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SUMMARY OF STATEMENT

OF THE

DIVISION OF TAXATION
(DIVISION 16)
OF THE
DISTRICT OF COLUMBIA BAR

CONCERNING

THE PRESIDENT'S PROPOSAL TO LIMIT THE USE OF THE CASH METHOD OF ACCOUNTING[1/]

Under Chapter 8.03 of the President's Tax Proposals to Congress dated May 29, 1985 ("the President's Proposal"), the following taxpayers would be required to compute their taxable income on the accrual method: (1) business and professional organizations having annual gross receipts (computed on the basis of a three-year moving average) of $5 million or more, and (2) businesses (other than farming businesses) which use the accrual method in preparing reports to owners, creditors or others.

The Division of Taxation of the District of Columbia Bar opposes Chapters 8.03 and 8.04 of the President's Proposal as

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1/ STANDARD DISCLAIMER

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applied to personal-service businesses (and particularly to law firms with which the Division of Taxation is most familiar), because the Division of Taxation believes that such proposal is unsound for the reasons summarized below and discussed in the annexed Statement of the Division.

Contrary to the suggestion in the President's Proposal, the test of the propriety of an accounting method for tax-accounting purposes is whether such accounting method clearly reflects income and not whether it is in accord with generally accepted accounting principles. Accordingly, the fact that the cash method of accounting currently used by the large majority of personal-service businesses may not be in accordance with generally accepted accounting principles is irrelevant in determining whether it is an appropriate method to be used in reporting the income of personal-service businesses. Nor is the proper test for tax-accounting purposes one of which accounting method "most clearly" reflects income. An accounting method need only clearly reflect a taxpayer's income for Federal income tax purposes; it need not reflect such taxpayer's income "more clearly" than any other accounting method. The cash method of accounting clearly reflects the income of the large number of personal-service businesses which use it and is, therefore, an appropriate method of accounting for the income of such businesses for Federal income tax purposes. Even if, as the President's Proposal states, the proper test for tax-accounting purposes is which accounting method most clearly reflects income, the cash method is still preferable for Federal income tax purposes in the case of the large number of personal-service businesses, because it more clearly reflects the income of those businesses than does the accrual method of accounting.

The President's Proposal is inherently inconsistent and unfair in that it fails to take into account issues unique to personal-service businesses, such as the valuation of work-in-process and the adjustment of fees in a taxable year subsequent to billing. It also fails to provide for a reserve for bad debts.

The President's Proposal discriminates against sellers of services vis-a-vis sellers of goods. Sellers of goods reporting their income on the accrual method are permitted to avail themselves of special rules which permit both cash-flow accounting (installment sales) and the consideration of inflation in computing the cost-of-goods sold (LIFO inventory accounting). None of these benefits would be available under the President's Proposal to the personal-service businesses which are slated to be changed to accrual accounting, even though, unlike sellers of goods, personal-service businesses have nothing to show for their efforts prior to the collection of their fees.

The $5 million gross-receipts dividing line unfairly discriminates against successful businesses. The arbitrary limit would create significant problems for cyclical businesses which might exceed the $5 million limit in one year but then fail to reach such limit in succeeding years.

The President's Proposal may well encourage, rather than discourage, the "mismatching" of income and deductions and will engraft complexity on the reporting of income, rather than promote simplicity. Where undue complexity would be engendered by the institution of a new tax-accounting method, the Congress itself has had a policy of ignoring any short-term "mismatching," in favor of simplicity.

Lastly, the Division of Taxation believes that the President's Proposal will subject a significant number of small businesses in the District of Columbia to a one-time penalty tax associated with a change-over from the cash to the accrual accounting method of accounting. The President's Proposal is applicable not only to businesses with gross receipts in excess of $5 million, but also to <u>all</u> businesses which may have used the accrual method for financial reporting. A large number of small businesses use the accrual method in order to secure loans. Thus, those taxpayers who are the least stable financially may be those among the most severely affected by the proposal.

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STATEMENT OF THE DIVISION OF TAXATION (DIVISION 16) OF THE DISTRICT OF COLUMBIA BAR CONCERNING THE PRESIDENT'S PROPOSAL TO LIMIT THE USE OF THE CASH METHOD OF ACCOUNTING[1/]

Under Chapter 8.03 of the President's Tax Proposals to Congress dated May 29, 1985 ("the President's Proposal"), the following taxpayers would be required to compute their taxable income on the accrual method: (1) business and professional organizations having annual gross receipts (computed on the basis of a three-year moving average) of $5 million or more, and (2) businesses (other than farming businesses) which use the accrual method in preparing reports to owners, creditors or others.

