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The All Events Test in an Era of Self-Regulation

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THE ALL EVENTS TESTS IN AN ERA OF SELF-REGULATION

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ABSTRACT

Accrual-method taxpayers must use the all events tests to account for rights and liabilities under contracts for sales of goods and services. These longstanding tests evolved from transactions that involved relatively straightforward exchanges of goods or services for payments, and the tests currently reflect an expectation that a taxpayer will usually make an accrual when a seller's performance fixes the contracting parties' respective right to and liability for payment. Business practices have changed such that many sales now occur in relationships where contracting parties assume, monitor, and enforce process-related obligations, including adoptions of codes of conduct by members of global supply chains. This Article explains how these efforts to self-regulate transactions complicate applications of the all events tests because the expectations of performance and consequences of noncompliance for credence attributes of goods or services have uncertain effects on the "fixed" nature of payment obligations. In order to avoid these complications, the Article proposes that the all events tests should recognize an implied requirement of acceptance. Under this proposal, a buyer's acceptance of goods or services, rather than the seller's performance, would establish a fixed payment obligation and respect the parties' efforts to regulate aspects of the sale transaction beyond the mere conveyance of the goods or services.

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INTRODUCTION

For decades, accrual-method taxpayers have accounted for sales of goods and services based primarily on their rights to receive payments or liabilities to make payments under contracts.[1] They have relied on tax accounting rules—known as the all events tests—that evolved from the application of accrual methods to discrete transactions, which often called for straightforward exchanges of goods or services for payments.[2] With greater frequency, these transactions now occur in complicated relationships with aspects of private regulation.[3] Because private regulation ordinarily creates obligations to do more than simply tender goods or services in exchange for payment, it becomes challenging to respect the complicated arrangements with meaningful applications of the all events tests.[4]

Private regulation takes many forms. It generally involves the establishment, monitoring, and/or enforcement of standards by private, non-government actors.[5] Private regulation might emerge to address social, environmental, or other concerns when governments have failed to act, private parties wish to forestall government regulation, or companies react to market pressures.[6] For example, trade associations and nongovernmental organizations set many technical standards, promoting uniformity and interchangeability, and regulatory standards, which address social and environmental externalities, for market participants that exceed the requirements of local law.[7] By its private nature, this type of governance allows organizations to develop and implement their

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[1] *See* INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. NO. 538, CAT. NO. 15068G, ACCOUNTING PERIODS AND METHODS 10–12 (2019), https://www.irs.gov/pub/irs-prior/p538--2019.pdf [https://perma.cc/8BWE-UXBY].

[2] *See infra* Part I.

[3] *See infra* Part I.

[4] *See infra* Part I.

[5] *See* Lesley K. McAllister, *Harnessing Private Regulation*, 3 MICH. J. ENV'T. & ADMIN. L. 291, 298–300 (2014).

[6] *See id.* at 293–94; Michael P. Vandenbergh, *The Implications of Private Environmental Governance*, 99 CORNELL L. REV. ONLINE 117, 121 (2014) [hereinafter *Implications*].

[7] *See* McAllister, *supra* note 5, at 301–06 (noting how codes establishing responsible business practices exist for almost every industry and commodity in the global marketplace).

own regulatory standards; however, these organizations lack the coercive power of government to enforce compliance with them.[8]

Considerable private regulation occurs through self-regulation.[9] Individual firms often take steps, such as adopting codes of conduct, to regulate themselves and their suppliers.[10] This self-regulation helps establish important performance expectations of suppliers that frequently exceed the requirements under public laws.[11] For instance, contracts often become vehicles for bringing labor, safety, environmental, and other regulatory regimes into transactions between individual firms and among members of global supply chains.[12] Whereas contracts have traditionally focused on exchanges of products and services, regulatory provisions within contracts now address additional concerns about related processes.[13] Thus, contracts regulate how parties will fulfill their promises.[14] For example, a company might engage a service provider to analyze the company's customer data, and their agreement could require the service provider to abide by the company's data security policy.[15] The agreement fundamentally involves a sale of services, but it also seeks to regulate the service provider's business practices.[16]

Self-regulation also includes efforts to monitor and enforce compliance with the regulatory provisions in supplier contracts.[17] Parties face "incentives to cheat" because compliance can increase operating costs, firms can often easily hide violations, and market demands for changes in conduct might dissipate with the mere adoption of regulatory standards.[18] Therefore, if they really intend to abide by regulatory standards, parties might undertake their

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[8] *See Implications*, *supra* note 6, at 122.

[9] *See* McAllister, *supra* note 5, at 301.

[10] *See id.* at 306–07.

[11] *See id.* at 307; Michael P. Vandenbergh, *Private Environmental Governance*, 99 CORNELL L. REV. 129, 156 (2013) [hereinafter *Private Environmental Governance*].

[12] *See* Fabrizio Cafaggi, *The Regulatory Functions of Transnational Commercial Contracts: New Architectures*, 36 FORDHAM INT'L L.J. 1557, 1563–66 (2013).

[13] *See id.* at 1558–59.

