"Taxpayers also argue that the moment the contract was signed there was a fixed and determined liability for damages if they breached the contract in 1946. True, if they had breached the contract in 1946, some amount (though not necessarily $8,796) might have become a fixed and determined liability, but the fact remains that there was no breach in 1946."

The law of Nebraska, Iowa and South Dakota follows the general rule that a party seeking to recover on an executory contract before performance is rendered is only entitled to recover damages for the breach which is measured by the loss of profits. *International Text-Book Co.* v. *Martin* (1908), 82 Neb. 403, 117 N.W. 994; *King Features Syndicate* v. *Courrier* (1950), 241 Iowa 870, 43 N.W. 2d 718; South Dakota Code, Sec. 37-1801 (1960 Supp.)[7] The foregoing authorities demonstrate that as a matter of general law the Tax Court was in error in holding that when the contracts were entered into the amounts due thereunder were fixed and the students were liable to pay.

III. THE AMERICAN AUTOMOBILE ASSOCIATION CASE IS NOT DISPOSITIVE OF THE ISSUE IN THE CASE AT BAR

The per curiam opinion of the Court of Appeals on remand (R. 273-274) held that in the light of *American Automobile Association*[8] case, the taxpayer's method of accrual accounting does not for income tax purposes clearly reflect income. The factual differences between the present case and the *American Automobile* case makes it clear that the Court below misinterpreted this Court's decision in the *American Automoble* case. In *American Automobile*, this Court approved the exercise by the Commissioner of his discretion in rejecting the accrual accounting system employed by the taxpayer which deferred the reporting of income to subsequent years. The Court found that the accounting system used by the Association did not accurately and factually match revenues with related costs because it was based on statistical predictions and averages reflecting the over-all cost of rendering services to all its members on a group or pool basis. The Association was unable to establish the cost of rendering service to an individual member. There, the accrual accounting system simply prorated the membership dues by the number of months and bore no relationship to the services to be rendered.

In the case at bar, the method of accounting for advance receipts accurately and precisely matched revenues from services performed in each tax year with related costs of rendering the services. The dancing business operated by the partnership was the type of business that easily enabled it to record the revenue from each contract and the cost of performing under each contract. This was accomplished by use of the individual card for each student. On the card there was listed all pertinent information, including type of contract, hours of instruction involved, total contract price, history of lessons taught and payments made under the contract. (R. 252) The gross income from each contract was determined for each year by multiplying the hours taught by the hourly rate applicable to that contract. Costs were incurred in the period

[7] South Dakota Code, Sec. 37-1801 (1960 Supp.):

"No person can recover a greater amount in damages for the breach of an obligation than he could have gained by the full performance thereof on both sides * * *."

[8] 367 U.S. 687 (1961).

that the partnership rendered services under the contract. (R. 193-195, 252.) The statistical approach employed by the *American Automobile* system cannot be compared with the accurate and precise card system used by the partnership here involved. Yet, the Court below, applying this Court's decision in the *American Automobile* case, rejected the taxpayer's accrual accounting system which accurately and precisely matched revenues derived from the performance of services in the same taxable year with the cost of rendering such service. The Courts below held that the entire contract price of the executory service contracts was income in the year in which the contracts were signed, even though the taxpayer could not receive nor earn the contract price except by performing services in a subsequent tax year. The *American Automobile* case only involved taxation of advance cash receipts. It did not involve unreceived and unearned income.

A. The Court below erred in holding income had accrued on the contracts on which payment had not been received nor earned by performance of services.

The Court below held that the entire contract price is income when the contract was signed even though the contracts were executory in that many payments were not due to be made until a subsequent taxable year.[9] No income had been earned under the contracts because the dancing lessons were not scheduled to be given until a subsequent year. This distinguishes the instant case from the *American Automobile* case which was dealing only with advance cash receipts paid to

[9] See dissenting opinion of three Tax Court Judges. (R. 262-264).

the Association for which there may or may not have been future services required.[10]

The taxpayers in the instant case derived income from the teaching of ballroom dancing, not the signing of contracts. The signing of an executory contract, wherein a student promises to pay for lessons to be given in the future, does not meet the definition of when income accrues as stated in *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182, 184, as follows:

> "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues. * * *"

While the contracts were executory, and until the dancing lessons were given, no income was *earned* and, consequently, could not accrue. The "event" giving rise to income was the giving of the dancing lessons. Until the lessons were given there was no "right to receive" an amount which had become fixed within the meaning of the accrual accounting concept. Cf. *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182; *Brown v. Helvering* (1934), 291 U.S. 193. The Court below misapplied the *American Automobile* case in failing to distinguish between a taxpayer who had received advance cash receipts for which it might not be called upon to perform services and a taxpayer who had not