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Under the cash method of accounting, income is recognized in the year in which it is actually or constructively received, and expenses are deducted in the year in which they are paid. This is in contrast with the accrual method of accounting which generally requires the inclusion of an item in income or a deduction when all events fixing either the right to receipt or the obligation to pay are fixed and the amount thereof is determined with "reasonable accuracy."[2/]

Under the President's proposal, every business required to convert its method of reporting taxable income to the accrual method of accounting would be required to pay a one-time tax, to be spread over a six-year period, on the balance of its receivables less its accounts payable on the effective date of the change. In the case of businesses operating as partnerships, such a one-time tax would have to be paid by the partners in such partnerships, and not by the partnerships themselves which only file information returns.

2/ A number of special rules have been developed, however, which (i) permit cash-flow tax accounting by accrual-method sellers of goods (e.g., installment sales); (ii) permit sellers of goods to take into account inflation in computing the deduction for cost of goods sold (e.g., LIFO accounting); and (iii) protect the government from the loss of revenues from "premature accruals" (e.g., section 461(h) of the Internal Revenue Code). In addition, both the Internal Revenue Service and the courts have generally required accrual-method taxpayers to report prepaid income on the cash basis. See Section II of our discussion, infra, with respect to the discrimination which is imposed upon cash-basis taxpayers by the President's Proposal when their treatment is compared with that of accrual-basis sellers of goods who will still be permitted to use the installment method in reporting their income.

Chapter 8.04 of the President's Proposal proposes to deny to accrual-basis taxpayers the right to maintain a bad-debt reserve.

The President's Proposal concludes that the industries which would be primarily affected by a mandate to change to the accrual method for tax purposes would be banks that use an accrual basis of accounting for financial reporting and large service organizations, such as accounting, law and advertising firms. Thus, the President's Proposal mistakenly provides an inference that it will affect only a few types of taxpayers. As a matter of fact, the General Explanation of the President's Proposal greatly understates the reach of the provision which would directly affect the entire service sector of the economy, including architects, engineers, contractors, plumbers, electricians, temporary-help services, maintenance services, repair crews, insurance claim adjusters, credit-reporting agencies, television and radio broadcasting stations, health-care providers, doctors, dentists, etc.

The Division of Taxation of the District of Columbia Bar opposes Chapters 8.03 and 8.04 of the President's Proposal as applied to personal-service businesses (and particularly to law firms with which the Division of Taxation is most familiar), because the Division of Taxation believes that such proposal is unsound for the reasons discussed below. The Division of Taxation offers no opinion with respect to the application of the President's Proposal set out in Chapters 8.03 and 8.04 to other forms of service.

I. THE CASH METHOD OF COMPUTING TAXABLE INCOME IS A CLEAR REFLECTION OF THE INCOME OF PERSONAL-SERVICE BUSINESSES.

A. Conformity Of An Acccunting Method To Generally Accepted Accounting Principles Does Not Necessarily Mean That Such Accounting Method Is A Clear Reflection Of Income For Tax Accounting Purposes.

Chapter 8.03 of the President's Proposal concludes that the cash method does not clearly reflect income because "the cash method of accounting is not considered to be in accord with generally accepted accounting principles and therefore is not permissible for financial accounting purposes." In so concluding, the President's Proposal suggests a need for greater conformity between tax and financial accounting. The President's Proposal appears to be premised upon the mistaken assumption that accrual accounting for tax purposes is in accord with (or more in accord with) the economic concepts of income recognition and generally accepted accounting principles than is the cash method. This is not the case, since, as we point out, infra, accrual tax accounting is not necessarily consistent with accrual financial accounting, e.g., the use of the installment method by accrual-basis sellers of goods is not in accord with generally accepted accounting principles. More importantly, however, as we also point out, infra, the Supreme Court has clearly stated that tax and financial accounting have different purposes and employ different characterizations of various items. Thus, the conclusion of the President's Proposal quoted above is incorrect because the key test of whether a method of accounting is acceptable for tax-reporting purposes is whether it clearly

reflects income, and not whether it is necessarily in accord with generally acceptable accounting principles.

