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James L. Dohr

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The Board of Tax Appeals and Net Income

By James L. Dohr

Ever since the passage of the first income-tax law requiring a determination of net income for the purpose of computing tax liability, tax administrators, accountants and lawyers have directed their efforts to the solution of the many problems of net-income determination. To the accountant the problems were by no means novel; the preparation of profit-and-loss statements and the determination of net profits had long given rise to similar questions. The experience gained in the accounting field and the principles and procedure developed therein are given a measure of recognition in the federal income-tax law which provides in general that taxable net income shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer—so long as such method "clearly reflects the income" (revenue acts of 1924 and 1926, section 212–b), and in the regulations issued thereunder which provide that "approved standard methods of accounting will ordinarily be regarded as clearly reflecting income" (*Regulations 65*, article 23). Nor can it be said that the problems of income determination were entirely new to the lawyer, though frankness compels the admission that many of the legal efforts devoted to its solution have left much to be desired.

Experience under the various federal revenue acts in the determination of net income has never been entirely satisfactory from the accounting point of view. In the center of a comparatively new and decidedly optimistic business field, the philosophy of the American accountant has been developed along the lines of a careful conservatism not always in harmony with the law and regulations affecting net income. A typical accounting definition of the term indicates this backward leaning. "The net income of a business is the surplus remaining from the earnings after providing for all costs, expenses and reserves for accrued or probable losses" (Montgomery, *Auditing Theory and Practice*, page 308). When such a definition is applied and careful provision is made for all "accrued or probable losses," a result is obtained which tends toward the understatement of net income rather than toward an inflated or optimistic presentation. The succinct definition of

income laid down by the supreme court can scarcely be used as a working standard. "Income may be defined as the gain derived from capital, from labor or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets" (*Eisner* v. *Macomber*, 252 United States 189). To say that income is a gain or a profit gained is to say nothing. Further than this, the supreme court in interpreting the word "income" as used in the constitutional amendment seems, curiously enough, to have regarded the word as the substantial equivalent of what the accountant calls gross income rather than net, and congress is permitted to levy a tax on an artificial net income in which no deduction is permitted for certain necessary expenses. No accountant, for instance, would compute net income from a mine without making allowance for depletion, yet so far as the supreme court is concerned such expense may be denied as a deduction without offending the constitutional limitation (*Stanton* v. *Baltic Mining Co.*, 240 United States 103). The result is clearly a tax on capital rather than on income. More effective, by far, is an effort toward definition such as that of Professor Robert Murray Haig: "Income is the money value of the net accretion to one's economic power between two points of time" (*The Federal Income Tax*, Columbia University Press, 1921). Economic power may be of a somewhat doubtful quantity, but substitute the term "economic wealth" and the accountant should recognize one of his own methods of net-profit determination, that of a comparison of balance-sheets. Further than this, however, the definition requires modification to permit recognition of the concept of realized income since increases in economic wealth may not, as in the case of appreciation in land value, give rise to realized income. This modification is extremely important since the income tax is in essence an attempt to reach ability to pay, which can only be properly measured by realized income. When net income is used as a basis for taxation, its determination involves the dual problem of establishing (a) what is income in a given situation, and (b) whether or not the income is realized by the taxpayer in the sense that he has received sufficient gain properly to pay the tax.

It is submitted, however, that the accountant's basic difficulty arises from a failure to recognize that there is, as a matter of law, a distinction between net profits and net income for tax purposes. Net income is a statutory concept, and once this fact is recognized

many rulings otherwise objectionable can be approved as being correct—at least under the taxing statute. Any objections to the concept should then of course be made to congress rather than to the administrators of the law. On the other hand, the lawyer has been prone to regard the term "net income" as an artificial concept, ignoring the explicit direction of the statute that net income be computed "in accordance with the method of accounting regularly employed in keeping the books of the taxpayer," so long as such method "clearly reflects the income."

After a long process of experimentation, congress, in the revenue act of 1924, created the board of tax appeals as a part of the federal tax collecting and administering plan. When the commissioner of internal revenue has finally determined that additional taxes are due from a taxpayer, the latter may take an appeal to the board. When the appeal is heard the taxpayer obtains, under proper pleadings, a de novo consideration of his return for the year involved, and the board decides whether the proposed deficiency shall be disallowed or allowed in whole or in part. In this situation the board has rendered numerous decisions, some of which are of considerable interest with relation to the problem under consideration, namely, the determination of net income. It is proposed to show by a review of these decisions that the board, while realizing clearly that it is dealing with a statutory concept, is disposed carefully to consider correct and approved accounting principles but has not as yet given these principles the full measure of recognition they deserve.

