Pierce Ditching Co. v. Commissioner, 73 T. C. 301, 1979 U. S. Tax Ct. LEXIS 19 (1979)

The IRS Commissioner has authority to authorize a taxpayer to continue using a non-standard method of accounting if it clearly reflects income, but such authorization requires a positive act.

Summary

Pierce Ditching Co. , a cash basis taxpayer, had historically deducted accrued bonuses and salaries at year-end, paid within 2. 5 months, without objection from the IRS. In 1974, the IRS disallowed these deductions, arguing that as a cash basis taxpayer, Pierce could not deduct accrued expenses. The key issue was whether prior IRS acceptance constituted authorization for this non-standard method under the tax regulations. The Tax Court held that the IRS had not positively authorized Pierce's method, thus disallowing the deductions. This case clarifies that IRS acquiescence is not sufficient to authorize a non-standard accounting method; a clear, positive act is required.

Facts

Pierce Ditching Co. , a construction company using the cash method of accounting, consistently deducted accrued bonuses and salaries at year-end, which were paid within 2. 5 months after the year closed. The IRS had previously examined Pierce's returns for 1967-1969 and accepted this practice. However, in an audit of the 1974 return, the IRS disallowed the deduction of $93,000 in accrued salaries and bonuses, claiming Pierce was a cash basis taxpayer and thus could not deduct these expenses until paid.

Procedural History

The IRS issued a statutory notice of deficiency for 1974, which Pierce contested in the U. S. Tax Court. The cases were consolidated for trial, briefing, and opinion, with Tri-City Paving & Construction Co. , Inc. agreeing to the IRS's deficiency. The sole issue for Pierce was the deductibility of accrued salaries and bonuses.

Issue(s)

1. Whether the IRS Commissioner has authority under 26 C. F. R. 1. 446-1(c)(2)(ii) to authorize the continued use of a method of accounting not specifically authorized by the regulations.
2. Whether the IRS's prior administrative review constituted authorization of Pierce's method of accounting.
3. Whether Pierce, as a cash basis taxpayer, could properly deduct accrued salaries and bonuses.

Holding

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1. Yes, because the regulation explicitly grants the Commissioner authority to authorize non-standard methods if they clearly reflect income.
2. No, because the IRS's prior administrative review did not constitute a positive act of authorization.
3. No, because Pierce was a cash basis taxpayer and thus could not deduct accrued expenses until paid, as per Connors, Inc. v. Commissioner.

Court's Reasoning

The Tax Court analyzed the IRS's authority under 26 C. F. R. 1. 446-1(c)(2)(ii), which allows the Commissioner to authorize a taxpayer to continue a non-standard method of accounting if it clearly reflects income. The court found that while the IRS had previously accepted Pierce's method, this acceptance did not constitute a "positive act" of authorization. The court noted that the IRS's administrative review of Pierce's 1967-1969 returns did not explicitly authorize the method, and the IRS's later decision in Connors, Inc. v. Commissioner disallowed similar deductions for cash basis taxpayers. The court emphasized that IRS acquiescence or failure to object does not constitute approval of a non-standard method. The court also considered that the IRS's proposed change to the accrual method in 1971, later reversed, did not clearly indicate approval of Pierce's hybrid method.

Practical Implications

This decision clarifies that IRS acquiescence to a taxpayer's non-standard accounting method does not constitute authorization. Taxpayers seeking to use non-standard methods must obtain explicit approval from the IRS, as mere acceptance in prior audits is insufficient. This ruling impacts how taxpayers and practitioners should approach IRS audits and requests for accounting method changes, emphasizing the need for clear documentation and formal approval processes. It also affects how businesses structure their accounting practices, particularly those using hybrid methods, and may influence future IRS guidance on accounting method authorization.

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