and the architect's certificate indicated acceptance.

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2. Yes, the North End Hotel contract was accepted in 1938 because the owner took possession and operated the hotel without contesting the work's sufficiency.

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3. No, the salaries paid to the company's officers were not entirely reasonable; the court determined a reasonable amount based on the services rendered by each officer.

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Court’s Reasoning

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The court relied on Article 42-4 of Regulations 101, which allows reporting income from long-term contracts in the year the contract is

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