Mark E. Schlude and Marzalie Schlude, et al., n1 Petitioners, v. Commissioner of Internal Revenue, Respondent

n1 The following proceedings are consolidated herewith: Mark E. Schlude, Docket No. 69591; Marzalie Schlude, Docket No. 69592; and Mark E. Schlude and Marzalie Schlude, Docket No. 69593.

Docket Nos. 62109, 69591, 69592, 69593

UNITED STATES TAX COURT

32 T.C. 1271; 1959 U.S. Tax Ct. LEXIS 78

September 28, 1959, Filed

DISPOSITION:
[1]**

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

Decisions will be entered for the respondent in Docket Nos. 69591, 69592, and 69593.

SYLLABUS:

The Studio, a partnership operating Arthur Murray Dance Studio, entered into contracts with students whereby it agreed to furnish dancing lessons and the student agreed to pay therefor. The student would make a downpayment and pay the balance in installments, sometimes giving a note therefor. The Studio, an accrual basis partnership, returned as gross income the pro rata amount of the contract price based on the number of lessons taught during the year. Usually, by the end of the year, the balance of the contract price or some portion thereof had been paid by the student. The Commissioner 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. *Held*, for the Commissioner. The entire contract price accrued at the time the contract was entered into since the Studio had a right to receive a fixed and determinable amount.

COUNSEL:

Carl F. Bauersfeld, Esq., and *Einar Viren, Esq.*, for the petitioners.

William E. McCormick, Esq., for the respondent.

JUDGES:

Black, *Judge*. Pierce, *J.*, dissenting. Train, *J.*, dissent. Drennen, *J.*, agrees with this dissent.

OPINIONBY:

BLACK

OPINION:

[*1271] The respondent determined deficiencies in income tax as follows:

Docket No.	Petitioner	Year	Deficiency

62109	Mark E. Schlude and Marzalie Schlude	1950	$ 15,819.14
69591	Mark E. Schlude	1952	9,264.69
69592	Marzalie Schlude	1952	8,971.55
		1953	83,395.82
69593	Mark E. Schlude and Marzalie Schlude	1954	11,544.32

Respondent on brief concedes that the proceeding for 1950 (Docket No. 62109) is barred by the statute of limitations. Therefore, findings of fact as to the partnership fiscal year 1950 will in the main be omitted. No deficiency for the fiscal year 1951 was determined.

In the remaining proceedings the deficiencies are based on a number of adjustments, **[**3]** only one of which (for each year) is in issue. The adjustment in issue relates to the income of a partnership known as Arthur Murray Dance Studio in which the petitioners were equal partners. This adjustment was the adding to the income of the partnership the yearly increases in an account entitled "Deferred Income" on the ground that such amounts represented taxable income.

For the fiscal year 1950, the respondent, in his deficiency notice, explained this adjustment as follows:

[*1272] Explanation of Partnership Adjustments.

1 -- Income is increased by the amount of prepaid income received during the fiscal year. Income is also increased by the amount of the accounts receivable and notes receivable that are attributable to the fiscal year.

The prepaid income was unrestricted as to use. It clearly represented income to the partnership in the year it is received.

As for the accounts and notes receivable, these are income to an accrual basis taxpayer for the period in which they arise. * * *

All the similar adjustments for the taxable years, in this respect, are the same as above except as to amounts.

FINDINGS OF FACT.

Some of the facts have been stipulated; they are incorporated **[**4]** herein by this reference.

Petitioners Mark E. and Marzalie Schlude, husband and wife, are residents of Omaha, Nebraska, and filed their returns on the cash basis for the years involved with the now district director of internal revenue for the district of Nebraska.

On June 18, 1946, the petitioners formed a partnership known as Arthur Murray Dance Studio, hereinafter sometimes referred to as the Studio, in which they were equal partners, for the purpose of conducting dance studios in territories authorized by various franchise agreements received from Arthur Murray, Inc., New York, New York.

