29 T.C. 666 (1958)

When a taxpayer changes its accounting method from cash to accrual, income received in the year of change must be recognized in that year even if the services were performed in a prior year when the taxpayer was on a cash basis, unless the income could have been properly accounted for in the prior year.

Summary

Advance Truck Company, a common carrier, changed its accounting method from cash to accrual in 1950 due to an Interstate Commerce Commission directive. The Tax Court addressed whether payments received in 1950 for services performed in 1949, when Advance Truck was on a cash basis, should be included in 1950 income. The court held that the payments were includible in 1950 income because they were received in that year, and section 42 of the Internal Revenue Code required the inclusion of gross income in the year received unless it could be properly accounted for in a different period. Since the company properly reported income on a cash basis in 1949, it could not have properly accounted for the income in that year.

Facts

Advance Truck Company, a California corporation, operated as a common carrier. From its incorporation through December 31, 1949, it properly kept its books and reported income on a cash basis. In January 1950, the Interstate Commerce Commission informed Advance Truck that it was classified as a class 1 motor carrier and required it to adopt the accrual method of accounting. Advance Truck complied and changed its accounting method as of January 1, 1950. The company received payments in 1950 for services rendered in 1949. These amounts were not included in 1949 income since the company was on cash basis. Advance Truck filed its 1950 return on the accrual basis.

Procedural History

The company filed its 1950 income tax return, which was prepared on the accrual basis. The Commissioner issued a notice of deficiency, accepting the accrual method but including amounts collected in 1950 for services performed in 1949 in the calculation of 1950 income. Advance Truck contested the inclusion of these amounts, arguing that they should not be included in 1950 income since they relate to 1949. The Tax Court considered the case and ruled in favor of the Commissioner.

Issue(s)

1. Whether amounts received in 1950 for services performed in 1949 are includible in the 1950 income when the taxpayer changed from the cash method in 1949 to the accrual method in 1950.

Holding

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1. Yes, because the amounts were received in 1950 and could not have been properly accounted for in 1949.

Court’s Reasoning

The court relied on Section 42 of the Internal Revenue Code of 1939, which states that gross income is included in the year received unless properly accounted for in a different period. The court distinguished the case from precedents where the Commissioner attempted to tax amounts that were not received or properly accrued in the prior year. In this case, the amounts were received in 1950. The court emphasized that since the taxpayer was on the cash basis in 1949, it could not have properly accounted for the income from those services in 1949. The fact that the change to the accrual method was involuntary did not alter the outcome. The court stated that the method of accounting in the year of receipt and whether the change was voluntary or involuntary are immaterial.

Practical Implications

This case highlights the importance of the timing of income recognition when changing accounting methods. Practitioners must carefully consider Section 42 (and its successor provisions) to determine when income is reportable, especially when the taxpayer is mandated to change its accounting method. It affirms that income is generally taxed in the year of receipt, regardless of when services are rendered, unless the taxpayer could have properly accounted for the income in a different period. The case emphasizes that an involuntary change to the accrual method, required by regulators, does not exempt a taxpayer from reporting income received in the year of the change. It also provides guidance that income must be recognized to avoid it falling through the cracks in transition to a new accounting method.

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