The Marquardt Corp. v. Commissioner, 36 T. C. 127 (1961)

Under the accrual method of accounting, income from cost-plus-fixed-fee contracts accrues when the taxpayer has a fixed or unconditional right to receive it, not when it is actually received.

Summary

In The Marquardt Corp. v. Commissioner, the court addressed whether income from a cost-plus-fixed-fee subcontract with Boeing should be accrued in 1953 when the taxpayer had expended more than the authorized amount. The court held that the taxpayer was not required to accrue income in excess of the authorized amount because it did not have a fixed or unconditional right to receive it. However, the court determined that $259,000, which was received in excess of the authorized amount, should be included in income for 1953 under the claim of right doctrine. The case also dealt with fixed fee retentions and termination claims, affirming that income is recognized when the right to receive it becomes fixed and unconditional.

Facts

The Marquardt Corporation entered into a cost-plus-fixed-fee subcontract with Boeing in 1951, which was subject to termination at the government's convenience. By the end of 1953, Marquardt had expended $8,050,517. 09 on the subcontract, exceeding the authorized cumulative amount of $6,750,000. Marquardt reduced its reported income by $1,257,525. 68 via a Schedule M adjustment to reflect only the authorized amount. However, Boeing paid Marquardt $259,000 more than authorized by December 31, 1953. Marquardt also had a practice of accruing 100% of fixed fees on its books, despite only billing 90% during the contract term. Additionally, Marquardt had unsettled termination claims amounting to $105,792. 19 at the end of 1953, which it excluded from income on its tax return.

Procedural History

The Commissioner determined deficiencies in Marquardt's income tax for 1952 and 1953, asserting that the Schedule M adjustment should be included in income and disallowing deductions for fixed fee retentions and termination claims. Marquardt contested these determinations, leading to the Tax Court's review of the issues.

Issue(s)

1. Whether Marquardt was required to accrue amounts from the Boeing subcontract which it had no fixed or unconditional right to receive.
2. Whether Marquardt changed its method of accounting for certain retainages.
3. Whether the Commissioner erred in including the amount of certain termination claims in Marquardt's income.

Holding

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1. No, because Marquardt did not have a fixed or unconditional right to receive amounts in excess of the authorized amount as of December 31, 1953.
2. No, because Marquardt was entitled to revise its accounting treatment of the 10% holdbacks without the Commissioner's consent.
3. No, because Marquardt had a fixed or unconditional right to receive the termination claims under the terms of the contracts.

Court's Reasoning

The court applied the principle that under the accrual method of accounting, income accrues when the taxpayer has a fixed or unconditional right to receive it. Marquardt did not have such a right to the amounts exceeding the authorized total from the Boeing subcontract as of December 31, 1953, so it was not required to accrue those amounts as income. However, the court found that the $259,000 received in excess of the authorized amount was taxable under the claim of right doctrine, as it was received without restriction. Regarding the fixed fee retentions, the court held that Marquardt could revise its accounting treatment without the Commissioner's consent, as it was correcting an error in applying the accrual method. For the termination claims, the court determined that Marquardt had a fixed right to a reasonably ascertainable amount under the contract terms, despite subsequent negotiations and settlements.

Practical Implications

This decision clarifies that taxpayers on the accrual method must report income when they have a fixed or unconditional right to receive it, which is particularly relevant for cost-plus-fixed-fee contracts. The ruling on the claim of right doctrine reminds taxpayers that amounts received under a claim of right are taxable, even if they may later be required to repay them. The case also emphasizes that taxpayers can correct errors in their accounting methods without needing the Commissioner's consent, which can impact how similar cases are approached in the future. For businesses involved in government contracts, this decision underscores the importance of understanding the accrual of income under termination clauses and the timing of income recognition.

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