Another difference in the facts in the *Andrews* case from those present in the instant case is that in the *Andrews* case when the Arthur Murray Studio partnership trans- [fol. 217] ferred the notes which it took from its students to the bank, the bank paid the studio partnership the full face amount of the notes, less a six per cent discount. In the instant case, when the Studio partnership transferred the student notes to the bank, it did not receive from the bank the full face amount of the notes. The bank held back 50 per cent of the face amount of the notes and set up a reserve account of the amounts withheld which the partnership could not use until after the note was paid in full by the student. This fact, however, does not preclude the accrual as income of the full amount of the note when it is received from the student. Cf. Commissioner v. Hansen et al., ... U. S. ....., decided June 22, 1959. These were the so-called "Dealers' Reserve Accounts" cases. In the *Hansen et al.* cases the Supreme Court held that the transactions involved were sales of installment paper and the amount of the purchase price retained and recorded as a liability to each dealer accrued as income to him, even though he could not presently recover it, since he had a fixed right to such sum whether it was applied, as he had authorized, to payment of his obligation as guarantor or endorser of the installment paper, or paid to him in cash.

One of the cases relied upon by us in *Curtis R. Andrews, supra*, was *Your Health Club, Inc., supra*. In the latter case the taxpayer corporation was engaged in the business of operating a health club. Its activities consisted in furnishing facilities and services for various sport activities, Russian and Turkish baths, massages, ultra violet ray and solarium treatments. These services and facilities were furnished by the taxpayer under *contracts* entered into with members. The contract membership entitled members to avail themselves of taxpayer's facilities for a period of 1 year; once, twice, or three times a week according to the type of contract selected by the member. The taxpayer kept its books and filed its returns on an accrual basis. All contracts entered into were immediately entered upon the books of the taxpayer in full. At the end of the taxable year, in the case of contracts extending beyond the close of

the year, the membership fee was allocated in each instance between the expired and unexpired portion of the contract, such allocation being based upon the number of months yet to run under the contract. The amounts allocated to the [fol. 218] expired portion of the contracts were carried to gross income for that year and the balance was set up in the form of a "reserve for uncompleted contracts" and excluded from the gross income of the taxable year as "unearned income." Generally, the members paid their membership fees in advance in cash, but not always. For example, during the fiscal year ended March 31, 1940, membership contracts entered into amounted to $48,280.21. Of this amount, $42,800.85 was paid in cash during the year and the balance represented accounts receivable due at the close of the year. The taxpayer filed its income tax returns in accordance with its method of allocation above described. The Commissioner disallowed this method as not correctly reflecting income and determined deficiencies. We upheld the Commissioner. In doing so we said:

> The amounts paid in cash were deposited in petitioner's general account and were subject to no restrictions as to use or application. The amounts unpaid but accrued constituted accounts receivable as of the close of the taxable year, and were unqualifiedly due and payable. In these circumstances, all such amounts received or accrued must be considered income to petitioner in the year received or accrued. [Citing numerous cases not necessary to enumerate here.]

Thus, it will be seen from the foregoing recitals from the *Your Health Club, Inc.*, case that the services which the taxpayer corporation in that case contracted to render its members, some of which lapsed over into the following year, were Russian and Turkish baths, massages, ultra violet ray treatments, etc. The taxpayer sought, by its method of accounting, to give recognition to this lapse-over of services to be rendered into the following year by allocating part of the membership fees provided for in the contract to the following year. This we denied in the *Your Health Club, Inc.*, case for reasons already stated.

While it is, of course, true that the giving of Turkish and Russian baths and massages is somewhat different from giving dancing lessons, we think there is no difference in principle as to how the contract price for the two kinds of services should be treated from an accounting [fol. 219] standpoint by one on an accrual basis. The rule which must govern the respective taxpayers, *Your Health Club, Inc.*, and the Studio in the instant case, is as was said in *Your Health Club, Inc.*: "In these circumstances, all such amounts received or accrued must be considered income to petitioner in the year received or accrued."