Contrary to the position expressed in the President's Proposal, adherence to generally accepted accounting principles does not necessarily mean that an accounting method clearly reflects income for tax purposes. In order for an accounting method to be in accordance with generally accepted accounting principles, it need only fairly present the results of operations; there is no requirement that it clearly reflect income either for tax or for other purposes. Indeed, the Congress itself has implicitly recognized that (i) conformity to the best accounting practice and (ii) a clear reflection of income for tax purposes are two independent and unidentical standards because, in drafting section 471[3/] applicable to inventory accounting, it required that inventory accounting meet both standards. Had the Congress believed that an inventory accounting method which was in conformity with generally accepted accounting principles necessarily was a clear reflection of income for tax purposes, it would have had no need to have imposed in section 471 an obligation that a taxpayer meet both

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3/ All references to "section" are to sections of the Internal Revenue Code of 1954, as amended; all references to "Reg. §" are to the Treasury Regulations on Income Tax promulgated thereunder; all references to "C.B." are to the Cumulative Bulletin which is a consolidation of the Internal Revenue Bulletins published by the Department of the Treasury in carrying out its responsibilities to interpret the Internal Revenue Code enacted by Congress; all references to "acquiesced" are to actions of the Department of the Treasury accepting conclusions reached by the courts in tax disputes.

criteria. Another example of the Congress' recognition that adherence to generally accepted accounting principles does not necessarily clearly reflect income is the fact that our Federal tax law does not recognize all of the reserves required by generally accepted accounting principles.

Indeed, the United States Supreme Court has recognized that adherence to generally accepted accounting principles does not necessarily mean that a taxpayer has clearly reflected its income. In American Automobile Association v. United States, 367 U.S. 687, 693 (1961), the Court stated: "This is only to say that in performing the function of business accounting the method employed by the Association 'is in accord with generally accepted commercial accounting principles and practices.' It is not to hold that for income tax purposes it so clearly reflects income as to be binding on the Treasury." In so holding, the Supreme Court adopted a position urged upon it by the Executive Branch of our Government, namely the Department of the Treasury as represented by the Department of Justice. Later, in Thor Power Tool Co. v. U.S., 439 U.S. 522 (1979), the Court stated that identical methods need not be used for the determination of taxable income and the preparation of financial statements.

Thus, it is altogether fair to state that, until the President's Proposal was sent to the Congress on May 29, 1985, the Executive Branch of our Government was in agreement with the long-standing view of both the Congress and the Judiciary that an accounting method does not have to be in accordance with

generally accepted accounting principles in order to clearly reflect income.

B. The Cash Method of Accounting, As Currently Used by Personal Service Businesses, Clearly Reflects The Income Of Those Businesses.

It is the view of the Division of Taxation of the District of Columbia Bar that the cash method of accounting as currently used by a majority of personal service businesses clearly reflects the income of those businesses, even if the cash method may be determined not to be in accordance with generally accepted accounting principles. Indeed, the cash method historically has been recognized as presumptively correct for service businesses, and numerous court decisions, as well as published and private rulings of the Internal Revenue Service, recognize that, for the service industry, the cash method clearly reflects income.

The cash method is simple and fair in both application and result. It accurately represents a taxpayer's annual disposable income. While the accrual method is often used in accounting for non-personal-service businesses (because accounts receivable and payable are indicators of both a business' current financial condition and its future prospects), nevertheless, accounts receivable and payable, in the context of a personal-service business, are merely indicia of accretion to wealth and not of current spendable income.

That the cash method clearly reflects income is substantiated by the fact that owners of personal-service businesses generally deal with one another on the cash basis,

such as in the case of entry and departure of partners in a partnership. Newly admitted partners generally share in fees collected after their admission, even though the services generating such fees were performed prior to their admission, and withdrawing partners rarely have continuing interests in receivables on hand at their withdrawal dates. Periodic changes in partners' interests in partnerships generally apply only to cash collections following such changes and not to receivables as of the dates of such changes. Moreover, even if such partnerships were placed on the accrual basis, because the partners in such partnerships do not have a right to uncollected amounts, uncollected amounts would not be includable in such partners' income under normal accrual methods of accounting as applied to such partners.

Since, under the President's Proposal, the uncollected fees owed to a partnership as of December 31, 1985 will be taxable to each partner in such partnership over the following six years, regardless of whether such partner performed services generating such fees, the additional taxes will have no relationship to the "earnings" of such partner. Instead of being a tool of simplicity, the President's Proposal, if enacted, may cause confusion by forcing service businesses to change their normal business practices in order to compensate partners for the taxes due on income which such partners did not receive. Thus, a change to the accrual method will actually distort the income of personal-service businesses. In contrast, the cash method has

been the long-accepted method of tax accounting for personal-service businesses because it does not distort taxable income.

