18 T.C. 737 (1952)

A taxpayer's choice of accounting method, such as the installment method, does not inherently establish grounds for relief from excess profits taxes under Section 722(b)(5) of the Internal Revenue Code if that method was the taxpayer's normal business practice during the base period.

Summary

Highland Merchandising Co., an installment-basis seller of household furnishings, sought relief from excess profits taxes, arguing that its election to use the installment method of accounting resulted in an inadequate standard of normal earnings during the base period. The Tax Court denied relief, holding that the chosen accounting method, consistently applied, did not inherently demonstrate inadequate normal earnings. The court emphasized that the transactions themselves, not the method of accounting, are the relevant factors in determining eligibility for relief under Section 722(b)(5). The court found that the taxpayer's normal method of accounting does not, by itself, warrant a finding of inadequate earnings.

Facts

Highland Merchandising Co. began selling household furnishings on the installment basis in 1934. The company consistently kept its books on the accrual method but filed its tax returns on the installment basis under Section 44(a) of the Internal Revenue Code. The company sought relief from excess profits taxes for the years 1941-1944, claiming the installment method resulted in an inadequate standard of normal earnings during the base period (1936-1939).

Procedural History

The Commissioner of Internal Revenue disallowed Highland Merchandising Co.'s claims for relief under Section 722(b)(5) for the tax years 1941-1944. The Tax Court reviewed the Commissioner's decision.

Issue(s)

Whether Highland Merchandising Co.'s election to file its income tax returns on the installment method under Section 44(a) was a factor affecting its business under Section 722(b)(5) which might reasonably be considered as resulting in an inadequate standard of normal earnings during the base period.

Holding

No, because the taxpayer's consistent use of the installment method of accounting during the base period indicated it was the normal method of accounting for the business and did not, by itself, demonstrate an inadequate standard of normal earnings.

Court's Reasoning

The Tax Court reasoned that to be entitled to relief under Section 722(b)(5), a taxpayer must show that some factor reasonably resulted in an inadequate standard of normal earnings during the base period. The court emphasized that if the earnings during the base period were normal, no relief could be granted. The court cited the Bulletin on Section 722, which stated that accounting methods are merely devices for recording the dollar results of completed transactions and do not inherently affect the operation of a business. The court quoted the bulletin stating: "It is therefore the transactions themselves and not methods of accounting for such transactions which constitute the factors to be considered in determining whether or not an inadequate standard of normal earnings has resulted." The court further noted that the Commissioner's acceptance of the accounting method indicated that it clearly reflected taxable income. Referencing *Commissioner v. South Texas Lumber Co., 333 U.S. 496 (1948)*, the court stated that taxpayers who elect a form of accounting best suited to their needs and are granted a tax advantage cannot complain when the Commissioner refuses to permit them to adopt a different method to achieve a further tax advantage denied to other taxpayers.

Practical Implications

This case clarifies that simply using a particular accounting method, even if it results in a different tax outcome compared to another method, is insufficient to justify relief from excess profits taxes under Section 722(b)(5). Taxpayers must demonstrate that some other factor affecting their business resulted in an inadequate standard of normal earnings, separate from the accounting method itself. This decision reinforces the importance of consistently applying accounting methods and highlights that the choice of method, with its associated tax advantages, carries with it the responsibility of accepting the resulting tax liabilities. Later cases distinguish *Highland Merchandising* by focusing on specific, external factors that negatively impacted a business's earnings, rather than solely relying on the inherent effects of an accounting method.