The board recognized from the start the proposition that income in general may be determined upon the so-called cash or accrual bases, and that the inclusion of items of gross income and the taking of deductions therefrom must be determined in the light of the method, cash or accrual, adopted by the taxpayer (appeal of Henry Reubel, 1 B. T. A. 676). When the taxpayer has reported on either of the bases allowed, the decision as to what amounts may be included in gross income or what amounts are deductible therefrom should be made with due regard to the underlying accounting principles involved. For instance, where the taxpayer reports on the cash basis, it is obviously improper to allow a deduction as a bad debt for interest accrued which has not at any time been reported as income (appeal of Charles A. Collins, 1 B. T. A. 305). Bad debts must be charged off in order to be deductible, and, as the board pointed out, what is charged

off must first be "charged on". On the cash basis no "charge on" is made for interest accruals.

Of course, strictly speaking, there are no accounting principles underlying the cash basis. No accountant would think of preparing a profit-and-loss statement on the cash basis and the phrase "income on the cash basis" is in itself a contradiction of terms, since even under that method of income determination a measure of accrual is required in the recognition of inventories, capital expenditures, accounts receivable for sales, accounts payable for purchases and depreciation. Where merchandise is an income-producing factor the only difference between the cash and accrual bases lies in the consideration of accounts receivable and payable at the opening and closing dates for other than merchandise sales or purchases. Only the necessities of the situation require a recognition of the fact that the so-called cash basis is actually used as a method of accounting.

While no quarrel may be had with the board on its general requirement of consistency in the method of accounting adopted, it is by no means clear that the taxpayer is limited to a choice of either the cash or the accrual basis. The board's decisions were made largely under the revenue act of 1918, but viewing the situation as it exists under later revenue acts as well, it would seem that other methods of reporting might be adopted. Consider the following statutory directions (the italics are ours):

(a) The net income shall be computed . . . in accordance with the *method of accounting regularly employed in keeping the books* of the taxpayer (section 212 (b), revenue act of 1926).

(b) *Unless the method so employed does not clearly reflect the income* (same section).

(c) The terms "paid or accrued" and "paid or incurred" shall be construed according to the *method of accounting* employed in determining net income, and

(d) The deductions shall be taken in the year in which paid or accrued, or paid or incurred, dependent upon the method of accounting used in determining net income, *unless in order to clearly reflect the income such deductions* should be taken as of a different period (section 200 (d), revenue act of 1926).

(e) Items of gross income shall be reported when received unless *under the methods of accounting permitted such items are prop-*

perly accounted for in a different period (section 213 (a), revenue act of 1926).

These provisions indicate only two limitations upon the method of net-income determination. The accounting method used on the books must be followed so long as it clearly reflects income. The statute permits not only the cash or accrual bases, but any accounting method which clearly reflects income. It is submitted that the commissioner of internal revenue, in prescribing two methods for the reporting of income on long-term contracts has correctly permitted as a third method any accounting method which clearly reflects the income (article 36 of *Regulations 62*).

A review of the decisions to date shows strikingly that the board has made commendable efforts to determine what are the recognized principles of accounting, and has not hesitated to overrule the commissioner of internal revenue when accounting principles were ignored. Thus, in the appeal of the Goodell-Pratt Co. (3 B. T. A. 30, Nov. 14, 1925), the board held that expenditures for developing patents, etc., which had been charged to expense in prior years by the taxpayer should have been capitalized, and that such expenditure should be restored to surplus account. The commissioner of internal revenue had held that such expenditures fell in a class where the taxpayer had an option to charge to expense or to capitalize, and that once charged either way the option was exercised and became binding. The board said, after reviewing the legal and accounting authorities, that the expenditures were clearly capital; that accounting principles did not permit an option as between two diametrically opposed methods of treatment, and that the expenditures heretofore erroneously charged to expense should be restored to the surplus account. The decision is typical of many efforts made by the board to recognize sound accounting principles.