[14] *See, e.g.*, *id.*; William McGeveran, *The Duty of Data Security*, 103 MINN. L. REV. 1135, 1170 (2019).

[15] *See* McGeveran, *supra* note 14, at 1170.

[16] *See id.*

[17] McAllister, *supra* note 5, at 313.

[18] *Id.* at 313–14.

own efforts to assess compliance through monitoring and to correct deviations through enforcement.[19] Self-regulated enforcement might also make use of arbitration procedures to circumvent local courts and local law by resolving disputes through the selection of procedural and substantive rules of the parties' choice.[20] In order to monitor and enforce compliance, the service agreement above might require periodic third-party audits to assure the service provider's compliance with the data security policy, and the parties might establish procedures to address potential security weaknesses.[21]

Self-regulation often occurs in the context of long-term business relationships, including among established participants in global supply chains.[22] Long-term relationships can affect how parties express their expectations in contracts and how closely they follow their contracts in practice.[23] For instance, regulatory provisions might express expectations in broad standards rather than precise rules or terms in order to accommodate unknown future events.[24] For example, the data security policy above might expect *reasonable* precautions against potential risks, which provides some flexibility in safeguarding information.[25] The enforcement of performance expectations might then happen off

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[19] *See id.* at 307–16; *Private Environmental Governance*, *supra* note 11, at 137 ("Much of the enforcement of public and private environmental standards in some countries arises through private inspectors enforcing private certification standards or supply chain contract requirements.").

[20] *See* Li-Wen Lin, *Legal Transplants Through Private Contracting: Codes of Vendor Conduct in Global Supply Chains as an Example*, 57 AM. J. COMP. L. 711, 714 (2009) (noting how international arbitration "show[s] a tendency toward westernization" rather than neutrality for global transactors).

[21] *See* McGeveran, *supra* note 14, at 1187–88.

[22] *See Private Environmental Governance*, *supra* note 11, at 157–58; *see also* David Frydlinger et al., *A New Approach to Contracts*, HARVARD BUS. R. (Sept.–Oct. 2019), https://hbr.org/2019/09/a-new-approach-to-contracts [https://perma.cc/AMY9-PQG4].

[23] *See* Gillian K. Hadfield & Iva Bozovic, *Scaffolding: Using Formal Contracts to Support Informal Relations in Support of Innovation*, 2016 WIS. L. REV. 981, 992–94.

[24] *See id.* (discussing how "businesses looked to industry and relational norms to adapt to contingencies and respond to the behavior of their contracting partners" instead of specific contract language); Ronald J. Gilson et al., *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377, 1390–91 (2010).

[25] *See* McGeveran, *supra* note 14, at 1176–79.

contract in order to preserve relationships—particularly in light of high costs of switching trading partners—which makes parties less likely to pursue formal damage claims when problems arise.[26] Contracting parties might recognize that the prospect of informal sanctions—like a decision to take future business elsewhere or the reputational harm caused by a disclosure of nonconforming performance—can encourage compliance and promote cooperative problem solving in established relationships.[27] Thus, the risk posed to the reputations of both the company and its service provider from a breach of customer data[28] might be enough to compel the parties to fix an identified security issue jointly without having to impose a contractually specified sanction, such as contract termination, for noncompliance.[29]

The all events tests will approach income and expense recognition for transactions subject to self-regulation, like other situations, by accounting for unconditional rights and liabilities.[30] As tests based on rights and liabilities, they must deal with the broadening scope of contractual obligations from the integration of regulatory aspects into commercial transactions and with the formal and informal responses to deviations from those requirements.[31] The tests should acknowledge that compliance with process standards has become an integral part of contractual arrangements whereas the means for achieving any such compliance had previously been externally driven through tort claims by injured parties and administrative actions by governments.[32]

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[26] *See* Hadfield & Bozovic, *supra* note 23, at 992, 994 (explaining how businesses, in non-innovative environments, "routinely faced unplanned-for contingencies and the problem of relational adaptation"; however, "rather than resorting to contractual terms ... these businesses said they made little use of formal contracting, rarely referred to formal contracts in dispute management, and they almost never litigated, or threatened to litigate, to enforce obligations.").

[27] *See* Gilson et al., *supra* note 24, at 1392–94; McAllister, *supra* note 5, at 314; *Private Environmental Governance*, *supra* note 11, at 137 (describing how enforcement of private environmental standards "occurs through shaming, boycotts, private inspections, contract terminations or non-renewals, and preferential purchasing").

[28] *See* McGeveran, *supra* note 14, at 1152–53.

[29] *See id.* at 1158–59.

[30] *See infra* Part I.

[31] *See infra* Part I.