The franchise agreements required the partnership to pay Arthur Murray, Inc., a royalty of 10 per cent of the gross receipts of such dancing school or schools. In addition, the agreements required the partnership to pay Arthur Murray, Inc., 5 per cent of its gross receipts to be held in escrow by Arthur Murray, Inc., and to protect and indemnify Arthur Murray, Inc., from any and all claims that may be made against it as a result of granting the franchise to the partnership. The payments to the escrow fund were to continue until the partnership had deposited the total sum of $ 20,000 with Arthur **[**5]** Murray, Inc. Thereafter, no further payments were to be made to the fund unless the fund was depleted by payments therefrom, in which case payments were to be

continued or resumed until the fund amounted to the sum of $ 20,000. These amounts were required to be paid weekly. The franchise agreement gave Arthur Murray, Inc., control and supervisory powers over many phases of the conduct of the business of the Studio. It also required the Studio to honor the unused portion of paid courses of lessons of students enrolled in any other studio licensed by Arthur Murray, Inc., by giving lessons to such students. Arthur Murray, Inc., also required other studios to do the same. The sum of $ 1.50 per hour was to be paid by the studio holding the contract to the studio giving the lesson.

[*1273] Pursuant to the franchise agreements, the partnership operated studios for the teaching of private ballroom dancing to individual students. The location of the various studios being operated by the partnership and the date of their formation is as follows:

Location	Date of formation
Omaha, Nebraska	June 18, 1946
Lincoln, Nebraska	Sept. 20, 1948
Sioux City, Iowa	Oct. 1, 1949
Sioux Falls, South Dakota	June 1, 1952
Grand Island, Nebraska	Oct. 3, 1953

[6]**

When a student engaged the Studio to teach dancing lessons, the student and the Studio executed one of the six forms of written contracts entitled as follows:

(a) Enrollment Agreement And Contract With Student For Instruction.

(b) Extension Agreement And Contract With Student For Instruction.

(c) Renewal Agreement And Contract With Student For Instruction.

(d) Deferred Payment Enrollment Agreement And Contract With Student For Instruction.

(e) Deferred Payment Extension Agreement And Contract With Student For Instruction.

(f) Deferred Payment Renewal Agreement And Contract With Student For Instruction.

There are basically two types of contracts entered into between the partnership and students, i.e., the cash plan contracts (contracts (a), (b), and (c)), and the deferred payment plan contracts (contracts (d), (e), and (f)). Each plan has three categories. The first sale of a dance course represents an original sales contract (contracts (a) and (d)). After the student has contracted for an original course, he has the privilege prior to the fifth hour of instruction on the original course of enlarging that course at a lesser rate by entering into an "extension" agreement course (contracts **[**7]** (b) and (e)). A renewal course (contracts (c) and (f)) is one sold to a student after his completion of the original and extension courses.

Under contracts (a), (b), and (c) a portion of the contract price was paid in cash at the time of signing the agreement and the balance was to be paid in deferred installments. Under contracts (d), (e), and (f) a portion of the downpayment was paid in cash at the time of contracting. The balance of the downpayment was to be paid in installments and the remaining balance of the contract price was to be paid in the manner set forth in a negotiable note which accompanied the contract.

All of the contracts provided that (1) the student should pay tuition for lessons in a certain amount, (2) the student should not be relieved of his obligation to pay the tuition agreed upon in the contract, (3) no refunds would

be made, and (4) the contract is noncancellable. The contracts provided for a specific number of hours of **[*1274]** lessons ranging from 5 hours to 1,000 and 1,200 hours. Some of the contracts were for lifetime courses which, in addition to 1,200 specified hours, the student is entitled to 2 hours of lessons per month plus 2 parties a **[**8]** year for life. Under many of the contracts the lessons extended beyond the fiscal year in which the contract was entered into. Most of the lessons which extended beyond the fiscal year in which the contract was entered into were taught in the fiscal year immediately succeeding the year in which the contract was entered into. At the time of contracting, the student and the Studio did not agree upon a schedule for performance of the lessons upon fixed dates. The dates for instruction were arranged from time to time as lessons were given.