We think it was quite appropriate for us, in *Curtis R. Andrews*, supra, to cite and rely upon the *Your Health Club, Inc.*, case as one of our supporting authorities for the result reached in that case. We also think it is appropriate to do so here. Cf. Automobile Club of Michigan v. Commissioner, 353 U. S. 180, affirming 230 F. 2d 585, which affirmed our decision, 20 T. C. 1033. See also Automobile Club of New York, Inc., 32 T. C.

Reviewed by the Court.

Decision will be entered for the petitioners in Docket No. 62109.

Decisions will be entered under Rule 50 in Docket Nos. 69591, 69592, and 69593.

PIERCE, J., dissenting:

1. As to those contracts for future services under which the entire contract price had not been prepaid either by cash or notes, and under which certain payments were not due to be made until a subsequent taxable year, I agree with the views expressed by Judge Train in his dissenting opinion. Such contracts were executory as to both parties; and the obligations to make the future payments thereunder had not matured, so as to become true accounts receivable, at the times when the contracts were executed. In such situation, I think there is no more justification for accruing the future contract payments as income of the year in which the contracts were executed, than there

would be for accruing as income at the time a lease is executed, all rental payments contracted to be made in subsequent years under such lease. The fact that a contract for future services, or a lease for future use of property, may be legally enforceable is not in itself justification for [fol. 220] accruing as income of the year in which the instrument is executed, all payments to be made thereunder in future years.

2. Even as to those contracts for future services upon which prepayment had been made, I think this Court has erred in refusing to permit the taxpayer to spread the income over the periods in which such income was to be earned, in accordance with sound business accounting practices. On the basis of the authorities and reasons which I have heretofore set forth in my dissenting opinion in the case of Automobile Club of New York, Inc., 32 T. C. (filed July 20, 1959), I think that such action of the Court not only defeats a true reflection of income, but also is out of harmony with the weight and trend of Courts of Appeals authority.

TRAIN, Judge: I respectfully dissent.

I do not agree that the petitioners should be required to report as income amounts which were not received in the taxable year, either in cash or by notes, and which were not due and payable by the close of the taxable year.

The majority opinion relies heavily on *Curtis R. Andrews*, 23 T. C. 1026 (1955), which applied the so-called claim of right doctrine and prohibited the deferral of amounts received but not earned in the taxable year. The facts of the instant case disclose that a portion of the contract amounts were not paid either in cash or by notes in the taxable year. As to that portion of the "student accounts receivable", the claim of right doctrine can have no applicability and the majority's reliance on the *Andrews* case is misplaced.

Moreover, even though the student's contractual obligation arose at the time of signing, it is clear that the contract amounts did not become due and payable in their

entirety in that year. To the extent that these same unpaid amounts were not due and payable in the taxable year, I do not believe that *Your Health Club, Inc.*, 4 T. C. 385 (1944), is authority for their inclusion in income of that year.

[fol. 221] I believe that the conclusion reached by the majority does violence to established rules of accounting, whether for business or tax purposes, and results in a distortion of income.

Dronnen, J., agrees with this dissent.

IN THE TAX COURT OF THE UNITED STATES

ORDER STRIKING AND SUBSTITUTING CERTAIN LANGUAGE IN OPINION—November 23, 1959

At the conclusion of the Opinion filed in these proceedings on September 28, 1959, we directed that the decision in Docket No. 62109 be entered for the petitioners and that decisions in Docket Nos. 69591, 69592, and 69593 be entered under Rule 50.

On November 19, 1959, respondent filed a motion in which he asked that the words "Decisions will be entered under Rule 50 in Docket Nos. 69591, 69592, and 69593" be stricken and that there be substituted for the language stricken the words "Decisions will be entered for the respondent in Docket Nos. 69591, 69592, and 69593." Counsel for petitioners has noted "No Objection" to said motion. Therefore, it is

Ordered, that said motion is granted and the words "Decisions will be entered under Rule 50 in Docket Nos. 69591, 69592, and 69593" in our Opinion filed September 28, 1959, be stricken and that there be substituted therefor "Decisions will be entered for the respondent in Docket Nos. 69591, 69592, and 69593."

Eugene Black, Judge.

Dated: Washington, D. C., November 23, 1959.

(Seal)

[fol. 222]

IN THE TAX COURT OF THE UNITED STATES

WASHINGTON

Docket No. 69591.

