Barber v. Commissioner, 64 T. C. 314 (1975)

The IRS has the authority to permit a taxpayer to retroactively change its accounting method if the new method more clearly reflects income and the change is not prohibited by statute.

Summary

In Barber v. Commissioner, the Tax Court held that the IRS has the discretion to allow a retroactive change in a taxpayer's accounting method from the completed-contract to the percentage-of-completion method, even after the tax return filing deadline. The case involved Sure Quality Framing Contractors, Inc. , which initially used the completed-contract method but later amended its return to use the percentage-of-completion method. The IRS accepted this change post-audit, finding it more accurately reflected the company's income. The court's decision emphasizes the IRS's broad discretion in accounting method changes and highlights the absence of statutory prohibition against such retroactive adjustments.

Facts

Sure Quality Framing Contractors, Inc. , a construction company, elected to be taxed as a small business corporation under Subchapter S. For its first taxable year ending April 30, 1971, it filed its original return using the completed-contract method of accounting, reporting a loss. Subsequently, on June 14, 1972, it filed an amended return for the same year, switching to the percentage-of-completion method and reporting taxable income. The IRS, after audit, accepted this change, adjusting the income figure slightly. Petitioner Ronnie L. Barber, a shareholder in the company during the relevant period, contested the IRS's authority to allow this retroactive change.

Procedural History

The IRS determined a deficiency in Barber's 1971 Federal income tax due to the amended return of Sure Quality Framing Contractors, Inc. Barber challenged this in the Tax Court, which then ruled in favor of the IRS, affirming its authority to permit the retroactive change in accounting method.

Issue(s)

1. Whether the IRS has the authority to permit a taxpayer to retroactively change its accounting method from the completed-contract method to the percentage-of-completion method after the filing deadline of the tax return.

Holding

1. Yes, because the IRS has broad discretion in determining accounting methods and there is no statutory prohibition against allowing such retroactive changes when

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they more clearly reflect income.

Court’s Reasoning

The Tax Court reasoned that the IRS has broad discretion under section 446(b) to determine whether an accounting method clearly reflects income. Although section 446(e) requires IRS consent for changes in accounting methods, it does not explicitly prohibit retroactive changes. The court cited numerous cases indicating that, in the absence of a statutory prohibition, the IRS can exercise its discretion to accept or reject requests for retroactive changes in accounting methods. The court emphasized that such changes, when bilaterally agreed upon and not barred by law, align with the purposes of the tax code, including the accurate reflection of income. The decision was also influenced by the absence of any abuse of discretion by the IRS in this case.

Practical Implications

This decision clarifies that taxpayers can seek retroactive changes in their accounting methods if they believe such changes would more accurately reflect their income, provided the IRS consents. It underscores the flexibility of the IRS in managing accounting method changes, potentially encouraging taxpayers to amend returns when they realize a different method might better represent their financial situation. For legal practitioners, this case serves as a reminder of the importance of understanding IRS discretion and the potential for retroactive adjustments in accounting practices. Subsequent cases have referenced Barber when addressing the IRS’s authority in similar contexts, reinforcing its impact on tax law practice.

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