2 T.C. 216 (1943)

A taxpayer operating a business on an accrual basis must report income from that business on an accrual basis, even if the taxpayer maintains personal accounts on a cash basis.

Summary

Berryman D. Fincannon took over a school book depository business from a corporation that used the accrual method of accounting. Fincannon, who kept his personal accounts on a cash basis, argued that he should be able to report the commissions in the year they were received. The Tax Court held that because the school book depository business required the use of the accrual method, Fincannon was required to report income from the business on that basis, regardless of his personal accounting methods. This case illustrates that the method of accounting must clearly reflect income and that a taxpayer cannot use the cash method to defer income earned by an accrual-basis business.

Facts

The Florida School-Book Depository, Inc., a corporation controlled by Fincannon, operated a school book distribution business, representing publishers and distributing books in Florida. The corporation used the accrual method of accounting. In June 1937, Fincannon took over the business. The business involved contracts with publishers to receive, store, and distribute school books, collect payments, and remit balances to the publishers, retaining a commission. In 1937, after Fincannon took over, books were delivered that resulted in commissions of $25,139.87, but the state did not pay for them until 1938.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Fincannon’s 1937 income tax, arguing that the commissions should have been reported in 1937 under the accrual method. Fincannon argued he was on a cash basis and could report the income in 1938, when it was received. The Tax Court reviewed the Commissioner’s determination.

Issue(s)

Whether a taxpayer who owns and operates a business requiring the accrual method of accounting can report income from that business on the cash basis because the taxpayer keeps personal books on a cash basis.

Holding

No, because the school book depository business was operated on an accrual basis and the income was properly accruable in 1937, the taxpayer cannot treat the

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proceeds as received on the cash basis, despite maintaining personal accounts on that basis.

Court's Reasoning

The Tax Court relied on its prior decision in *Georgia School-Book Depository, Inc.*, which involved similar facts and held that commissions were properly accruable in the year the sales were made. The court emphasized that Fincannon's business required the use of inventories, accounts receivable, and accounts payable, indicative of the accrual method. The court noted, "the books of the depository continued to be kept on the accrual basis." While a person may report personal income separately from business income, the court found that Fincannon, as the owner of the business, must adhere to its accrual method of accounting. The court also pointed out that changing from the accrual method used by the corporation to a cash method would require permission from the IRS, which was not obtained. The court reasoned that allowing the taxpayer to report on the cash basis would contravene the rule against changing a long-continued basis without permission.

Practical Implications

This case reinforces the principle that the method of accounting must clearly reflect income. It highlights that even if an individual taxpayer prefers the cash method, they must use the accrual method for a business when that method is necessary to properly account for income. It prevents taxpayers from using the cash method to defer income earned by an accrual-basis business. This decision informs the analysis of similar cases by clarifying that the nature of the business dictates the accounting method, regardless of the taxpayer's personal accounting preferences. It remains relevant for tax practitioners advising clients on the proper accounting methods for their businesses.

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