In other cases, however, accounting principles have not fared so well at the hands of the board. In the case of a paving contractor who received full payment in the year in which a contract was performed, the entire amount received was held to be taxable although the contractor had agreed to keep the paving in repair for a period of years (Uvalde Co.'s appeal, 1 B. T. A. 932). The taxpayer attempted to reserve a part of the income to take care of the expenditures for repairs. No accountant, of course, would consider any proposition other than just such a reservation before stating the net income from the contract. As a practical matter,

however, the accountant would take care of the situation somewhat as follows:

Gross income from contract		$100,000
Cost of performance	$50,000	
Reserved for repairs	5,000	
		55,000
Net income		$45,000

Handling the situation in this way indicates that the item "Reserved for repairs" is a deduction similar to expenses of performance. If the accountant were discriminating he would portray the situation as follows:

Gross income from contract (less unearned portion of $5,000)	$95,000
Expenses of performance	50,000
Net income	$45,000

The board treated the estimated cost for maintenance as in the nature of an expense or expenditure, and since it could not be said to have been paid or incurred in the taxable year no deduction could be allowed. What the board failed to see was that the question was in no sense one of deductibility but rather a question of determining how much of the money received was income. Money received in circumstances imposing upon the recipient a liability to perform certain acts is not income so long as the liability exists. The money is not earned until the services are performed.

If the board were correct in supposing that the reservation for repairs involved a deduction the decision would be sound as a matter of law. As indicated above, the supreme court, in defining income as used in the constitutional amendment, has consistently made a curious distinction between gains, or credits to profit-and-loss account, and losses, or debits to that account. The amendment covers gains or credits only, and congress may apparently do as it pleases in the matter of allowing deductions. Congress may tax a net income without allowing a deduction for depletion (*Von Baumbach, collector* v. *Sargent Land Co.*, 242 U. S. 503) or it may allow depletion as a deduction only up to 5 per cent. of the gross value of the output at the mine (*Stanton* v. *Baltic Mining Co.*, 240 U. S. 103). Following this idea the circuit court of appeals, third circuit, said in *Ludington* v. *McCaughn* (1 Fed. 689):

> "Taxable gain is a constitutional concept denoting income which the taxpayer has derived, while deductible loss is a creation of congress, varying from time to time, as congress deals with it in various ways."

The board, of course, must follow this distinction as a matter of law even though every accountant might disagree with it. To the accountant income is a matter of both gross income and deductions. The board, however, was not obliged to use this judicial interpretation in a situation where it was not applicable.

Where the taxpayer makes payment in cash for benefits to be obtained in future years he is not allowed to deduct such payment at the time made. In Allard & Bro.'s appeal (1 B. T. A. 631), the taxpayer in 1921 paid his rent in advance for 1922 to 1925. His returns were made on a cash basis. The board said that no deduction should be permitted in 1921 because the payment, as far as that year was concerned, was a capital item. The accountant would, of course, agree but he would also insist that the lessor had no income by virtue of the payment, and that the situation of the lessor and that of the paving contractor were identical. The accountant can not consider any money received as income so long as there is a fair probability that further expense must be incurred. This possibility is taken care of by a reservation which, carefully considered, is the segregation of a part of the receipts, and the exclusion of that part from the profit-and-loss account. The board, treating such reservations as claims for deductions, naturally finds no authority therefor.

In another group of cases the board has passed upon the question as to when, upon the accrual basis, a given item of expense becomes deductible. The decisions are somewhat narrow and overly legalistic, in that generally no deduction is allowed until a legal liability has been incurred. A typical decision along this line is that of the appeal of the Guarantee Construction Co. (2 B. T. A. 1145), holding that the federal income tax, under the revenue act of 1918, accrues on March 15th of the following year, when due and payable, and may not be set up as a liability on December 31st of the year to which it is applicable. Accounting principles require a broader viewpoint. While there will always be some doubt as to how far accruals should be made, the accountant goes beyond legal liabilities and accrues all probable expenses or costs. The accountant on December 31st requires:

(1) A showing of all legal liabilities due and payable.

(2) A showing of all legal liabilities though payable at a future date.

(3) A reservation for expenses and losses applicable to the past period which will probably be incurred or experienced. For in-

stance, if the company is legally bound to pay a pension on disability of a workman, provision is made in advance for such liability by charging the periods in which the workman performs services.

While the wording of the statute will not permit a full recognition of the accounting principles involved it is contended that a broader viewpoint could be adopted by the board. The owner of accounts receivable who is bound to allow a discount if a debtor makes payment within a certain time should be allowed a deduction in advance where experience shows that a large percentage of customers will probably take advantage of the discount.

