Barnett Banks of Florida, Inc. and Subsidiaries v. Commissioner of Internal Revenue, 106 T. C. 103 (1996)

An accrual basis taxpayer may defer income from prepaid annual credit card fees under Rev. Proc. 71-21 if the fees are for services and reported ratably over the period the services are to be performed.

Summary

Barnett Banks of Florida, Inc. , an accrual basis taxpayer, sought to defer income from annual credit card fees under Rev. Proc. 71-21. The Tax Court ruled that these fees were payments for services, not interest or loan commitment fees, and thus eligible for deferral. The court found that Barnett Banks' method of reporting fees ratably over 12 months was consistent with the revenue procedure, and the Commissioner's denial of this method was an abuse of discretion. This decision impacts how banks account for prepaid service fees and reinforces the applicability of Rev. Proc. 71-21 to such arrangements.

Facts

Barnett Banks of Florida, Inc. , and its subsidiaries issued Visa and Mastercard credit cards and began charging cardholders an annual membership fee of $15 starting in October 1980. The fee entitled cardholders to card usage, free replacement of lost or stolen cards, 24-hour customer service, and the withholding of disputed charges. The fee was refundable on a pro rata basis if the card was cancelled. Barnett Banks reported these fees as income ratably over 12 months for financial, regulatory, and tax accounting purposes.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Barnett Banks' federal income tax for the years 1972, 1976, 1978, 1980, and 1981, arguing that the annual fees should be included in income in the year received. Barnett Banks petitioned the Tax Court, asserting that the fees were for services and thus eligible for deferral under Rev. Proc. 71-21. The Tax Court ruled in favor of Barnett Banks, finding the fees were for services and the Commissioner had abused her discretion in denying the deferral method.

Issue(s)

1. Whether the annual credit card fees received by Barnett Banks constitute payments for services rendered or made available to cardholders or payments for extension of credit in the nature of additional interest or loan commitment fees.
2. If the annual fees represent payments for services, whether Barnett Banks is entitled under Rev. Proc. 71-21 to defer income from the annual fees received in one taxable year for services to be performed by the end of the next taxable year.

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Holding

1. Yes, because the annual fees were payments for services provided to or made available to cardholders, including card issuance, 24-hour customer service, and dispute resolution services.
2. Yes, because Barnett Banks' method of reporting the fees ratably over 12 months was consistent with Rev. Proc. 71-21, and the Commissioner's denial of this method was an abuse of discretion.

Court's Reasoning

The Tax Court held that the annual fees were for services, not additional interest or loan commitment fees, as evidenced by the services provided and the refund policy. The court applied Rev. Proc. 71-21, which allows accrual basis taxpayers to defer income from payments received for services to be performed by the end of the next succeeding taxable year. The court rejected the Commissioner's argument that a matching of income and expense on an individual cardholder basis was required, finding that Barnett Banks' method of reporting fees ratably over 12 months reconciled financial and tax accounting without undue deferral. The court cited the purpose of Rev. Proc. 71-21 to facilitate reporting and verification, which Barnett Banks' method achieved. The Commissioner's demand for individual matching was deemed an undue burden, and the court concluded that the Commissioner had abused her discretion in denying the deferral method.

Practical Implications

This decision allows banks to defer income from prepaid annual credit card fees under Rev. Proc. 71-21 if the fees are for services and reported ratably over the service period. It clarifies that such fees do not need to be matched to individual cardholder expenses, easing the administrative burden on banks. The ruling may influence how other service providers with prepaid fees account for income. It also reinforces the importance of revenue procedures in guiding tax accounting methods and the potential for abuse of discretion claims against the IRS when such guidance is disregarded. Subsequent cases, such as Signet Banking Corp. v. Commissioner, have distinguished this ruling based on the refundability of the fees and the nature of the services provided.

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