Blum's, Inc. v. Commissioner, 7 T.C. 1325 (1946)

A corporation selling goods on the installment plan cannot include unrealized profits from unpaid installment notes in its equity invested capital for excess profits tax purposes.

Summary

Blum's, Inc., a retailer selling goods on the installment basis, sought to include unrealized profits from unpaid installment notes in its equity invested capital for excess profits tax calculations. The Tax Court, relying on its prior decision in *Kimbrell's Home Furnishings, Inc.*, held that such unrealized profits cannot be included as accumulated earnings and profits. The court rejected Blum's attempt to distinguish its case based on its method of reporting profits, emphasizing that the underlying principle of not recognizing anticipated profits remains consistent. This case clarifies that the computation of accumulated earnings and profits should follow the same rules for both income tax and excess profits tax purposes.

Facts

Blum's, Inc. sold goods at retail on the installment plan.
The company received installment notes from purchasers at the time of sale.
Blum's sought to include unrealized profits represented by these unpaid installment notes in its equity invested capital.

Procedural History

The Commissioner of Internal Revenue disallowed Blum's inclusion of unrealized profits in its equity invested capital.
Blum's, Inc. petitioned the Tax Court for review.

Issue(s)

Whether a corporation engaged in installment sales can include unrealized profits represented by unpaid installment notes in its equity invested capital for excess profits tax purposes.

Holding

No, because including anticipated and unreported profits from installment sales in equity invested capital would be equivalent to applying different rules for computing accumulated earnings and profits for excess profits purposes than for income tax purposes.

Court's Reasoning

The Tax Court relied heavily on its recent decision in *Kimbrell's Home Furnishings,* *Inc.*, which addressed the same issue with indistinguishable facts. The court found no substantive difference between a taxpayer computing net income on the installment basis under Section 44(a) and a taxpayer filing income and excess profits tax returns on the accrual basis but electing to report profit from installment sales under Section 44(a).

The court stated that approving the inclusion of anticipated and unreported profits from installment sales would be equivalent to admitting "that a different rule applies in the computation of accumulated earnings and profits for excess profits purposes than in the computation of earnings and profits for income tax purposes." The court reiterated the principle that the computation of accumulated earnings and profits should be consistent across both income tax and excess profits tax contexts, citing *Federal Union Insurance Co.* to support this principle.

Practical Implications

This case reinforces the principle that unrealized profits cannot be included in equity invested capital for tax purposes. It clarifies that the method of reporting income (installment or accrual) does not alter this fundamental rule.

Legal practitioners must ensure that businesses calculate their equity invested capital based on realized profits, not anticipated or unrealized gains.

This decision has implications for businesses that utilize installment sales, emphasizing the need to accurately report and account for profits only when they are realized.

Later cases would likely cite this case to support the proposition that tax accounting should reflect economic reality and that anticipated income should not be prematurely recognized for tax purposes.