MARK E. SCHLUDE, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION IN DOCKET NO. 69591 November 23, 1959.

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion filed September 28, 1959, and Order of this Court dated November 23, 1959, it is

Ordered and Decided: that there is a deficiency in income tax for the taxable year 1952 in the amount of $9,264.69.

Eugene Black, Judge.

Enter:

Entered Nov. 23, 1959.

(Seal)

IN THE TAX COURT OF THE UNITED STATES

WASHINGTON

Docket No. 69592.

MARZALIE SCHLUDE, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION IN DOCKET NO. 69592—November 23, 1959.

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion filed September 28,

[fol. 223] 1959, and Order of this Court dated November 23, 1959, it is

Ordered and Decided: that there is a deficiency in income tax for the taxable year 1952 in the amount of $8,971.55.

Enter: Eugene Black, Judge

Entered Nov. 23, 1959.

(Seal)

IN THE TAX COURT OF THE UNITED STATES

WASHINGTON

Docket No. 69593.

MARK E. SCHLUDE AND MARZALIE SCHLUDE, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION IN DOCKET NO. 69593 November 23, 1959.

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion filed September 28, 1959, and Order of this Court dated November 23, 1959, it is

Ordered and Decided: that there are deficiencies in income tax for the taxable years 1953 and 1954 in the respective amounts of $83,395.82 and $11,544.32.

(Signed) Eugene Black, Judge

Enter:

Entered Nov. 23, 1959.

(Seal)

[fol. 224]

IN THE TAX COURT OF THE UNITED STATES

The United States Court of Appeals
For the Eighth Circuit.

T. C. Docket Nos. 69591, 69592, 69593

MARK E. SCHLUDE AND MARZALIE SCHLUDE, Husband and Wife, Petitioners on Review,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent on Review.

PETITION FOR REVIEW OF DECISIONS IN DOCKET NOS. 69591, 69592 AND 69593 Filed February 3, 1960

Petitioners on review are Mark E. Schlude and Marzalie Schlude, husband and wife, whose address is 459 Beverly Drive, Omaha, Nebraska. Petitioners on review filed separate, individual income tax returns for the year 1952 and joint returns for the years 1953 and 1954, the taxable years here involved, with the now Director of Internal Revenue for the District of Nebraska at Omaha, Nebraska, which collection district is within the jurisdiction of the United States Court of Appeals for the Eighth Circuit, where this review is sought.

The petitioners on review petition the United States Court of Appeals for the Eighth Circuit to review the decisions entered by the Tax Court of the United States on the 23d day of November, 1959, wherein and whereby it was ordered and decided that there were deficiencies in income tax in respect of the Federal income tax liabilities of the above-named petitioners on review for the years 1952 to 1954, inclusive, as follows:

Petitioner	Docket No.	Year	Deficiency
Mark E. Schlude	69,591	1952	$ 9,264.69
Marzalie Schlude	69,592	1952	8,971.55
Mark E. Schlude and Marzalie Schlude	69,593	1953	83,395.82
		1954	11,544.32

[fol. 225] The respondent on review is the duly appointed qualified and acting Commissioner of Internal Revenue, appointed and holding office by virtue of the laws of the United States.

This petition for review is filed pursuant to the provisions of sections 1141 and 1142 of the Internal Revenue Code of 1939 and sections 7482 and 7483 of the Internal Revenue Code of 1954.

Nature of Controversy.

On June 18, 1946, petitioners on review, Mark E. Schlude and Marzalie Schlude, formed a partnership for the purpose of conducting Arthur Murray Dance Studios in territories authorized by a franchise agreement received from Arthur Murray, Inc., New York City, New York.

From its inception, the partnership employed a certified public accountant to install its bookkeeping system, and that accountant maintained its books since that date. The partnership's books of account have been maintained on a fiscal-year basis ending March 31, and the accrual method of accounting has been employed. The partners report their income on a calendar-year basis.