Notes accompanying deferred payment contracts received by the Studio were negotiated with a local bank. At the time a student's note was negotiated with the bank, the bank would deduct its interest charges and give approximately 50 per cent of the balance of the note to the partnership and set up a reserve account for the other 50 per cent of the note which the partnership could not use until after the note was paid in full by the student. After the note was paid, the balance in the reserve account was transferred to the partnership's general bank account. The notes were transferred to the bank because it was felt that the student (maker of the **[**9]** note) would be more likely to pay the bank than the partnership. The bank made no credit investigation of the student because it had complete recourse against the partnership.

Cash payments received by the partnership directly from students, the amounts received by the partnership at the time notes were transferred to the bank, and the amounts received by the partnership when notes transferred to the bank were fully paid were either deposited or credited to a partnership general bank account without segregation from other partnership funds.

Although the contract stated that they were noncancellable, the Studio frequently rewrote contracts reducing the number of lessons for a smaller sum of money. Also, despite the fact that the contracts provide that no refund will be made, and despite the fact that the Studio discouraged refunds, occasionally a refund would be made on a canceled contract.

The Studio paid Arthur Murray, Inc., of New York in weekly payments on Friday of each week, 10 per cent of the gross cash receipts of the Studio for the preceding calendar week. Commissions for selling lessons were, in general, paid at the time cash payments were received by the Studio.

When **[**10]** the partnership was organized in 1946, a public accountant employed by a firm of certified public accountants installed a complete double-entry bookkeeping system. An accrual method and a fiscal year ending March 31 were employed. This accounting system was **[*1275]** used continually and consistently from 1946 throughout the years in question. The public accountant (who became a certified public accountant in 1948) installed the accounting system, kept the Studio's books and prepared its partnership income tax returns in conformity with the books.

In addition to the books, individual student record cards were maintained. On these cards are recorded the name and address of the student, the type of contract, the hours involved, the total contract price, and a history of the lessons taught and payments made under the contract.

Under its system of accounting all of the transactions affecting each contract were recorded on individual record cards at the time they occurred. On its books the various transactions were recorded as follows:

(1) When a contract was entered into: Accounts Receivable is charged for the total contract price and Deferred Income is credited for a like amount. **[**11]**

(2) When a cash payment, downpayment or otherwise, on a contract is received: Cash is debited and Accounts Receivable is credited.

(3) The record does not show the entries which are made when the installment notes are transferred to the bank but it appears that the Studio treated the amounts withheld by the bank, viz, the Reserve Fund, as an Account Receivable.

(4) Expenses were recorded and deducted in the periods incurred except that the 10 per cent royalties to Arthur Murray, Inc., and certain other items were recorded and deducted when paid. (Actually many of these amounts were also incurred at about the same time as when paid.)

(5) At the close of each fiscal year all of the individual student's record cards were analyzed and the total number of hours taught and remaining untaught were determined. The total number of taught hours was multiplied by the designated rate per hour of each contract. (This rate is apparently arrived at by dividing the total number of contract hours into the total contract price.) The amounts arrived at (taught hours times rate per hour) for each contract are totaled and this total is regarded as earned income. This amount is then charged to Deferred **[**12]** Income and credited to Earned Income.

(6) If there had been no activity in a course under a contract for a period of over a year entries would be made canceling the course and contract. In the event a course was canceled or reduced in amount, the following entries would be made: Deferred Income would be charged with the amount of deferred income applicable to the canceled portion. (Untaught hours canceled times rate per hour equals amount of deferred income applicable.) Accounts Receivable would **[*1276]** be credited for the amount due on the canceled hours, if any, and any other amount due which would not be paid because of the cancellation or reduction. The difference between the amount charged to Deferred Income and the amount credited to Accounts Receivable would be debited or credited to Gain or Loss on Cancellations. (There would be a gain if the amount charged to Deferred Income exceeded the amount credited to Accounts Receivable and a loss if the latter exceeded the former.)

