Schroeder v. Commissioner, 27 T.C. 1225 (1957)

A taxpayer cannot deduct a reserve for future expenses related to services to be performed under a contract in a subsequent year when the income for those services was received in the current tax year, aligning with the 'claim of right' doctrine.

Summary

The case of *Schroeder v. Commissioner* addresses the deductibility of a reserve for future service expenses in the context of prepaid income. The taxpayer, an accrual-basis taxpayer, sold furnaces and provided a five-year service agreement. The court determined that the taxpayer could not deduct a reserve for future service costs in the year the furnace sale and service contract were made, because the income was received that year. The court found this was in line with the "claim of right" doctrine, which dictates that income received without restrictions must be recognized in the year of receipt, even if the income might have to be returned later. The Tax Court distinguished this from generally accepted accounting practices and sided with the IRS, denying the deduction for the reserve.

Facts

The taxpayers, an accrual-basis partnership, sold furnaces and provided a five-year service agreement as part of the sales contract. The taxpayer included the full amount of the sale, including the future servicing component, in their gross income in the year of sale. To offset the income from future servicing, they established a reserve for the anticipated costs of these future services. They sought to deduct the calculated reserve amount in the same tax year as the income from the sales.

Procedural History

The case was heard by the United States Tax Court. The IRS disallowed the deduction for the reserve. The Tax Court sided with the IRS, and this decision became the final disposition of the case.

Issue(s)

Whether a reserve for the cost of services to be performed in subsequent years is a proper deduction from income in the year when the contract to perform such services is made and payment is received.

Holding

No, because the court found that the taxpayers could not deduct the reserve for future expenses in the year of the sale because the income had already been received and was subject to the

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