## *Forcum-James Co. v. Commissioner, 7 T.C. 1195 (1946)*

A taxpayer using the completed contract method of accounting must recognize income when a joint venture is closed, and the Commissioner has broad authority under Section 45 of the Internal Revenue Code to allocate income between related entities to clearly reflect income.

### Summary

Forcum-James Co. ("Forcum-James"), a construction company, appealed a determination by the Commissioner of Internal Revenue that increased its taxable income. The Commissioner included profits from a contract with DuPont, arguing that the withdrawal of joint participants in the contract constituted a completed transaction, giving rise to taxable gain. The Tax Court upheld the Commissioner's determination, finding that the income was realized when the joint venture terminated, and the Commissioner acted properly in allocating income from a related partnership to Forcum-James to accurately reflect income.

### Facts

Forcum-James entered into a contract with DuPont for construction work. It then formed a joint venture with Forcum-James Construction Co. (a partnership) and other entities to perform the contract. Forcum-James Co. received purchase orders from DuPont in its own name, and DuPont dealt directly with Forcum-James Co. The joint venture was terminated prior to November 30, 1941. Forcum-James Co.'s books reflected deferred income from the project. The Commissioner determined that $313,195.98 of deferred income and $500,000 paid to the partnership should be included in Forcum-James Co.'s income.

### Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Forcum-James Co. Forcum-James Co. petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's determination in part, finding that the income was properly allocated and recognized, but allowed a deduction for pension trust contributions.

### Issue(s)

1. Whether the $313,195.98 was realized by Forcum-James Co. from a long-term contract extending beyond November 30, 1941, thus not taxable in the period ended November 30, 1941, given the completed contract method of accounting?
2. Whether the Commissioner properly included $500,000 paid to Forcum-James Construction Co. in Forcum-James Co.'s income under Section 45 of the Internal Revenue Code?
3. Whether Forcum-James Co. is entitled to deduct the full amount contributed to

a pension trust?

### Holding

1. No, because the $313,195.98 was not realized from a long-term contract extending beyond November 30, 1941; it was realized as a result of the termination of a joint venture in that period.
2. Yes, because Section 45 allows the Commissioner to allocate income between entities controlled by the same interests to clearly reflect income, and the $500,000 was effectively earned by Forcum-James Co., not the partnership.
3. Yes, in part. The amount of $72,500 contributed by petitioner to the pension trust, less $1,500 contribution for the benefit of Donald Forcum, is deductible by petitioner as a business expense under section 23 (a) (1) of the Internal Revenue Code.

### Court's Reasoning

The Tax Court reasoned that the $313,195.98 was not earned from a long-term contract, but from the termination of a joint venture, making it taxable in the period ended November 30, 1941. Regarding the $500,000, the court found that Forcum-James Co. and the partnership were controlled by the same interests, and the partnership performed no significant services to earn the income. Thus, the Commissioner properly allocated the income to Forcum-James Co. under Section 45 to clearly reflect income. The court emphasized that "In any case of two or more organizations, trades, or businesses * * * owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations…if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses." As to the pension trust, the court found the contributions (except for one) were reasonable compensation.

### Practical Implications

This case reinforces the Commissioner's broad authority under Section 45 of the Internal Revenue Code to reallocate income between related entities to prevent tax evasion or to clearly reflect income. Businesses operating through multiple related entities must be prepared to demonstrate that each entity independently earns the income it reports. The case also illustrates that using the completed contract method doesn't allow indefinite deferral of income; income must be recognized when the contract, or the taxpayer's involvement in it, is complete. Later cases have cited Forcum-James for its holding on the Commissioner's authority under Section 45, emphasizing the need for a clear business purpose and economic substance in transactions between related entities.

 