The following schedule reflects the number of untaught hours (of lessons) at the end of the following fiscal years:

	March 31 --		
	1952	1953	1954
Balance -- beginning	15,091 1/2	17,486	31,168
Additions:			
Sales	28,975	52,649 1/2	54,128
	44,066 1/2	70,135 1/2	85,296
Deductions:			
Hours taught -- transferred to earned income	17,436 1/2	28,436 1/2	39,159
Hours untaught -- canceled due to inactivity	9,144	10,531	14,459 1/2
Total deductions	26,580 1/2	38,967 1/2	53,618 1/2
Balance -- ending -- of untaught hours **[**13]**	17,486	31,168	31,677 1/2

The following schedule reflects a history of the Deferred Income account for the fiscal years ended March 31, 1952, 1953, and 1954:

	March 31 --		
	1952	1953	1954
Contract amount of deferred income:			
Balance -- beginning	$ 106,541.70	$ 131,143.92	$ 235,942.33
Additions during year: Contract amount of sales	235,396.68	430,293.65	452,040.70
	341,938.38	561,437.57	687,983.03
Deductions:			
Contract amount transferred to earned income	143,949.63	243,277.46	325,266.97
Contract amount unearned and canceled due to lack of activity	66,844.83	82,217.78	113,975.76
Total deductions	210,794.46	325,495.24	439,242.73
Balance -- ending -- of contract:			
Amount of deferred income	131,143.92	235,942.33	248,740.30

The following schedule reflects the beginning and ending balance in the Deferred Income account (as shown above) and the net change therein for the following fiscal years:

	March 31 --		
	1952	1953	1954
Contract amount of deferred income:			
Ending balance	$ 131,143.92	$ 235,942.33	$ 248,740.30
Beginning balance	106,541.70	131,143.92	235,942.33
Increase	24,602.22	104,798.41	12,797.97

[*1277] The following **[**14]** schedule reflects the composition n2 of the beginning balance, ending balance, and net change of the Deferred Income account for the following fiscal years:

	March 31 --		
	1952	1953	1954
Students accounts receivable (installment contracts carried by studio, notes not yet processed through the bank, and unpaid balances on planned cash courses):			
Ending balance	$ 63,627.23	$ 86,698.33	$ 85,177.10
Beginning balance	55,241.99	63,627.23	86,698.33
Increase or decrease	8,385.24	23,071.10	(1,521.23)
Reserve fund held by bank on students notes financed:			
Ending balance	7,943.74	37,747.61	34,533.22
Beginning balance	8,112.28	7,943.74	37,747.61
Increase or decrease	(168.54)	29,803.87	(3,214.39)
Deferred income collected (considering reserve fund held by bank as not collected until funds			

are released and made available for withdrawal by bank):			
Ending balance	59,572.95	111,496.39	129,029.98
Beginning balance	43,187.43	59,572.95	111,496.39
Increase	16,385.52	51,923.44	17,533.59

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n2 By composition we mean the debits corresponding to the credits in the Deferred Income account. For example, the balance in the Deferred Income account at March 31, 1952, is $ 131,143.92. This amount is represented by the following ended balances at March 31, 1952:

Uncollected:	
Students accounts receivable	$ 63,627.23
Reserve fund -- bank	7,943.74
Collected	59,572.95
	131,143.92

In order to check the composition of any of the balances or net changes in the Deferred Income schedule the same computation must be made.