A serious doubt has been cast on the correctness of the board's decision in this type of case by the recent supreme court decision of *United States* v. *The Yale & Towne Mfg. Co.* (decided January 4, 1926). In this case the Yale & Towne Mfg. Co. was, during the year 1916, engaged in the manufacture of munitions. The munitions tax for that year became due and was paid in 1917. The revenue act of 1916 permits a deduction for taxes paid, and the company contended that inasmuch as the munitions tax was not paid during the year and did not become due and payable until 1917, it should be deducted in 1917. The returns were made on the accrual basis, and it was argued that the tax did not accrue until due and payable. The supreme court rejected this legalistic argument and held the tax a deduction in 1916. The court said that the provisions of the statute permitting the returns to be made on the basis on which the books were kept, so long as such basis clearly reflected income, were intended

> ". . . to enable taxpayers to keep their books and make their returns according to scientific accounting principles by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; . . ."

The court said further:

> "The appellee's true income for the year 1916 could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year. The reserve for munitions taxes set up on its books for 1916 must have been deducted from receivables for munitions sold in that year before the net results of the operations for the year could be ascertained."

The narrow and legalistic view that accruals are permissible only when the items of expense become due and payable was definitely rejected in the following passage:

> "In a technical legal sense, it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in ad-

vance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and treasury decision are concerned, the taxes had accrued."

The reasoning of the Guarantee appeal was applied consistently in the appeal of L. S. Ayers & Co. (1 B. T. A. 1135). It was there held that in determining invested capital the surplus at the beginning of the year need not be reduced by dividends paid during the year (outside of dividends paid within the first sixty days) so long as the year's earnings up to the dividend date, without deducting therefrom any portion of the year's income and profits taxes, were large enough to take care of the dividend. Thus, in determining the amount available for payment of a dividend on April 1, 1918, no deduction need be taken from the earnings from January 1, 1918, to April 1, 1918, for the 1918 tax due and payable in 1919. This decision is entirely consistent with the Guarantee Construction Co. appeal, but like that appeal it is seriously questionable under the decision in the Yale and Towne case. The board of tax appeals says, in effect, that the tax for 1918 accrues on March 15, 1919, whereas the supreme court says it accrues in 1918. The question now remains as to what the supreme court would do in the situation presented by the L. S. Ayres appeal.

The court of claims recently had occasion to answer this question in the case of *D'Olier, et al.* v. *United States*, decided March 15, 1926, and it was held that the earnings available to pay a dividend in any year must be reduced by the proportionate part of the year's taxes. The court seemed to consider the question as answered by the Yale and Towne case, and interpreted that case as holding that the taxes accrued during the year rather than on March 15th of the succeeding year, thus arriving at an opinion contrary to that of the board of tax appeals. It is submitted in this relation that the court of claims has overlooked an alternative interpretation of the Yale and Towne case, namely, that the tax in question accrues, not on March 15th of the succeeding year, nor during the year, but rather at December 31st of the year in question. It is only on December 31st of any year that it becomes certain that a tax will have to be paid, since prior to that time a profit may be changed to a loss by subsequent events. On this

basis, the L. S. Ayres case may be approved and reconciled to the Yale and Towne case.

Since the time of these decisions the revenue act of 1926 has been passed with a clause apparently nullifiying the effect of the Guarantee Construction Co. case. This section appears as follows:

> "Sec. 1207. The computation of invested capital for any taxable year under the revenue act of 1917, the revenue act of 1918, and the revenue act of 1921, shall be considered as having been correctly made, so far as relating to the inclusion in invested capital for such year of income, war-profits, or excess-profits taxes for the preceding year, if made in accordance with the regulations in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes for the preceding year."

The regulations referred to required a deduction from surplus as of the beginning of the year for the instalments of income and profits taxes paid, but only from the date of each instalment (article 845 of *Regulations 45* and article 845 of *Regulations 62;* see appeal of Russel Wheel and Foundry Co., docket 2029, decided April 3, 1926).

