Marcor, Inc. v. Commissioner, 89 T. C. 181 (1987)

Only costs incurred in acquiring merchandise are includable in cost of goods sold under the installment method; installation and preparation expenses are deductible as period costs.

Summary

Marcor, Inc. , through its subsidiary Montgomery Ward, reported income using the installment method. The case addressed whether installation and merchandise preparation costs, as well as costs attributed to markdowns and discounts, could be deducted as period expenses rather than included in cost of goods sold. The court ruled that installation and preparation costs, not being costs of acquiring the merchandise, were properly deductible as period costs. However, costs attributed to markdowns and discounts must be included in cost of goods sold. Additionally, state sales and use taxes imposed on the consumer were not to be included in the total contract price for installment sales.

Facts

Marcor, Inc. , and its subsidiary Montgomery Ward, Inc. , reported income from installment credit sales under section 453 of the Internal Revenue Code. Ward sold merchandise at retail, offering installation and preparation services for which it charged separate fees, usually stated separately from the purchase price. Ward included these fees in the total contract price for installment sales but deducted the costs of these services as period expenses, not including them in cost of goods sold. Ward also reduced its cost of goods sold by amounts attributed to various markdowns and discounts and included state sales and use taxes imposed on the seller in the total contract price, but not those imposed on the buyer.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Marcor's federal income tax for the years 1972 through 1976. Marcor and the Commissioner filed cross-motions for partial summary judgment in the United States Tax Court to resolve issues related to the calculation of gross profit under the installment method.

Issue(s)

1. Whether installation and merchandise preparation costs are includable in cost of goods sold for purposes of calculating gross profit under the installment method?
2. Whether a portion of cost of goods sold can be allocated to price discounts and markdowns and deducted as a promotional or advertising expense?
3. Whether state sales and use taxes imposed upon the vendee are includable in the total contract price for installment sales?

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Holding

1. No, because installation and merchandise preparation costs are not costs incurred in acquiring possession of the merchandise, and thus are not inventory costs includable in cost of goods sold. They are properly deductible as period expenses.
2. No, because the costs attributed to markdowns and discounts represent the cost of goods sold and cannot be deducted as period expenses.
3. No, because state sales and use taxes imposed on the consumer are not part of the sales price and thus are not includable in the total contract price.

Court’s Reasoning

The court applied the inventory accounting rules of section 471, which dictate that only costs incurred in acquiring merchandise are includable in cost of goods sold. Installation and preparation costs, being ancillary to the sale and not costs of acquiring the merchandise, were deemed properly deductible as period costs under section 471. The court rejected the Commissioner’s argument that these costs should be matched with the income from installation and preparation services, noting that no such requirement exists in the regulations under section 453. Regarding markdowns and discounts, the court found that the costs attributed to them are part of the cost of goods sold and cannot be treated as separate deductible expenses. The court also clarified that state sales and use taxes imposed on the buyer are not part of the sales price and thus not includable in the total contract price for installment sales. The court’s decision was influenced by the principle that taxes are deductible only by the person upon whom they are imposed.

Practical Implications

This decision clarifies that retailers using the installment method can deduct installation and preparation costs as period expenses rather than including them in cost of goods sold. This could affect how retailers structure their sales and service offerings, potentially leading to increased deductions in the year services are provided. The ruling also impacts how retailers account for markdowns and discounts, requiring them to include the associated costs in cost of goods sold rather than treating them as separate deductible expenses. This may influence pricing and promotional strategies. Furthermore, the decision reinforces the principle that taxes imposed on the buyer are not part of the sales price for installment sales, affecting the calculation of total contract price and gross profit. Subsequent cases and IRS guidance have followed this decision, shaping the application of the installment method in tax accounting.

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