C. H. Leavell & Co. v. Commissioner, 53 T. C. 426 (1969)

Under the completed contract method, income from a long-term contract must be reported in the year the contract is finally completed and accepted, even if some claims remain unresolved.

Summary

C. H. Leavell & Co. , part of a joint venture to construct launch and service buildings for an Atlas ICBM installation, contested the IRS's determination that all income from the contract should be reported in a fiscal year ending September 30, 1961. The Tax Court held that the joint venture correctly reported its income on a calendar year basis, and that the contract was completed and accepted by December 19, 1960. Despite unresolved claims for additional compensation, the income was properly reported in 1960. The court also ruled that a Form 875 signed by one partner did not bind the others to the IRS's findings.

Facts

In May 1959, C. H. Leavell & Co. , along with three other companies, formed a joint venture to construct launch and service buildings for an Atlas ICBM installation under a contract with the U. S. Corps of Engineers. The joint venture elected to use the completed contract method of accounting and reported its income on a calendar year basis. By December 19, 1960, the contract was fully completed and accepted by the Corps of Engineers, but claims for additional compensation remained unresolved until 1961. The joint venture reported the income received in 1960, and additional income from resolved claims in 1961.

Procedural History

The IRS audited the joint venture's returns and determined that all income should be reported in a fiscal year ending September 30, 1961. MacDonald Construction Co. 's representative signed a Form 875 accepting these findings, but C. H. Leavell & Co. was not informed and contested the determination. The Tax Court ruled in favor of C. H. Leavell & Co. , affirming the joint venture's calendar year reporting and the proper reporting of income in 1960 and 1961.

Issue(s)

1. Whether the joint venture reported its income on the basis of a calendar year or a fiscal year.
2. Whether the contract was finally completed and accepted in 1960.
3. Whether unresolved claims for additional compensation required deferring the reporting of gross income from the contract until the claims were settled.
4. Whether the execution of a Form 875 by one partner bound the other partners to the IRS's findings.

Holding

1. Yes, because the joint venture's returns were filed on a calendar year basis and all partners had different fiscal years, and no approval was sought for a fiscal year.
2. Yes, because the contract was completed and accepted by December 19, 1960.
3. No, because under the completed contract method, gross income must be reported in the year of completion and acceptance, even if some claims remain unresolved.
4. No, because the Form 875 was signed without authority from C. H. Leavell & Co. , and it did not preclude litigation of the issues.

Court's Reasoning

The court applied the rules governing the taxable year of partnerships and the completed contract method of accounting. It found that the joint venture's adoption of a calendar year was proper under Section 706(b) and Section 441(g)(2) of the Internal Revenue Code, given the different fiscal years of the partners and the lack of an annual accounting period. The court also emphasized that the completed contract method requires income to be reported in the year the contract is completed and accepted, as per Section 1. 451-3(b)(2) of the Income Tax Regulations. The unresolved claims for additional compensation were deemed "contingent and uncertain," and thus properly reported in the following year. The court rejected the IRS's reliance on Thompson-King-Tate, Inc. v. United States, as the contract in question was completed and accepted in 1960. Finally, the court found that the Form 875 signed by MacDonald's representative did not bind C. H. Leavell & Co. , as it was signed without their knowledge or consent.

Practical Implications

This decision clarifies that joint ventures using the completed contract method must report income in the year the contract is completed and accepted, even if some claims remain unresolved. It emphasizes the importance of clear communication and consent among joint venture partners regarding tax reporting and agreements with the IRS. Practitioners should ensure that all partners are informed and consent to any agreements made on behalf of the joint venture. This ruling may affect how joint ventures structure their accounting and tax reporting, particularly in ensuring that unresolved claims do not delay the reporting of income from completed contracts.