The board's theory of accruals is again of somewhat doubtful and inconsistent character with relation to deductions for officers' salaries. It is frequently desired to compensate officers in proportion to the results they obtain in the way of profits. As a practical matter, such profits are usually not ascertainable until after the close of the year. Of course, if an officer has an agreement whereby he is to receive a certain percentage of profits, a legal liability exists on the closing day of the year, and no one would dispute the deductibility of such bonus. Wherever the board can find a legal obligation to pay arising within the taxable year, the deduction is allowed even though the amount is determined and entered after the close of the year (appeal of Reub Isaacs and Co., 1 B. T. A. 45). Where no such legal obligation can be found the deduction is not allowed (Jamestown Worsted Mills appeal, 1 B. T. A. 659).

It is submitted that the determination of income depends upon no such requirements of a legal obligation, and that there is ample warrant in the statute for deductions when no legal liability exists. Suppose that officers' salaries (in excess of a normal amount) are determined after the close of the taxable year, without prior agreement, on the basis of profit as shown by the books, and that the amounts so determined are reasonable compensation for the

services rendered. The following might be a typical situation for a series of years:

	1917	1918	1919	1920
Net income before extra compensation........................	$100,000	$250,000	$640,000	$20,000
Additional compensation determined without prior agreement........	40,000	100,000	250,000	None

According to the board's decisions the net income would be determined as follows:

	Net before bonus	Bonus deduction	Taxable income
1917..............................	$100,000	None	$100,000
1918..............................	250,000	$40,000	210,000
1919..............................	640,000	100,000	540,000
1920..............................	20,000	250,000	Loss— 230,000

Obviously such a method results in a ridiculous statement of income, and if ever there was a situation in which the statutory mandate of clearly reflecting the income should be brought into play, this is it. The bonus of $250,000 was intended to be paid from the profits of the year 1919 and should be deducted therefrom. In other words, quite apart from any requisite of a legal obligation, reference should be had to the period to which the expenditure relates and the period which received the benefit of the services for which the payment compensates. According to the Yale and Towne case, the earnings of the period are to be reduced by expenses properly attributable to the process of earning income during the period.

In the matter of inventories, the board has expressed itself as regarding consistency in inventory practice of greater moment than the methods of inclusion and valuation with relation to a specific inventory (Buss Co.'s appeal, 2 B. T. A. 266). In this position the board has correctly determined the accounting significance of the inventory, namely, the correct allocation of income to the various accounting periods. If the tax rates were the same from year to year, there would usually be no difference in the tax payable, whatever the inventories used, since the closing inventory of one year (a credit to profit-and-loss account) becomes the opening inventory of the next year, and a debit to profit-and-loss account. In determining the valuation of inventory items under the rule of cost or market, whichever is lower, the board

has failed to apprehend the accounting problem involved. Every accountant realizes that both market and cost, particularly in the case of goods in process and finished goods, is a matter of estimate. This is equally true of goods which are damaged, deteriorated or obsolete. In many cases proper valuation can be arrived at only by a process of estimating and adding or deducting percentage allowances for various items. In other words, there are no such things as absolute true inventories as required by the board. An intelligent attempt to approximate proper valuations by percentage allowances should be permitted though the board hold otherwise (Kleeman Dry Goods Co.'s appeal, 2 B. T. A. 369). The board's difficulty here seems to arise from a failure to recognize that inventory valuation is at best a matter of judgment and approximation.

In the matter of the general rule for the inclusion of items in the inventory, the board has accepted the title basis established by the commissioner's regulations (article 1611, *Regulations 62*). That is, where a taxpayer has made purchase commitments, and on the closing day of the taxable year finds that the market has declined he is unable to take the loss because he does not have title to the merchandise in question (appeal of Haas Bros., 3 B. T. A. 113). It is difficult to see the precise difference between a taxpayer who has acquired title to merchandise and his fellow taxpayer who is under a contractual obligation to take merchandise where the market has declined. The mere fact that one taxpayer has acquired possession and title would not seem to give him a loss any more than if he had merely a contractual liability to take goods where the market has declined. From the accounting point of view, such a loss is realized and could easily be included in the income-tax return under a modification of the title rule. In this relation it may be pointed out that as a matter of practical convenience the test of possession would be far preferable to that of title. The determination of title often involves numerous complications, whereas possession may easily be determined by anyone (section 100, New York personal property law). As a matter of fact, the title basis can be justified only on the ground that risk of loss, with one or two exceptions, follows title (section 103, same). The proper basis for inventory inclusion, in theory at least, would seem to be that which gives proper effect to risk of loss, including in such risk the risk of decline in market value.

