

Federal Income Taxation: Tax Accounting: Effect of Events Occuring After the Close of the Taxable Year on an Accrual Taxpayer's Deduction

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conduct amounts to bad faith has been a rather broad one.¹⁵ Hence the approach of the court in the different cases varies with the particular circumstances of each. This of course furnishes no guide as to what will or will not be good faith bargaining in that vast area beyond flat refusal to negotiate in the first instance. The *White* decision shows that the good faith test, although codified by Taft-Hartley into the National Labor Relations Act, still retains the indefiniteness of §8 (a)(5)¹⁶ of the original act. Since, however, it appears that the existence of good faith can only be determined by an objective evaluation of all of the acts and circumstances in each case, in order to ascertain the purpose or subjective intention of the parties,¹⁷ the inadvisability of a more specific rule seems apparent.

The decision in the *White* case,¹⁸ under the application of the good faith test, seems to be a well-considered one, which is in conformity with the statutory recognition of the non-concession privilege and the Congressional intent that the terms of the agreement be left to the parties, and not to governmental supervision. However, in finding no fault with the insistence on a management function clause under §8(d), the court did caution:

"We do not hold that under no possible circumstances can the mere content of the various proposals and counterproposals of management and union be sufficient evidence of a want of good faith to justify a holding to that effect. We can conceive of one party to such bargaining procedure suggesting proposals of such a nature or type or couched in such objectionable language that they would be calculated to disrupt any serious negotiations. . . ."¹⁹

ROBERT J. URBAN

Federal Income Taxation—Tax Accounting—Effect of Events Occurring After The Close of The Taxable Year On An Accrual Taxpayer's Deductions—A corporate taxpayer on the accrual basis accrued on its books on July 1, 1945 a capital stock tax which was payable June 30, 1946. At the close of its fiscal year on August 31, 1945 an independent accounting firm audited the taxpayer's books for the purpose of reports to stockholders, reports to creditor banks and as a basis for filing tax returns. This audit was completed on October 30, 1945. On November 8, 1945, the capital stock tax was repealed. The taxpayer, after obtaining extensions, filed its tax returns on Janu-

¹⁵ See *e.g.*, *J. I. Case, Inc. v. N.L.R.B.*, 253 F.2d 149 (7th Cir. March 12, 1958): "Particular circumstances in each case must be considered in determining whether statutory obligations of the employer to bargain in good faith has been met."

¹⁶ 29 U.S.C.A. §158 (a) (5).

¹⁷ See *Singer Mfg. Co. v. N.L.R.B.*, 119 F.2d 131 (7th Cir. 1941), *cert. denied*, 313 U.S. 585.

¹⁸ *White's Uvalde Mines v. N.L.R.B.*, *supra* note 5.

¹⁹ *White's Uvalde Mines v. N.L.R.B.*, *supra* note 5, at 2005.

ary 15, 1946, taking the accrued capital stock tax as a deduction for its 1945 fiscal year. The Commissioner disallowed the deduction and assessed a deficiency. The taxpayer, after satisfying the deficiency, brought this suit for a refund in the Federal District Court. HELD, *inter alia*, the taxpayer was not required to reopen its books and eliminate the deduction for capital stock taxes but could file its return on January 15, 1946 showing a deduction for the accrued tax, although it would never be paid. *Rahr Malting Co. v. United States* 157 F. Supp. 803 (E.D. Wis. 1957), now on appeal to the 7th Circuit Court of Appeals.

The decision in the present case is based on the authority of a series of cases which holds that a taxpayer who has correctly accrued a tax and taken a deduction on one year's return need not thereafter file an amended return to reflect events occurring after the close of its taxable year.

In *Van Norman Co. v. Welch*,¹ the taxpayer accrued a Massachusetts' excise tax for 1935 and took the amount as a deduction against 1935 income on a return filed March 15, 1936. In June of 1936 a law was passed increasing the excise tax rate 10%. This law was retroactive to 1935. The Commissioner claimed that the taxpayer should have readjusted its accrual for 1935 and taken the deduction for the extra 10% in that year. The court held that the event which fixed the amount of the extra tax and made the taxpayer liable to pay it did not occur until June of 1936, so it was a proper deduction for 1936 and the taxpayer need not go back and include it in its deduction for 1935.

