W.B. Leedy & Co., Inc. v. Commissioner, 1950 Tax Ct. Memo LEXIS 71 (1950)

Income is not accruable to a taxpayer using an accrual method of accounting until there arises in him a fixed or unconditional right to receive it.

Summary

W.B. Leedy & Co. (the petitioner), an insurance agency using the accrual method of accounting, contracted with Houston Fire and Casualty Insurance Co. to write insurance under a government contract. The IRS argued that Leedy should have accrued the entire commission amount for each policy written within the taxable year, regardless of whether the commission was actually payable within that year due to an escrow agreement. The Tax Court held that Leedy was only required to accrue commissions actually payable within the taxable year because Leedy did not have an unrestricted right to the funds placed in escrow.

Facts

Leedy contracted with Houston to write insurance policies under a government contract. Under the contract, Leedy was entitled to commissions of 17.5% of the premiums on each policy issued. However, for policies lasting more than one year, only the proportional commission for the first year was immediately payable to Leedy. The remaining commissions were placed in an escrow account. Leedy could only withdraw funds from the escrow account with Houston's approval. The escrow arrangement protected Houston against potential losses due to cancelled policies. Leedy was required to maintain a Washington office and service the policies over their terms.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioner's income tax for the taxable years 1941, 1942, 1943, and 1945. The petitioner contested these deficiencies in the Tax Court. This case involves four separate issues, but this brief will focus on the first issue regarding the accrual of commissions.

Issue(s)

Whether an insurance agency using the accrual method must include in its gross income the full amount of commissions on multi-year insurance policies in the year the policies are written, even when a portion of those commissions are placed in escrow and not immediately available to the agency.

Holding

No, because the insurance agency did not have a fixed and unrestricted right to the

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commissions placed in escrow until the services were performed and the funds were released, the commissions were not accruable until those later years.

Court's Reasoning

The court reasoned that income is accruable when the right to receive it becomes fixed, citing *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182. The court distinguished this case from *Brown v. Helvering*, 291 U.S. 193, where overriding commissions were taxable in the year received because the general agent had an unrestricted right to the funds. In the present case, the commissions were not fully earned at the time the policies were written because Leedy was obligated to service the policies over their full terms. The escrow agreement restricted Leedy's access to the commissions, and the funds were meant to protect Houston. The court emphasized that "Income does not accrue to a taxpayer using an accrual method until there arises in him a fixed or unconditional right to receive it," citing *San Francisco Stevedoring Co.*, 8 T.C. 222. Because Leedy did not have a fixed right to the commissions at the close of the year the policies were written, the court found that the IRS was in error to include the escrowed commissions in Leedy's income.

Practical Implications

This case illustrates that the accrual method of accounting requires a fixed and unconditional right to receive income. It clarifies that simply earning income is not enough; the taxpayer must have control over the funds. Attorneys should look at the specific contract terms and any restrictions placed on the taxpayer's ability to access or use the funds when determining whether income has accrued. This decision provides a helpful contrast to *Brown v. Helvering*, highlighting the importance of unrestricted access to funds when applying the accrual method. This case has been cited in numerous subsequent cases dealing with accrual accounting and contingent income, and it remains a key reference point for practitioners in this area.

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