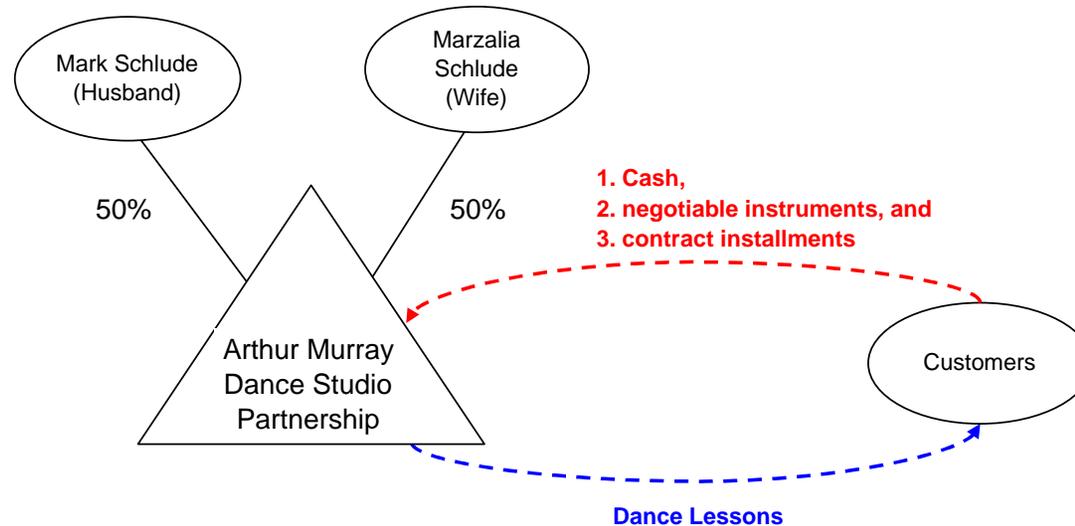


Schlude v. Commissioner
372 U.S. 128 (1963)

Prepaid Dance Lessons

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The facts of Schlude were summarized in *RCA Corporation v. United States*, 664 F2d 881 (2nd Cir. 1981) as follows:

[I]n Schlude . . . the taxpayers, operators of a dance studio, contracted with some of their students to provide a specified number of dancing lessons in exchange for a prepaid fee; the lessons were to be given from time to time, as the student specified, during the contract term. For both tax and book accounting purposes, the taxpayers credited contract prepayments to a deferred income account, and then at the end of each fiscal period credited to current income for that period the fraction of the contract price that represented the fraction of the total number of hours of instruction available under the contract that the student had actually used during the period. In addition, if for more than a year a student failed to request any lessons, the taxpayer treated the contract as cancelled and recognized gain to the extent of the amount of the student's prepayment. Despite the fact that the taxpayer's method of accounting was based largely on its actual performance of services during the taxable year, the court upheld the Commissioner's rejection of the method, viewing the case as "squarely controlled" by AAA . . . because the taxpayer was required to perform services under its contracts only at the student's demand . . .

The Supreme Court summarized its holding in Schlude by stating:

[T]he Commissioner was fully justified in including payments in cash or by negotiable note in gross income for the year in which such payments were received. If these payments are includible in the year of receipt because their allocation to a later year does not clearly reflect income, the contract installments are likewise includible in gross income . . . in the year they become due and payable. For an accrual basis taxpayer "it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income." . . . and here the right to receive these installments had become fixed at least at the time they were due and payable.

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