In *United States v. Detroit Moulding Co.*² the taxpayer filed its return on March 15, 1938 claiming a deduction for an accrued capital stock tax of \$7885 for 1937. On May 27, 1938 a new capital stock tax law was passed which allowed the taxpayer to lower its capital stock valuation and thereby decrease its capital stock tax liability for 1937 to \$1500. The Commissioner denied the full deduction taken for the year 1937 and assessed a deficiency. In a suit for a refund of the deficiency the court held that the accrual of the tax was correct at the end of the taxpayer's tax year and the deduction was proper. The change should be reflected by crediting the amount by which the obligation was lessened as income for the 1938 tax year.³

These cases appear to be in accord with the "annual accounting concept" under which income taxes are assessed on the basis of annual returns showing the net result of all the taxpayer's transactions

¹ 141 F. 2nd 99 (1st Cir. 1944)

² 56 F. Supp. 754 (E.D. Mich. 1944)

³ See also *Cedar Rapids Engineering Co. v. United States*, 86 F. Supp. 577 (N.D. Iowa 1949) which involves an almost identical fact situation.

during the fixed accounting period.⁴ The result of this rule is to deny both to the government and to the taxpayer the privilege of allocating income or deductions to years other than the year in which it is properly accrued.⁵ The test laid down by the Supreme Court is of the United States as to when a deduction is to be accrued is the "all events test." This test requires that all events which determine the amount of the obligation and the taxpayers liability to pay must occur in the taxable year in which the deduction is taken.⁶

In *United States v. Anderson*,⁷ the court held that a tax on profits from sales of munitions in the taxable year of 1916 must be taken as a deduction against 1916 income even though it was not assessed and due until 1917, because all the events which determined the amount of the tax and the liability to pay it had occurred in 1916.⁸

Applying these rules to the principal case, it seems clear that at the end of the taxpayer's fiscal year in August of 1945 all of the events had occurred which made it liable for the capital stock tax and the tax was definite in amount. Therefore, the tax had accrued and was a proper deduction for 1945, in order to clearly reflect income for that year, even though the tax was never actually paid.

It would therefore seem safe to say that when a tax is properly accrued, according to recognized accounting procedures, events which occur after the close of the tax year need not be taken into account in determining the tax liability for the year.

However, there is one limitation to this general statement. This exception stems from the rule of *Fawcus Machine Co. v. United States*.⁹ In the *Fawcus Case* the taxpayer accrued excess profits taxes imposed by the Revenue Act of 1917 in a reserve for its taxable year of 1918; however, it failed to deduct this amount from its 1918 income. The Commissioner claimed that the deduction should have been taken in 1918. The taxpayer claimed that the tax did not accrue until it was assessed and paid. The court, following the rule laid down in the *Anderson Case*,¹⁰ held that the tax must be accrued as a liability for the current year's business, even though it is not due until the next year. The taxpayer then contended that the tax could not accrue in 1918, since a retroactive tax law was passed in February of 1919 which increased the rates and therefore the amount of its liability was

⁴ *Burnet v. Sanford and Brooks Co.*, 282 U.S. 359 (1931).

⁵ *Security Flour Mills v. United States*, 321 U.S. 281 (1944) and *Baltimore Transfer Co. v. Commissioner*, 8 T.C. 1 (1947).

⁶ *United States v. Anderson*, 269 U.S. 422 (1925).

⁷ *Ibid.*

⁸ See 21 CHICAGO LAW REVIEW 293 (1954) for a discussion of the "all events test."

⁹ 282 U.S. 375 (1930).