The President's Proposal fails to point out any significant abuses on the part of those taxpayers currently using the cash method. Moreover, the Division of Taxation of the District of Columbia Bar knows of no evidence to support a conclusion that a significant number of personal-service businesses artificially defer the receipt of taxable income by originating billings late in the year in order to generate fee payments in the following taxable year. In fact, many personal-service businesses maintain aggressive billing and collection practices. As professional service organizations grow, there is an even greater need to accelerate the collection of income to meet increasing expenses and less of an opportunity to defer the collection of income from a large number of clients. Indeed, the accounts received of large service organizations are generally lower at year end than at any other time during the year. Moreover, to the extent that there may be taxpayers who are presently abusing the cash method, it is altogether possible that there would be an equal number of abusive taxpayers under the accrual method, if it were adopted.

The clear-reflection-of-income argument propounded by the Administration in Chapters 8.03 and 8.04 is inconsistent in itself. On the one hand, the Administration argues in Chapter 8.03 that the accrual method most clearly reflects income, because such method adheres to generally accepted accounting principles. On the other hand, however, the Administration, in

Chapter 8.04, proposes to deny to accrual-basis taxpayers the right to maintain a reserve for bad debts, which reserve is mandated if an accrual method is to operate in accordance with generally accepted accounting principles. The impression created by this inconsistency is that the Administration is not so much interested in a "simplified" method of accounting which clearly reflects taxable income as it is in collecting the most tax dollars. Maximizing tax collection would appear to be masquerading as tax reform.

Moreover, the proposal to deny a bad-debt reserve will, most likely, create controversial factual issues before both the Internal Revenue Service and the courts relating to whether bad-debt losses are actually sustained. If personal-service businesses accounting for their taxable income on the accrual basis are forced to litigate the collection of their claims in order to sustain their bad-debt deductions -- even though statistical proof shows that only a small percentage of billed and uncollected fees are ever collected -- then the Division of Taxation suggests that the bad-debt deduction will become more, rather than less, complicated.

A question of consistency is also presented by the lack of direction in the President's Proposal with respect to the treatment of cash retainers paid in advance of the performance of the services to which such retainers relate. It appears that, under the President's Proposal, fees paid in advance may be fully taxable in the year when paid, absent the applicability of Rev.

Proc. 71-21, 1971-2 C.B. 549, even though proper accrual accounting practice dictates the establishment of a liability to represent the obligation of the payee to perform future services against which such retainers would be applied. Thus, the President's Proposal may produce the anomalous result of the application of the cash method where it will generate the earlier reporting of income than under the accrual method and the application of the accrual method where it will generate the earlier reporting of income than under the cash method. Such a result is hardly consistent with a professed policy of "matching." Once again, maximizing tax collection may be masquerading as reform, and income will not be reflected as clearly as it is currently reflected by personal-service businesses operating under the cash method.

Even though, as we have shown, the cash method clearly reflects the income of personal-service businesses for tax-accounting purposes, the President's Proposal appears to be predicated on the assumption that the income of such personal-service businesses would be more clearly reflected for income tax purposes if such businesses were to use the accrual method of accounting, rather than the cash method. The Internal Revenue Service's previous attempts to force taxpayers to change from one method of accounting which already clearly reflects income to another which the Service feels more clearly reflects income have been consistently rejected. Brown v. Helvering, 291 U.S. 193 (1934); Garth v. Commissioner, 56 T.C. 610 (1971), acq., 1975-1

C.B. 1; Photo-Sonics, Inc. v. Commissioner, 357 F.2d 658 (9th Cir. 1966); Auburn Packing Co. v. Commissioner, 60 T.C. 794 (1973), acq., 1974-2 C.B. 1. Indeed, the Service itself, in explaining its position in acquiescing in the result of Auburn Packing, recognized that it lacks the authority to challenge the consistent use of a method of accounting specifically authorized by the Regulations. Rev. Rul. 74-505, 1974-2 C.B. 154. Accordingly, there is no basis at law for the attempt by the President's Proposal to change the accounting methods used by personal-service businesses, even assuming arguendo that the change proposed by the President would more clearly reflect income for tax-accounting purposes than the cash-method currently used by such personal-service businesses.