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[15]**

Unpaid balances on notes held by the bank for the fiscal years ended March 31, 1952, through March 31, 1954, were as follows:

	March 31 --		
	1952	1953	1954
Ending balance	$ 9,618.00	$ 40,627.96	$ 23,440.75
Beginning balance	1,842.10	9,618.00	40,627.96

The following schedule reflects the amount of sales canceled, the uncollectible accounts receivable on the canceled sales, and the gain on cancellations on the Studio's books and returns for the years involved:

	Fiscal years ended March 31 --		
	1952	1953	1954
Sales canceled	$ 66,844.83	$ 82,217.78	$ 113,975.76
Uncollectible receivable on cancellation	39,983.43	62,734.42	85,527.15
Gain on cancellation	26,861.40	19,483.36	28,448.61

[*1278] The following schedule reflects ordinary gross income and deductions on the Studio's books and returns for the following fiscal years:

	March 31 --		
	1952	1953	1954
Gross income:			
Contract amounts transferred to earned income	$ 143,949.63	$ 243,277.46	$ 325,266.97
Gains from cancellation	26,861.40	19,483.36	28,448.61
Other income	4,041.21	11,426.23	16,987.31
Total	174,852.24	274,187.05	370,702.89
Deductions	137,267.91	223,390.69	301,609.76

Ordinary net income	37,584.33	50,796.36	69,093.13

[16]**

The respondent, in his notices of deficiency, n3 increased the ordinary net income of the partnership for the fiscal years ended March 31, 1952, 1953, and 1954, by the amounts of the increases in the Deferred Income account in those years, viz, $ 24,602.22 for 1952, $ 104,798.41 for 1953, and $ 12,797.97 for 1954. (See schedule of income in Deferred Income account, *supra*.)

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n3 The respondent also disallowed certain expenses of the Studio, which are not in issue, and added to each partner's distributive share of partnership income his respective share of the additional income.

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A supplemental stipulation of facts was filed April 8, 1958, which reads as follows:

It is hereby stipulated that the tuition paid to other studios during the taxable years ending March 31, 1950 to March 31, 1954, inclusive, is as follows:

Taxable year ended March 31, 1950	$ 592.00
Taxable year ended March 31, 1951	751.10
Taxable year ended March 31, 1952	825.00
Taxable year ended March 31, 1953	1,328.13
Taxable year ended March 31, 1954	1,955.32

[17]**

OPINION.

The petitioners are equal partners in the Studio, a partnership which owns and operates five Arthur Murray Dance Studios under franchise agreements with Arthur Murray, Inc. In dispute is the amount of the Studio's gross income. Specifically, the dispute relates to the manner in which the receipts from contracts for dancing lessons are to be reported.

The problem may best be explained by the following illustration: On August 1, 1952, the Studio enters into a contract with a student whereby the Studio agrees to teach the student 24 1-hour dancing lessons and the student agrees to pay $ 240 therefor, $ 100 down and $ 20 per month for the next 7 months. (In some cases the student gives a negotiable note for the installment payments.) Lessons are arranged from time to time and at the end of 1952 the Studio has given the student 10 lessons and the student has paid $ 180, the $ 100 **[*1279]** down and 4 $ 20 installments. By March 1953, the Studio gives the student 10 additional lessons and the student pays $ 40, 2 more installments. The student loses interest in the course and does not take the remaining 4 lessons and the Studio is unable to collect the remaining $ 20.

In **[**18]** 1952 the Studio, which reports on an accrual basis, returns as gross income $ 100, representing 10 lessons taught at $ 10 per lesson. During 1953 the Studio returns as gross income $ 100 representing 10 lessons taught at $ 10 per lesson. After the contract has been inactive for a year the Studio cancels it, computing a gain or loss thereon. Here the gain would be $ 20. (Four lessons untaught at $ 10 per lesson equals $ 40, less contract price unpaid of $ 20 equals $ 20 gain.) This $ 20 gain on cancellation would be returned as gross income in 1954.

The Commissioner determined that the entire $ 240, the contract price, should be returned in 1952 when the contract was entered into and the amount of the contract was paid or agreed to be paid. We agree.

