34 T.C. 199 (1960)

Expenditures for “Work in Process” under long-term contracts, for which progress payments were billed, are not includible in “assets” for computing the excess profits credit under I.R.C. 1939, except to the extent that costs exceed billings.

Summary

The United States Tax Court addressed whether a pipe line contractor, Anderson Brothers Corporation, could include the total costs accumulated in its “Work in Progress” account as assets when calculating its excess profits credit. The IRS argued, and the court agreed, that only the excess of costs over billings represented a true asset, as billings reduced accounts receivable. Since the company’s progress billings often equaled or exceeded the expenses, the court concluded that the “Work in Progress” account didn’t represent an additional asset beyond the accounts receivable that were already accounted for. The court aimed to determine the meaning Congress intended for “total assets” in the context of the excess profits tax, emphasizing that it aimed to prevent a duplication of asset values.

Facts

Anderson Brothers Corporation was a pipe line contractor operating primarily in the fiscal years ending June 30, 1950, 1951, and 1952. The company used the completed contract method for tax purposes. Under its contracts, customers provided the right-of-way and pipe, while Anderson Brothers supplied labor, equipment, and other materials. The contracts provided for progress payments, typically 80-90% of the estimated amount for work completed, with the remainder paid upon contract completion. Anderson Brothers accumulated all costs related to a contract in a “Work in Progress” asset account and credited billings to a “Deferred Income – Job Contracts” account. The company included the balance of the “Work in Progress” account in its total assets for excess profits credit calculations, while the Commissioner of Internal Revenue disputed this inclusion, arguing that it overstated the company’s assets because the billings should offset the work in progress.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Anderson Brothers’ income and excess profits tax for the fiscal year ended June 30, 1951. The sole issue was whether the “Work in Progress” account was properly included in the company’s total assets when calculating its excess profits credit. The case was brought before the United States Tax Court, where the facts were stipulated. The Tax Court issued an opinion in favor of the Commissioner, ruling against the inclusion of the entire amount of work in progress as an asset for the purpose of calculating the excess profits credit.

Issue(s)

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Whether expenditures for “Work in Progress” are includible in total assets, for the purpose of calculating the excess profits credit, when such expenditures are offset by progress billings to customers.

Holding

No, because under the statute and accepted accounting principles, only the excess of costs over billings constitutes an asset for excess profits tax purposes.

Court’s Reasoning

The court focused on what Congress intended by “total assets” in the context of the excess profits tax. The court examined the purpose of the tax and the relationship between costs, billings, and accounts receivable. The court noted that when work was performed and expenses incurred, these were carried in an asset account, but at the time a bill was sent to the customer, an account receivable was created. The court reasoned that to treat the total expenditures in the “Work in Progress” account as an asset, without considering the billings made to the customer that reduced the company’s accounts receivable would be a duplication of assets. The court emphasized the concept of a billing creating an account receivable. The Court’s view was that the company should include expenditures only to the extent that they exceeded related billings. The court considered that the company’s accounting methods, which were used before the excess profits tax, reflected a similar understanding, suggesting that costs were not seen as assets until billings exceeded those costs. The court stated, “[W]e note in this connection petitioner’s explanation of the practice of intermediate payments, on account, by customers before work is completed…This means, of course, the elimination of the offset to excess profits credit envisioned by section 445(b)(1)(B), consisting of interest, which is presumably intended to measure the effect of borrowed capital on petitioner’s income.”

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