9 T.C. 966 (1947)

A taxpayer using the accrual method of accounting must recognize income when the right to receive it becomes fixed and definite, even if services related to that income are to be performed in a future year.

Summary

Capital Warehouse Co., an accrual-basis taxpayer, sought to defer a portion of its handling revenue by placing it in a "Reserve for Handling Out" account, arguing this represented a future obligation to remove goods. The Tax Court upheld the Commissioner's determination that these amounts were includible in gross income in the year received. The court reasoned that the right to receive the income was fixed, and the accrual method requires income recognition when the right to receive becomes definite, regardless of future performance obligations. This decision reinforces the principle that accrual-basis taxpayers cannot defer income based on anticipated future expenses related to earned revenue.

Facts

Capital Warehouse Co. was a public warehouse company using the accrual method of accounting. The company received a "handling charge" for receiving, stowing, and redelivering stored merchandise. It created a "Reserve for Handling Out" account to cover the cost of redelivering goods at the end of the storage period. In 1943 and 1944, the company allocated portions of its handling revenue to this reserve, effectively excluding those amounts from its reported income. The company estimated that 69% of handling revenue would be needed to cover the cost of handling out merchandise. Later developments revealed that the merchandise stored was shipped out in carload lots, contrary to initial assumptions.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Capital Warehouse Co.'s income and excess profits taxes for the fiscal years ended May 31, 1943, and May 31, 1944. The Commissioner argued that the amounts placed in the "Reserve for Handling Out" account should have been included in gross income. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether a public warehouse company, keeping its books and filing its returns on the accrual basis, can exclude from its income that portion of its revenue which the company set aside in a reserve account as its contractual liability to remove goods from its warehouse at the end of the storage period.

Holding

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No, because the amounts transferred to the reserve account represented income earned in the year received, and the accrual method requires recognition of income when the right to receive it becomes fixed and definite, regardless of whether related services are performed in a subsequent year.

Court’s Reasoning

The court relied on Section 41 of the Internal Revenue Code, which dictates that net income be computed according to the taxpayer’s regular accounting method, provided that method clearly reflects income. Citing Security Flour Mills Co. v. Commissioner, <span normalizedcite="[321 U.S. 281](#)“>321 U.S. 281, the court emphasized that taxation requires revenue to be ascertainable and payable at regular intervals. The court reasoned that the taxpayer’s attempt to defer income contradicted the accrual method’s core principle of recognizing income when the right to receive it becomes final and definite, irrespective of when related services are performed. The court distinguished the taxpayer’s situation from cases involving deductions based on long-established practices. The court also cited other cases, such as Your Health Club, Inc. and South Tacoma Motor Co., where accrual-basis taxpayers were not allowed to defer income despite having future obligations. The court also quoted Schram v. United States stating,

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