[10] Respondent recognized this in its Brief for the Respondent in Opposition, No. 793, Supreme Court, 1961 Term pp. 10-11, where it was stated, "Since the AAA case in fact involved only actual cash receipts, the Court cannot be said to have passed on this precise question in that case."

received advance receipts nor rendered any services. The difference betwen sales (as evidenced by contracts signed during the year) and cash received during the year equalled $48,200.13, $115,609.39 and $80,791.54 for 1952, 1953 and 1954, respectively.[11] In addition, the record in the instant case shows that there was no assurance whatever that payments would in fact be made on the contracts in future years. The Tax Court's opinion points out that cancellations were considerable in amount. A large number—over 20%—of the service contracts were cancelled during the years here involved. In addition, other contracts were required to be rewritten for a smaller number of lessons than had originally been contracted for in order to retain the student and not have the contract cancelled in its entirety. (R. 192, 239) In view of the foregoing, it is unrealistic to assume that the partnership would receive the unpaid portion of the contract at the time it was signed by the student. Until the services were rendered and the income earned, the partnership did not have a "fixed and unconditional right to receive the amount" due under the contract.

B. The Court below erred in holding income had accrued on the contracts on which payment had been received but not earned by performance of services.

The *American Automobile* case is not authority for holding that an accrual accounting system that accurately and precisely matches revenues derived from services performed in a tax year with related items of cost and expense may be rejected by the Commissioner

[11] The above amounts were arrived at by subtracting "Cash receipts" on Pet. Ex. 28, R. 209 from "Additions During Year—Contract Amount of Sales" on Pet. Ex. 24, R. 191.

as not clearly reflecting income. The decisions of this Court are uniform in pointing out that in accrual accounting the time when cash is actually received is not determinative of the time of its inclusion in gross income for purposes of taxation. In *Brown* v. *Helvering* (1934), 291 U.S. 193, 199, the Court stated:

> "If the accounts are kept on the accrual basis the income is to be accounted for in the year in which it is *realized* even if not then actually received; and the deductions are to be taken in the year in which the deductible items are incurred." [Italics supplied]

In *Spring City Foundry Co.* v. *Commissioner*, 292 U.S. 182, 185, the Court stated:

> "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the right to receive *and not the actual receipt* (italics supplied) that determines the inclusion of the amount in gross income. When the *right* to receive an amount becomes fixed, the right accrues. When a merchandising concern makes sales, its inventory is reduced and a claim for the purchase price arises."

See also *Security Flour Mills Co.* v. *Commissioner* (1944), 321 U.S. 281, and *Commissioner* v. *Hansen*, 360 U.S. 446. See Mr. Justice Stewart's dissenting opinion in *American Automobile*, 367 U.S. pp. 711-715. The statement in *Brown* v. *Helvering, supra,* that "Income is to be accounted for in the year in which it is *realized*" (italics supplied) is the equivalent of saying that income is to be accounted for in the year in which it is *earned.*

In the *American Automobile* case the taxpayer failed to prove that the method of deferral used bore any significant relation to the services to be performed in the future. In the instant case, the deferral bears direct relation to the services to be performed and which are in fact required to be performed under the terms of the contract. The partnership's obligation to provide services subsequent to the tax year was fixed, definite and certain and, furthermore, was identifiable as to untaught hours and unearned contract amount for each student contract outstanding at the end of the year.[12] The important factual distinctions are that in the case at bar (1) there was no pro rata allocation of income to periods on a time elapsed basis; (2) there was no pooling of expenses or a deduction of expenses on a pro rata basis; (3) there was no computation of profits based on average experience in rendering services or performance, and (4) there was no selling of availability of services. In the case at bar, (1) income is returned in the year of actual performance; (2) expenses are deducted when incurred; (3) profit is computed on the basis of actual events or transactions and the exchange of values, and (4) actual services are sold which can be identified for each contract as to the amount of performance rendered and the amount of performance yet to be rendered. Consequently, the case at bar falls within the rules of *Beacon Publishing Company* v. *Commissioner*, (C.A. 10, 1955) 218 F. 2d 697, and *Schuessler* v. *Commissioner*, (C.A. 5, 1956) 230 F. 2d 722, because the studio rendered actual dancing instructions to its students on fixed dates as scheduled, in accordance with the terms of the contracts.

