Resale Mobile Homes, Inc. v. Commissioner, 91 T. C. 1085 (1988)

An accrual basis taxpayer must report participation interest income from installment contracts in the year the right to such income accrues, even if payment is deferred, when the amount can be reasonably estimated.

Summary

Resale Mobile Homes, Inc. , a Colorado corporation selling mobile homes on credit, sold consumer installment contracts to finance companies, receiving the principal and a portion of the interest (participation interest) earned on the contracts. The Tax Court held that Resale must report the participation interest as income in the year the contracts were sold to the finance companies, not when received, as the right to the income was fixed at the time of sale and the amount could be reasonably estimated. This ruling affirmed that accrual method taxpayers must recognize income when all events fix the right to receive it, despite deferred payments.

Facts

Resale Mobile Homes, Inc. , sold new and used mobile homes and provided financing through installment contracts. These contracts were sold to finance companies, with Resale receiving the principal and a share of the interest (participation interest) collected from the buyers. Prior to the years in dispute, Resale reported the participation interest as income in the year of sale. Following a change in Colorado law regarding prepayment calculations in 1975, Resale altered its reporting method to recognize the interest as it was received from the finance companies. The IRS determined that Resale should have continued to accrue the interest in the year the contracts were sold.

Procedural History

The IRS determined deficiencies in Resale's federal income taxes for the taxable years ending May 31, 1978 through 1981, asserting that Resale should have accrued participation interest in the year the contracts were sold. Resale filed a petition with the United States Tax Court, contesting these deficiencies. The court upheld the IRS's position, ruling that Resale was required to accrue the participation interest income at the time of sale.

Issue(s)

1. Whether Resale Mobile Homes, Inc. , correctly reported its participation interest income under consumer installment contracts sold to finance companies by recognizing the income when received rather than when the contracts were sold?

Holding

1. No, because under the accrual method of accounting, income must be reported in

the year all events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Resale's right to receive the participation interest was fixed at the time of sale of the contracts, and the amount could be reasonably estimated.

Court's Reasoning

The court applied the general rule under Section 446(a) of the Internal Revenue Code that taxable income must be computed under the method of accounting regularly used by the taxpayer, and under Section 451(a) that income is to be included in the year received unless properly accounted for in a different period under the taxpayer's accounting method. The court cited *Spring City Foundry Co. v. Commissioner* and *Commissioner v. Hansen* to establish that under the accrual method, income is includable when the right to receive it is fixed and the amount can be determined with reasonable accuracy, regardless of actual receipt. The court reasoned that Resale's right to the participation interest was fixed at the time of sale, and the amount could be reasonably estimated using amortization schedules, despite potential variances due to prepayments or defaults. The court rejected Resale's argument that the absence of a reserve account distinguished this case from *Hansen*, noting that the economic effect was the same. The court also found that any errors in estimation could be corrected in later years.

Practical Implications

This decision clarifies that accrual basis taxpayers must report income from installment contracts in the year the right to such income is fixed and the amount can be reasonably estimated, even if the actual receipt of funds is deferred. This ruling impacts how businesses that sell installment contracts should account for income, emphasizing the importance of using reasonable estimates for income recognition. It may affect tax planning strategies for companies in similar industries, requiring them to accrue income at the time of sale rather than waiting for actual receipt. Subsequent cases have referenced this decision to support the principle that income must be reported when all events fix the right to receive it, influencing tax practice in the area of installment sales and deferred income.