The partnership is engaged in the business of giving private ballroom dance instruction to students. There are basically two types of contracts with students; (1) a cash plan and (2) a deferred-payment plan. The dance courses given cover a certain number of hours which range from five hours to one-thousand hours or even to lifetime courses. Some of the contracts extend beyond the taxable year in which the contract is made. In many of the deferred-payment contracts payment was not due until after the year of making the contract. The partnership reported the income it received from the dancing business when it was earned. Expenses were taken into account when incurred, regardless of when paid. In other words, the advance payments for dancing instructions were not taken into account until hourly instruction was given. That is the time when the income was earned and the operating costs are known. The partnership returned as

[fol. 226] gross income the pro rata amount of the contract price based on the number of lessons taught during the year.

The Commissioner of Internal Revenue determined that the entire contract price had to be returned as gross income in the year the contract was entered into on the ground that it had been received or accrued. The Tax Court sustained the Commissioner and held that the entire contract price accrued at the time the contract was executed. The question presented for decision is: Has the partnership reported its true income?

Statement of Points Upon Which Petitioners on Review Intend to Rely

The Tax Court of the United States erred:

(1) In holding and deciding that petitioners owed deficiencies in income tax for the years 1952 to 1954, as follows:

Petitioner	Docket No.	Year	Deficiency
Mark E. Schlude	69,591	1952	$ 9,264.69
Marzalie Schlude	69,592	1952	8,971.55
Mark E. Schlude and		1953	83,395.82
Marzalie Schlude	69,593	1954	11,544.32

(2) In holding and deciding that the entire contract price for dancing lessons accrued at the time the contract was entered into.

(3) In holding and deciding that the partnership, Arthur Murray Dance Studios, was required to take into income the entire amount of a contract price for dancing lessons when the contract was entered into, regardless of when the contract price was paid or agreed to be paid or regardless of when the services were agreed to be rendered.

(4) In holding and deciding that the signing of a contract for dancing lessons was the event which fixed the amount due and determined the student's liability to pay with sufficient certainty as to cause the entire amount to be immediately accruable.

[fol. 227] (5) In holding and deciding that the cancellation of about 17 per cent of sales would not provide a sufficient basis for finding that there was a real uncertainty that the amounts due under any one or all of the contracts would be uncollectible at the time the contracts were entered into.

(6) In holding and deciding that the memorandum accounts receivable of students were true accounts receivable.

(7) In holding and deciding that the partnership must take into income each year the yearly increases in the deferred income account on the books of the partnership.

(8) In failing to hold and decide that the partnership reported its true income and that the method of accounting employed consistently and properly reflects its true income and is the only practical business way of keeping its books and reporting its income.

(9) In failing to hold and decide that the accounting method employed by the partnership reflects the consistent application of generally accepted accounting principles.

(10) In failing to take into consideration and disregarding the uncontradicted and unimpeached testimony of the witnesses for petitioners on review, who testified that the books and records of the partnership were maintained in accordance with generally accepted and sound accounting principles which properly reflected the partnership's true income.

(11) In failing to take into consideration and disregarding the uncontradicted and unimpeached testimony of the witnesses for petitioners on review, who testified that the method of accounting and of adjustments proposed by the Commissioner would distort the partnership's income.

(12) In that each of the decisions is not supported by the evidence.

(13) In that the decisions are contrary to law.

Wherefore, the taxpayers petition that the opinion and decision of the Tax Court, hereinbefore referred to, be re-

[fol. 228] viewed by the United States Court of Appeals for the Eighth Circuit; that a transcript of record be prepared in accordance with the law and rules of said Court and transmitted to the Clerk of said Court for filing; that appropriate action be taken to the end that errors complained of may be reviewed and corrected by the Federal Court.

Mark E. Schlude, Marzalie Schlude, by Robert Ash,
1921 Eye Street, N. W., Washington 6, D. C.
Attorney for Petitioners on Review.

Of Counsel: Einar Viren, Omaha, Nebraska.

February 3, 1960.

Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 229]

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Docket No. 16,443

MARK E. SCHLUDE and MARZALIE SCHLUDE, Husband and Wife, Petitioners on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

DESIGNATION OF PETITIONER OF PARTS OF RECORD TO BE PRINTED ON REVIEW—Filed March 16, 1960

Come now the petitioners on review in the above-captioned case and request that the following parts of the record be printed under supervision of the Clerk of the Court:

1. Docket entries of proceedings in Tax Court Docket Numbers 69591, 69592 and 69593.

2. Pleadings:

(a) Petition, including annexed copies of notices of deficiency and statement attached, in each of the above Tax Court docketed numbers.

