Ready Paving & Construction Co. v. Commissioner, 61 T. C. 826 (1974)

Special assessment warrants received as payment for services are considered current assets in determining whether a corporation has accumulated earnings beyond reasonable business needs.

Summary

Ready Paving & Construction Co. received special assessment warrants as payment for its paving services to municipalities. The IRS determined that these warrants should be treated as current assets for the purpose of calculating accumulated earnings tax. The Tax Court agreed, ruling that the warrants, being readily marketable, were indeed current assets. This decision was based on the fact that Ready Paving could sell the warrants or hold them for tax-exempt interest, and their inclusion as current assets showed the company had accumulated earnings well beyond its reasonable business needs, subjecting it to the accumulated earnings tax.

Facts

Ready Paving & Construction Co. , an Illinois corporation, performed paving services for municipalities and was compensated with special assessment warrants. These warrants had a fair market value of 92 to 96 percent of face value and were recorded as current assets in the company's financial statements. Ready Paving received these warrants in 1966 and 1967, and at year-end, its current assets exceeded current liabilities. If the warrants were not considered current assets, Ready Paving's net current assets would fall below its business needs.

Procedural History

The IRS issued a notice of deficiency for accumulated earnings tax for the years 1966 and 1967. Ready Paving contested this in the United States Tax Court, arguing that the special assessment warrants should not be considered current assets. The Tax Court upheld the IRS's determination that the warrants were indeed current assets, and thus, Ready Paving was subject to the accumulated earnings tax.

Issue(s)

1. Whether special assessment warrants received as payment for services should be considered current assets in determining whether a corporation has accumulated earnings beyond reasonable business needs.

Holding

1. Yes, because the warrants were readily marketable and could be used by the company for working capital or dividend payments, they were properly considered current assets.

Court’s Reasoning

The court reasoned that the special assessment warrants were current assets because they were received as payment for services, were marketable, and could be sold or held for tax-exempt interest. The court rejected Ready Paving’s argument that the warrants should be treated as long-term receivables, emphasizing that once received, the warrants did not represent accounts receivable but rather payment for services rendered. The court also noted that including these warrants as current assets aligned with the company’s financial statements and the practice of its surety company, which considered these warrants in assessing the company’s ability to obtain performance bonds. The court concluded that the company’s net liquid assets, including the warrants, exceeded its reasonable business needs, leading to the imposition of the accumulated earnings tax.

Practical Implications

This decision impacts how companies receiving non-cash payments, like special assessment warrants, should treat these assets for tax purposes. It clarifies that such assets, if readily marketable, should be considered current assets in calculating accumulated earnings tax. This ruling may lead companies to reevaluate their accounting practices and tax strategies, particularly in industries where non-cash payments are common. It also underscores the importance of aligning financial statements with tax reporting to avoid discrepancies that could trigger tax penalties. Subsequent cases have cited Ready Paving in discussions about the treatment of non-traditional assets for tax purposes.