[12] The accurate matching of revenue with related cost in the instant case has been referred to by law journal writers as a "sophisticated system" when compared with the "rather crude accounting system" employed by the American Automobile Association, Journal of Taxation, August 1962, p. 104.

This is the principle on which this Court distinguished the *Automobile Club of Michigan* case and the *American Automobile Association* case from the *Beacon* and *Schuessler* cases.

In *Automobile Club of Michigan* v. *Commissioner* (1957), 353 U.S. 180, the *Beacon* and *Schuessler* cases were distinguished factually by pointing out that performance of the subscription in *Beacon* in most cases was in part, necessarily deferred until the publication dates after the tax year. In *Schuessler* it was pointed out that performance of the service agreement required the taxpayer to furnish services at specified times in years subsequent to the tax year. In the *Automobile Club* cases substantially all the services were performed only upon a member's demand and the taxpayer's performance was not related to fixed dates after the tax year. In the case at bar, the dancing students do not buy the availability of services. They buy the actual dancing instruction itself. In the *Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180, the Court found that (p. 189) "The pro rata allocation of membership dues in monthly amounts is purely artificial and bears no relation to the services which petitioner may in fact be called upon to render for the member." This is not true in the case at bar. The Court of Appeals in its original opinion in this case pointed this out and said: (R. 289)

> "The facts before us are distinguishable. Here, petitioners' obligation to provide services subsequent to the tax year was fixed, definite and certain, thereby effectively rebutting any contention that petitioners' method of deferral was purely artificial. The system and method of accounting on an accrual basis with the deferral of income

> so that it could be closely matched to the corresponding expenses, was designed to clearly reflect petitioners' true income within the meaning of the applicable statutes and regulations. As pointed out in the *Beacon* and *Schuessler* cases, any other method would result in a distortion of true income."

It is submitted that this Court's decision in the *American-Automobile* case does not prevent the use of an accrual accounting system for tax purposes which accurately and precisely matches revenues derived from services performed in a tax year with the cost of performing such services.

C. The legislative history of the enactment and repeal of sections 452 and 462 of the Internal Revenue Code of 1954 is not authority to support the Commissioner's action in disregarding the taxpayer's accrual accounting system which accurately and precisely matches revenues and related cost.

The majority opinion in the *American Automobile* case gave consideration to the legislative history surrounding the enactment and repeal of sections 452 and 462 of the Internal Revenue Code of 1954 in finding that the Commissioner had properly exercised his discretion in disregarding the Association's accounting system. The Court held:

> "Finding only that, in light of existing provisions not specifically authorizing it, the exercise of the Commissioner's discretion in rejecting the Association's accounting system was not unsound, * * *."

Here the majority opinion specifically limited itself to the American Automobile Association's particular

accrual accounting system. The opinion of the Court had previously pointed out a number of reasons why the Association's accounting system did not reflect its true income. The enactment of sections 452 and 462 would clearly have justified the accrual accounting system used by the American Automobile Association. However, since those provisions were repealed, there was no specific provisions authorizing the sytem used by the American Automobile Association. The enactment and repeal of sections 452 and 462 is certainly no authority for holding that a taxpayer's method of accounting, which accurately and precisely matches revenues with related expenses so as to reflect its true income, can be disregarded. The issue here is whether the accrual method of accounting used by the taxpayer clearly reflected its true income. This issue must be decided by interpreting sections 41 and 42 of the Internal Revenue Code of 1939 and sections 446 and 451 of the Internal Revenue Code of 1954.

The enactment and repeal of sections 452 and 462 did not alter or affect the basic requirement of the law that each taxpayer is required to report his true income. Nor do they change the necessary and inevitable conclusion that when a taxpayer has reported his true income he has complied with the law. Matters of form in the dress of bookkeeping or accounting practices should not be extolled over truth and substance.

CONCLUSION

The accrual method of accounting used by the partnership clearly reflected its true income. The hybrid system of accounting imposed by the Commissioner results in a complete distortion of income because of a failure to match revenues with related expenses.

Petitioners, therefore, pray that the judgment entered by the Court below should be reversed.

Respectfully submitted,

ROBERT ASH
CARL F. BAUERSFELD
1921 Eye Street, N. W.
Washington 6, D. C.
Attorneys for Petitioners

Of Counsel:
ASH, BAUERSFELD & BURTON

September 14, 1962.

APPENDIX

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

• • • • •

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * * and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

• • • • •

(26 U.S.C. 1952 ed., Sec. 23.)