Moreover, even if the premise of the President's Proposal were correct -- namely, that the test for tax-accounting purposes is which accounting method most clearly reflects income, and not merely which accounting method clearly reflects income -- under such premise of the President's Proposal, the Proposal itself does not provide for as clear a reflection of the taxable income of personal-service businesses as is currently the case under cash-method, because the Proposal offers no guidance as to the application of the accrual method beyond the statement that "[c]onsideration will also be given to taking into account the billing of clients for services... ." The unanswered question -- which cannot properly be left "hanging" until regulations are issued -- is whether, under the Administration's concept of the

accrual method, service businesses must accrue earned, but unbilled, income at the time that the services generating such income are performed, or whether such businesses need only accrue earned income when they bill their clients. The value of work-in-process is, in the opinion of the Division of Taxation, too contingent to mandate its accrual. The value of work-in-process is undeterminable under the principles of accrual accounting, because the value is generally dependent on such factors as completion of an entire undertaking; the accomplishment of a particular result; the occurrence of a subsequent event which may be beyond the control of the service provider, such as the issuance of a permit or contract; or an adjustment prior to formal billing either by the service provider alone or by the service provider in consultation or negotiation with the client.

By the same token, undue complexities would be entailed under the President's Proposal if, after services were billed by a service provider in one taxable year, a client were to protest, and the service provider were to adjust, the fee or claim it as a bad debt in a subsequent taxable year. If a reserve for bad debts were permitted, such an adjustment would have been taken into account by an experientially based addition to the service provider's bad-debt reserve. But, if no reserve for bad debts is permitted, then how will a service business be permitted to reflect a fee adjustment in a year subsequent to the year of billing in computing its income? Unless a fee adjustment is treated as an ordinary and necessary business expense in a year

subsequent to billing, if service businesses are forced to prove the uncollectability of amounts which they charge off, then the Division of Taxation suggests that such businesses' income will not be clearly reflected for tax purposes, because often a billed fee, although collectible, may be reduced in a subsequent year by a service provider merely in order to avoid discord and preserve goodwill.

In determining what method of accounting most clearly reflects the taxable income of a service business, the President's Proposal fails to take into account the basic difference between manufacturing businesses and personal-service businesses. While it may be appropriate for a manufacturer to accrue income from the sale of a tangible product which may be recovered or resold in the event that such accrued income is not eventually collected, this is not the case with a service business which has nothing tangible to show for its efforts prior to the collection of its fees.

II. THE PRESIDENT'S PROPOSAL DOES NOT PROMOTE FAIRNESS AMONG TAXPAYERS

The President's Proposal discriminates against the sellers of services. Sellers of property who reflect their income on the accrual basis are permitted to elect the installment method of

reporting their income[4/] which ties the recognition of taxable income to the receipt of payments of cash. Thus, sellers of property have been effectively placed on a modified cash method of reporting income. In contrast, there is no provision in the President's Proposal which would permit service businesses to use the installment method. Accordingly, taxpayers will be treated inequitably. An additional provision by the Congress at this point, in order to "right the wrong" by permitting service business to report their income on the installment method, would only increase the complexity of the Internal Revenue Code at the price of a modest change in tax revenues.

While manufacturers of tangible products are often able to defer payments relating to inventory production simultaneously with their accrual of expenses, this is not the case with personal-service businesses which have ongoing expenses for salaries and rent which cannot be deferred. Increased tax obligations resulting from the necessity to accrue uncollected income will place an inequitable burden on personal-service businesses vis-a-vis their manufacturing counterparts.

The ultimate taxpayers affected by such inequitable treatment will be consumers of personal services. Because

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4/ It bears mention that the installment method is not in accord with generally accepted accounting principles even though it has been viewed by the Congress as contributing to the clear reflection of taxable income. This further underscores the difference between the clear-reflection-of-income test for tax-accounting purposes and the depiction of financial condition for financial-accounting purposes.

service businesses will have an increased cash liability for taxes, due to the imposition of the accrual method, there is a strong likelihood that the increased tax cost of doing business will be implicitly reflected in higher base fees and that such service businesses will also be forced to impose late payment fees. Service providers will become no different than department stores and oil companies which distribute credit cards. They will impose a charge on their clients if such clients fail to pay their bills within a reasonable period of time.

The $5 million gross-receipts dividing-line criteria unfairly discriminates against successful businesses. The message will be: If service businesses are too successful and their receipts become too large, they will be forced to compute their taxable income in a less-favorable manner. Such a result goes against the grain of the basic capitalistic tenets of our economy and ensures that business decisions as to size and growth will be influenced by tax considerations, rather than by sound business judgment. Indeed, the Proposal might actually encourage large partnerships to subdivide into smaller partnerships solely in order to avoid the $5 million threshold. Growth will be discouraged. This is precisely the type of decision-making that the President's Proposal was designed to eradicate.