It was in a series of decisions relating to the so-called instalment method of reporting income from sales of personal property and real estate that the board arrived at one of its most startling conclusions. After recognizing this method of accounting in an early case (Franc Furniture Co.'s appeal, 1 B. T. A. 420), the board later held that the method was not warranted by the revenue act of 1918 (appeal of B. M. Todd, 1 B. T. A. 762). In spite of the emphasis placed in that act upon methods of accounting which clearly reflect income, the board held that only two methods were permissible, the cash or the accrual, and inasmuch as the instalment-sales method was neither of the two it could not be used. The decision was followed in the appeal of H. B. Graves Co. (1 B. T. A. 859), and later in the appeal of the Hoover-Bond Co. (1 B. T. A. 929), though not in the latter case without a tremor of remorse for old article 42 of *Regulations 45*. In the appeal of 650 West End Ave. Co. (2 B. T. A. 958), the same bitter treatment was given the instalment method as applied to realty sales.

It seems clear, as pointed out above, that the board is in error in stating that only the cash or the accrual method is permissible in the determination of net income. The act permits any method of accounting which clearly reflects income. The board's decision can be accepted only as the basis of a holding that the instalment-sales method does not clearly reflect income. On this proposition the accountant can not agree with the board. As to sales of personalty, where the taxpayer's business is made up largely of such transactions, the accrual basis may be justly applied in the long run by a liberal allowance for bad debts, based on the taxpayer's experience with instalment-sales agreements which are not carried out. This procedure is not free from difficulties, however, and the board's decision leaves us with the embarrassing question as to how the income shall be determined. The basic theory of income taxation lies in the concept of realized income, so that a small payment on account for a sale to customers of generally doubtful credit does not warrant the reporting of realized income on the transaction. Furthermore, in the case of instalment sales, and particularly sales of real estate, the alternative of the instalment-sales method may, as a matter of law, be the method whereby no profit is taxable until the amounts received exceed the cost of the property sold, by forcing the courts to a strictly cash method of income determination. In *State ex rel. Waldheim & Co.*,

Inc., v. *Wisconsin tax commission* (204 N. W. 481), the court followed the decision of the Todd case, but the dissenting opinion indicates what some courts may decide, namely, that a promise to pay can not give rise to taxable income.

Where a dealer sells a phonograph costing $50 for $100 in cash, there can be no question that a profit of $50 is realized. If the $100 is paid in any other way than in cash, the test of realized income is the fair market value of the property received (section 202 (a) and (b), revenue act of 1918). Where the sale is made upon a so-called open account the obligation of the buyer is treated as the equivalent of cash, and where the credit of the buyer is good, and a deduction is allowed in the form of a reserve for bad debts, the profit may be regarded as realized. In the instalment business, however, the credit of the buyer is often questionable, and it is a matter of extreme doubt whether or not his obligation should be treated as having a fair market value. Approaching the problem from this angle, it may be that no profit is realized until the instalment payments exceed the cost of $50. The board's decisions may result in ultimately giving the taxpayer more than he would get if the instalment-sales method were approved.

Following these decisions, the revenue act of 1926 was passed with a provision designed to negative the effect of the board's decisions. Under section 212 of this act, the instalment dealer is accorded the privilege of reporting his profit as cash is collected. This method is made retroactive by section 1208, which provides as follows:

> "Section 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of the revenue act of 1916, the revenue act of 1917, the revenue act of 1918, the revenue act of 1921 or the revenue act of 1924, or any of such acts as amended. Any tax that has been paid under such acts prior to the enactment of this act, if in excess of the tax imposed by such acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284."

It seems rather regrettable that congress should be called upon to legislate on the detailed procedure of computing income. If the process continues, there will eventually be no need for regulations as such, since the revenue act will include sections covering all details.

As indicated at the outset, this summary, while not exhaustive, indicates a commendable effort on the part of the board to recog-

nize generally accepted accounting principles in the determination of net income. Whatever one's criticism of the decisions may be, it is obvious that the accountant's theories and practices are being considered more carefully than ever before. No one should hesitate to approve this tendency, since the accountant's conservatism lends itself peculiarly well to the measurement of an equitable basis of taxation, namely, ability to pay as shown by realized income. Questions of statutory construction will always arise and must be dealt with fairly, but it requires no great amount of optimism to predict that accounting principles will be given more and more recognition in the administration of income taxation.