(b) Answers in each of the above-named docketed cases.

3. Stipulation of facts, together with Exhibits 1A to 24U, inclusive.

[fol. 230] 4. Supplemental stipulation of facts.

5. Official report of proceedings before the Honorable Eugene Black, Judge of the Tax Court of the United States at Omaha, Nebraska, on March 24, 1958.

6. Petitioners' Exhibits 22 to 31, inclusive.

7. Findings of fact and opinion of the Tax Court of the United States, filed September 28, 1959.

8. Decisions of the Tax Court of the United States entered in each of the above-named docketed cases on November 23, 1959.

9. Petition for review, filed February 3, 1960.

Robert Ash, 1921 Eye Street, N. W., Washington 6, D. C., Attorney for Petitioners on Review.

[fol. 231]

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 16,443

MARK E. SCHLUDE and MARZALIE SCHLUDE, Husband and Wife, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

On Petition to Review Decision of The Tax Court of the United States.

OPINION—December 15, 1961

Before SANBORN, VAN OOSTERHOUT and MATTHES, Circuit Judges

PER CURIAM.

For the second time this case is here for determination. Our first opinion, 283 F.2d 234, reversed the decision of the Tax Court. On June 19, 1961, the Supreme Court of the United States rendered its decision in *American Automobile Association* v. *United States*, 367 U.S. 687. On the same day the Supreme Court, by per curiam order in this case, directed that "(t)he judgment is vacated and the case is remanded in light of *American Automobile Association* v. *United States* . . . ." *Commissioner of Internal Revenue* v. *Schlude et ux.*, 367 U.S. 911.

[fol. 232] On October 9, 1961, in denying petition for rehearing, the Supreme Court amended its per curiam order of June 19, 1961, as follows: "The judgment is vacated and the case is remanded *for further consideration* in the light of

American Automobile Association v. *United States* . . ." (Emphasis supplied.)

Pursuant to our invitation, counsel for petitioners and the Commissioner filed supplemental briefs and presented oral arguments directed largely to the question of whether this case falls within the ambit of the teachings of *American Automobile Association*, supra. In light of that case we have carefully examined and considered petitioners' method of accrual accounting and are convinced that such method does not, for income tax purposes, clearly reflect income.

Accordingly, our judgment previously entered is vacated, and the decision of the Tax Court is affirmed.

[fol. 233]

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

September Term, 1961.

No. 16,443

MARK E. SCHLUDE and MARZALIE SCHLUDE, Husband and Wife, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

JUDGMENT—December 15, 1961

On Petition to Review Decision of The Tax Court of the United States.

This cause came on to be heard on the Petition to Review the Decisions of The Tax Court of the United States entered November 23, 1959 (Tax Court Docket Nos. 69591, 69592 and 69593), determining that there are deficiencies in the income taxes of the Petitioners for the years 1952, 1953 and 1954, after remand by the Supreme Court of the United States for further consideration in the light of the

decision in *American Automobile Association* v. *United States*, 367 U.S. 687, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Opinion of this Court heretofore filed October 19, 1960, be withdrawn, and the judgment entered thereon is hereby vacated, set aside and held for naught.

It is further Ordered and Adjudged by this Court that the decisions of The Tax Court of the United States be, and they are hereby, affirmed.

And it is further Ordered and Adjudged by this Court that the petition to review in this cause be, and the same is hereby, dismissed.

December 15, 1961.

[fol. 234]

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

September Term, 1961.

No. 16,443

MARK E. SCHLUDE and MARZALIE SCHLUDE, Husband and Wife, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition to Review Decision of The Tax Court of the United States.

ORDER STAYING ISSUANCE OF MANDATE, ETC.—December 29, 1961

On Consideration of the Motion of the petitioners for a stay of the mandate in this cause pending a petition to the Supreme Court of the United States for a writ of certiorari,