¹⁰ *Supra*, note 6.

not definite at the close of its 1918 tax year. In answer to this contention the court said:

"But the Act of 1917 was in force and required the same sort of taxes, and petitioner concedes it accrued its taxes for 1918 and set them up in reserve at the end of the year. The Act of 1919 was retroactive and replaced the prior Act of October 3, 1917 and the taxpayer understood that the policy of the United States with respect to income and excess profits taxes was continuous. . . . The taxes in questions were provided for by an act passed in February, 1919 but they were for the year 1918. The act was passed in ample time to allow the taxpayer to readjust its accounts for that year by including these taxes; and, since its books were kept on an accrual basis, it was necessary that this should be done in order to clearly reflect income for 1918."¹¹

The result reached in the *Fawcus Case* appears to be inconsistent with the "annual accounting concept" and the "all events test". Although there was a definite liability under the 1917 act, the amount of liability imposed by the 1919 act was not fixed until the latter was passed. Therefore, it would appear that this amount was not definite at the close of the taxpayer's 1918 tax year and did not become definite until a month after the close of the tax year of 1918. However, the court held that the tax was definite under the Act of 1917 at the close of the tax year and therefore was a proper accrual for 1918, and since the taxpayer should have anticipated the change in the tax law occurring within a reasonable time after the close of its fiscal year, it should have readjusted its accrual of the tax under the Act of 1917 to clearly reflect income for 1918.

Apparently, the court was of the opinion, in the *Fawcus Case*, that if an event can be anticipated as occurring within a reasonable time after the close of the tax year, it should be taken into account in computing the tax for that year. In other words, if an event which fixes the amount of the obligation can be reasonably anticipated as occurring within a reasonable time after the close of the tax year, it should be treated as if it had occurred at the end of the tax year.

This contention is borne out by the fact that subsequent cases interpret *Fawcus* as having turned on the fact that the taxpayer should have anticipated the event which fixed the amount of its liability.¹² In the *Detroit Moulding Case*,¹³ the court did not require the taxpayer to readjust its accrual for a past year to reflect a change caused by an event which occurred about five months after the close of the taxpayer's tax year. The court in the *Detroit Moulding Case* based its

¹¹ *Fawcus Machine Co. v. United States*, 282 U.S. 375 (1930).

¹² *Lewyt Corp. v. Commissioner*, 349 U.S. 237 (1941), and *Rahr Malting Co. v. United States*, 157 F. Supp. 803 (E.D. Wis. 1957).

¹³ *Supra*, note 2.

decision on the fact that the event was unexpected at the close of the taxpayer's tax year.

In summary then, it would appear that when a taxpayer on the accrual basis has correctly accrued an item according to recognized accounting procedures and has filed its return on that basis, it need not readjust that return to account for changes due to events occurring after the close of its fiscal year unless it could reasonably anticipate those events occurring within a reasonable time after the close of its fiscal year. In cases where an event can reasonably be anticipated, the taxpayer must hold his books open for a reasonable time in order to readjust, or else it will be required to reopen its books, if already closed, to adjust for the change.

The principal case extends this rule so as to allow an accrual taxpayer who has correctly accrued an item and closed its books but has not yet filed its tax return, to go ahead and file its tax returns on that basis even though an event has occurred after the close of its fiscal year which changes its tax liability; providing the event could not reasonably have been anticipated and it would be unreasonable to require the taxpayer to reopen its books for the past year and readjust them.

In these cases the proper procedure is to adjust for the change on the next year's return. However, if an item is incorrectly accrued the proper procedure is to go back to the year in which the mistake was made and file an amended return for that year.¹⁴ The theory being: an erroneous reporting of income because of a mistake in a prior year does not authorize an erroneous reporting in a subsequent year in order to adjust for the prior mistake.¹⁵

ROBERT WATSON

Defenses To A Charge of Offering Services and Facilities To Customers in Violation of The Robinson-Patman Act—Petitioner, a corporation, was charged by the FTC with violation of Sec. 2 (e) of the Robinson-Patman Act¹ in that it gave services and facilities to customers on a discriminatory basis (other than a "proportionally equal" basis). Petitioner sells patterns for women's dresses. Its principal customers are of two types: "fabric" shops and "Red Front" stores. The "fabric" shops sell materials as their principal commodity and offer patterns to their customers primarily as a service. Many make

¹⁴ §1.451 - 1 (a) and §1.461 - 1 (a) (3) INTERNAL REVENUE REGULATIONS (1958).

¹⁵ *Escanaba and Lake Superior R. R. Co. v. Commissioner*, 24 B. T. A. 412 (1931).

¹ This section provides: "(e) It shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser . . . by contracting to furnish or furnishing . . . any services or facilities . . . not accorded to all purchasers on proportionally equal terms." 49 Stat. 1526 (1936), 15 U.S. C. §13 (1952).