Moreover, the President's Proposal would also create severe problems for taxpayers whose businesses are cyclical. Such taxpayers could be forced to change to the accrual method, because a "spurt" of growth may push them over the $5 million

threshold, and may then be unable to obtain the consent of the Commissioner of Internal Revenue to change back to the cash method, despite their return to their consistently lower level of revenues.

Lastly, the Division of Taxation believes that the President's Proposal will impact severely on those residents and workers in the District of Columbia. Much discussion has centered around the impact of the President's Proposal on large businesses which gross in excess of $5 million annually. The fact is, however, that the President's Proposal will have a deleterious effect not only on law firms but also on many small businesses which currently use the accrual method for financial-accounting, but not for tax, purposes. These small businesses, of which there are many in the District of Columbia, will be overcome by the requirement that they change to accrual accounting, and pay the one-time tax associated with such change-over, merely because they may have used the accrual method to develop financial statements which they have submitted to lenders. Thus, those taxpayers who are the least stable financially may be among those most severely affected by the proposal. This is, in our opinion, altogether unfair.

III. THE ADMINISTRATION'S CONCERN ABOUT THE MISMATCHING OF INCOME AND DEDUCTIONS IS UNREALISTIC

It has been alleged by the Administration that the cash basis of accounting for income used by personal-service businesses promotes the mismatching of income and deductions.

First, in the case of many personal-service businesses, there is no "mismatch" at all because many of the billings for personal services go to clients for whom such fees are not tax-deductible because they are personal or because they may have to be capitalized.

Second, a perfect "mismatch," where the payor and the payee use the same taxable years, is altogether rare. Moreover, to the extent that the President's Proposal will not extend to personal-service businesses which have not used the accrual method or whose gross receipts do not reach the $5 million level, it will do nothing to correct "mismatching" in such instances. This consideration is particularly important in light of the Administration's statement tnat "[t]he proposed restriction on the use of the cash method of accounting would affect only a small percentage of firms."

Third, when the Congress recently examined other tax situations involving the short-term "mismatching" of various items of income and expense, it properly avoided imposing needless complexity. Consider, for example, section 467 (prepaid rent); section 461(h)(3)(A)(ii) (the accrual of expenses for certain recurring items before the commencement of economic performance); and sections 1272-1275 (original issue discount), all of which exempt short-term differences in treatment from mandatory "matching" rules.

Lastly, even if a "mismatching" argument were relevant, the President's Proposal will itself create "mismatching" where it

does not presently exist. If, as the Administration has stated, only a small number of businesses will be affected by the restriction on the use of the cash method, the income of some service businesses will be accelerated, while a larger number of payors will not be eligible for concurrent deductions.

IV. THE PROPOSAL PROMOTES COMPLEXITY, RATHER THAN SIMPLICITY IN TAX REPORTING

The President's Proposal promotes complexity in tax reporting in the following instances.

1. As noted earlier, complexity will evolve in the cases of accounting for bad debts, charge-offs and unbilled fees.

2. The accrual method in itself is more complex than the cash method, as the Proposal itself admits.

3. By forcing one group of service businesses to change to the accrual method as soon as income reaches $5 million, the Proposal will generate constant problems as more businesses have to change their method of accounting year after year from cash to accrual back to cash. As we have pointed out, even further problems will be encountered by businesses which inadvertently become subject to the accrual method due to a series of unusually large and nonrecurring fees. The statute will require extensive attendant regulations defining such terms as the "regular use of financial accrual," work-in-process and other accruable fees.

In conclusion, the position of the Division of Taxation of the District of Columbia Bar is that: (1) the proper test for tax-accounting purposes is the clear-reflection-of-income test,

and not either an adherence-to-generally-accepted-accounting-principles test or a "clearest"-reflection-of-income test; (2) the cash method of accounting currently used by a larger number of personal-service businesses clearly reflects the income of those businesses; (3) even if the clearest-reflection-of-income test were applicable, the cash method more clearly reflects the income of personal-service businesses than does the accrual method; (4) the President's Proposal is inherently inconsistent and unfair; (5) the President's Proposal may promote, rather than correct, "mismatching;" and (6) the President's Proposal may lead to greater complexity, rather than simplicity, in tax reporting.

With respect to personal-service businesses, the cash method is not broke. It ought not to be "fixed" unnecessarily.

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