The Studio, being on an accrual basis, must return items of gross income in the year in which they accrued. Sec. 42 (1939 Code). "Items must be accrued as income when the events occur to fix the amount due and determine liability to pay." *Spring City Foundry Co. v. Commissioner, 292 U.S. 182 (1934).* When the contracts were entered into the amounts due thereunder were fixed and the students were **[**19]** "liable to pay." It is true that a payment of a portion of the contract price was deferred but that does not affect the fixed and unconditional right of the Studio to receive the amount. Nor does the fact that the Studio was required to perform future services under the contract alter the Studio's right to receive since the deferred payments were in many cases due prior to the rendering of the services. And the record shows that in most instances substantial payments were received prior to the performance of the services for which the payments were made.

The exception to the rule stated above is where there is a real uncertainty as to whether the taxpayer will ever receive the amount in question, cf. *San Francisco Stevedoring Co., 8 T.C. 222.* Here, the Studio actually received substantial cash or negotiable notes under each contract. The contracts themselves provided that they were noncancelable and that no refunds should be made. Despite this provision in the contract some contracts were canceled. The facts show that the cancellations were considerable in amount. These amounts, according to the Studio's records, were about 17 per cent, 15 per cent, **[**20]** and 19 per cent of sales for the respective years. Assuming that the rate of cancellation was about 17 per cent of sales that fact still would not provide a sufficient basis for a finding that there was a real uncertainty **[*1280]** that the amounts due under any one or all of the contracts would be uncollectible (and therefore not accruable) at the time the contracts were entered into. The normal manner of providing for this type of contingency is through the use of a bad debt reserve. We have no issue in the instant case as to any addition to a bad debt reserve nor do we have any issue concerning debts of the partnership which became worthless in the taxable year.

It seems to us that the instant case is controlled by our decision in *Curtis R. Andrews, 23 T.C. 1026,* on the first point decided in that case. That first point decided in the *Andrews* case was essentially the same as the main issue we have in the instant case. While it is true that the facts in the *Andrews* case are not precisely the same as the facts in the instant case, nevertheless we do not think that such differences in facts as do exist would justify a holding in the instant **[**21]** case different from what we held in the *Andrews* case. For example, in the *Andrews* case, according to the Findings of Fact, the Arthur Murray Studios in that case did not have any accounts receivable but they did take notes receivable from their dancing students. In the instant case, apparently the Studio had accounts receivable as well as notes receivable. This difference, it seems to us, is not sufficient to make a valid distinction between the *Andrews* case and the instant case. To an accrual taxpayer, accounts receivable must be taken into income just the same as notes receivable. We know of no authority to the contrary. Petitioners, in their brief, argue that their accounts receivable for dancing lessons contracts were not true accounts receivable but were what they term "memorandum accounts receivable." Their argument on this point is, in part, stated in their brief as follows:

The record shows that at the time the contract is executed and the entries made to the deferred income account, the so-called students accounts receivable at that time are not true, earned receivables. True accounts receivable are entered after a product has been delivered or services **[**22]** have been rendered. * * *

In other cases before our Court we have not made the distinction in accounts receivable which petitioners seek to draw. See *Your Health Club, Inc., 4 T.C. 385,* which we will discuss more at length later.

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 transferred 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 6 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 **[*1281]** 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, 360 U.S. 446 (1959).* These **[**23]** were the so-called "Dealers' Reserve Accounts" cases. In the *Hansen* case 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, ultraviolet 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 **[**24]** 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 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 **[**25]** 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 **[*1282]** 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, ultraviolet 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. **[**26]** 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 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.* **[**27]** See also *Automobile Club of New York, Inc., 32 T.C. 906.*

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

Decisions will be entered for the respondent in Docket Nos. 69591, 69592, and 69593.

DISSENTBY:
PIERCE; TRAIN

DISSENT:

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 **[*1283]** 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 **[**28]** of property, may be legally enforcible is not in itself justification for 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. 906,* 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, *J.*: 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),* **[**29]** 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.

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.