Sec. 41. General Rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

Sec. 42 [As amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. Period in Which Items of Gross Income Included.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

Sec. 43. Period for Which Deductions and Credits Taken.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1952 ed., Sec. 43.)

Internal Revenue Code of 1954:

Sec. 446. General Rule for Methods of Accounting.

(a) *General Rule.*—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) *Exceptions.*—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

(c) *Permissible Methods.*—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate.

* * * * *

(26 U.S.C. 1958 ed., Sec. 446)

SEC. 451. GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

(a) *General Rule.*—The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless under the method of accounting used in computing taxable income such amount is to be properly accounted for as of a different period.

(26 U.S.C. 1958 ed., Sec. 451)

SEC. 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

(a) *General Rule.*—The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

* * * * *

(26 U.S.C. 1958 ed., Sec. 461.)

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

SEC. 39. 41-1 *Computation of net income.* Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him

in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See §§ 39.42-1 to 39.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

SEC. 39.41-2. *Bases of computation and changes in accounting methods.* (a) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. But see sections 42 and 43. See also section 48. For instance, in any case in which it is necessary to use an inventory, no method of accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See §§ 39.42-2 and 39.42-3.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. (But see § 39.22(c)-5.)

* * * * *

SEC. 39.41-3. *Methods of Accounting.* It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. * * *

SEC. 39.42-1. *When included in gross income.*—(a) *In general.*—Except as otherwise provided in section 42, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. See §§ 39.41-1 to 39.41-3, inclusive. * * *

* * * * *

SEC. 39.43-1. *"Paid or incurred" and "paid or accrued."* (a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48(c).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Internal

Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

* * * * *

SEC. 39.43-2. *When charges deductible.* Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year canot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a growing business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. * * *

Treasury Regulations on Income Taxes (1954 Code).

SEC. 1.446-1. GENERAL RULE FOR METHODS OF ACCOUNTING. (a) *General Rule.*—(1) Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term "method of accounting" includes not only the over-all method of accounting of the taxpayer but also the accounting treatment of any item. Examples of such over-all methods are the cash receipts and disbursements method, an accrual method, combinations of such methods, and combinations of the foregoing with various methods provided for the accounting treatment of special items. These methods of accounting for special items include the accounting treatment prescribed for research and experimental expenditures, soil and water conservation expenditures, depreciation, net operating losses, etc. Except for deviations permitted or required by such special accounting treatment, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. For requirement respecting the adoption or change of accounting method, see section 446(e) and paragraph (e) of this section.

(2) It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

* * * * *

(b) *Exceptions.*—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

(c) *Permissible methods*—(1) *In General.* Subject to the provisions of paragraphs (a) and (b) of this

section, a taxpayer may compute his taxable income under any of the following methods of accounting:

(i) *Cash receipts and disbursements method.*—Generally, under the cash receipts and disbursements method in the computation of taxable income, all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made. For rules relating to constructive receipt, see § 1.451-2. For treatment of an expenditure attributable to more than one taxable year, see section 461(a) and paragraph (a)(1) of § 1.461-1.

(ii) *Accrual method.*—Generally, under an accrual method, income is to be included for the taxable year when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Under such a method, deductions are allowable for the taxable year in which all the events have occurred which establish the fact of the liability giving rise to such deduction and the amount thereof can be determined with reasonable accuracy. The method used by the taxpayer in determining when income is to be accounted for will be acceptable if it accords with generally recognized and accepted income tax accounting principles and is consistently used by the taxpayer from year to year. For example, a taxpayer engaged in a manufacturing business may account for sales of his product when the goods are shipped, when the product is delivered or accepted, or when title to the goods passes to the customer, whether or not billed, depending upon the method regularly employed in keeping his books. Likewise, the extent to which indirect costs shall be included in computing cost of goods sold depends upon the method used by the taxpayer in treating such items in keeping his books.

* * * * *

SEC. 1.451-1. GENERAL RULE FOR TAXABLE YEAR OF INCLUSION — (a) *General Rule.* — Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. To the extent that income is attributable to the recovery of bad debts for accounts charged off in prior years, it is includible in the year of recovery in accordance with the taxpayer's method of accounting, regardless of the date when the amounts were charged off. For treatment of bad debts and bad debt recoveries, see sections 166 and 111 and the regulations thereunder. For rules relating to the treatment of amounts received in crop shares, see section 61 and the regulations

thereunder. For the year in which a partner must include his distributive share of partnership income, see section 706(a) and § 1.706-1(a). If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom.

* * * * *