[32] *See* Cafaggi, *supra* note 12, at 1597; Fabrizio Cafaggi, *The Many Features of Transnational Private Rule-Making: Unexplored Relationships Between Custom,*

These regulatory provisions are now commonplace and changing business practices[33] as they impose wide-ranging obligations, such as requiring suppliers to curb deforestation,[34] provide their employees with paid family leave and paid sick and vacation time,[35] or track sources of goods or materials with blockchain.[36] The all events tests must also accommodate noncompliance and any responses to it. Suppliers do not always comply with regulatory provisions, even if audited as part of certification programs, as they employ child labor and strip forests, for example, in violation of their commitments.[37]

This Article considers the application of the all events tests to self-regulated transactions that incorporate regulatory provisions in contracts for the sale of goods or services.[38] Part I exposes problems in applying the all events tests in the context of self-regulation.[39] These problems originate from unresolved

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Jura Mercatorum and Global Private Regulation, 36 U. PA. J. INT'L L. 875, 891 (2015) ("This change is driven by the need for effective regulation across national jurisdictional boundaries when chain leaders outsource activities to suppliers located in different jurisdictions. Private standards are addressed to the [multinational corporation] and its whole supply chain linked via contracts."); *Private Environmental Governance*, *supra* note 11, at 136 ("Many corporations have adopted environmental management systems not because of government requirements but because their supply contracts require them to comply with a private standard.").

[33] *See Implications*, *supra* note 6, at 128 (noting how "supply chain contracting requirements are so widespread and influential that" the policies of large multinational corporations "are becoming the de facto regulatory floor for the use of many toxic chemicals").

[34] *See* Justin Gillis, *Companies Take Baton on Global Warming*, INT'L N.Y. TIMES (Sept. 25, 2014), https://www.nytimes.com/2014/09/24/business/energy-environment/passing-the-baton-in-climate-change-efforts.html [https://perma.cc/KVP9-DB2T].

[35] *See* Lauren Weber, *Microsoft Presses Vendors on Leave*, WALL ST. J., Aug. 31, 2018, at B3.

[36] *See* Michael Corkery & Nathaniel Popper, *From Farm to Blockchain: Walmart Tracks Its Lettuce*, N.Y. TIMES (Sept. 24, 2018), https://www.nytimes.com/2018/09/24/business/walmart-blockchain-lettuce.html [https://perma.cc/YAS2-66FQ].

[37] *See* Peter Whoriskey, *Chocolate Companies Sell 'Certified Cocoa.' But Some of Those Farms Use Child Labor, Harm Forests*, WASH. POST (Oct. 23, 2019), https://www.washingtonpost.com/business/2019/10/23/chocolate-companies-say-their-cocoa-is-certified-some-farms-use-child-labor-thousands-are-protected-forests/ [https://perma.cc/KVP9-DB2T].

[38] *See infra* Part I.

[39] *See infra* Part I.

issues under the all events tests that create uncertainty in many contexts; however, this Part illustrates how self-regulation increases the uncertainty.[40] In particular, Part I discusses how self-regulation interacts with conditions on payment obligations, satisfaction of performance obligations, and certainty about rights and liabilities.[41] This Part also explores how self-regulation influences knowable information and its potential effect on accruals.[42] In response to these problems, Part II proposes that the all events tests recognize an implied requirement of acceptance.[43] This Part explains that, if rights and liabilities were conditioned on acceptance, the all events tests could readily handle conforming and nonconforming performances without ignoring the significance of self-regulation in modern commercial transactions.[44]

I. THE ALL EVENTS TESTS

Two separate tests determine when a taxpayer accrues items of income and expense for tax purposes.[45] One all events test generally requires income recognition when all events have occurred to fix a taxpayer's right to receive the income and its amount is determinable with reasonable accuracy.[46] Subject to economic performance requirements,[47] the other all events test generally permits an expense deduction when all events have

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[40] *See infra* Part I.

[41] *See infra* Part I.

[42] *See infra* Part I.

[43] *See infra* Part II.

[44] *See infra* Part II.

[45] *See* Treas. Reg. §§ 1.446-1(c)(1)(ii)(A), 1.461-1(a)(2)(i).

[46] *See* I.R.C. § 451(b)(1)(C); Treas. Reg. §§ 1.446-1(c)(1)(ii)(A), 1.451-1(a). For certain taxpayers and items of income, the all events test is treated as satisfied no later than when a taxpayer includes income in its financial statement revenue. *See* I.R.C. § 451(b)(1). This earlier-of approach still requires that the taxpayer determine when its right becomes fixed and the amount is determinable with reasonable accuracy in order to identify the earlier occurrence. *See id.*

[47] *See* I.R.C. § 461(h). The economic performance rules generally try to prevent a deduction before a taxpayer economically incurs a liability even if the taxpayer faces an unconditional obligation to pay it. *See* STAFF OF J. COMM. ON TAX'N, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 (Comm. Print 1984). Accordingly, the economic performance rules generally prevent the all events test from being satisfied any earlier than when economic performance occurs. *See* I.R.C. § 461(h)(1).

occurred to fix the taxpayer's liability to pay the expense and its amount is determinable with reasonable accuracy.[48] Each of these two-part tests thus includes a fixed prong and an amount prong.[49] A taxpayer must satisfy both prongs before satisfying a test and accruing an item.[50]

The all events tests would naturally apply to the sale of goods or services in arrangements where contracting parties choose to self-regulate their activities. In fact, the same events would presumably satisfy the fixed prong of each test such that a buyer's unconditional obligation to pay for goods or services should correspond to the seller's unconditional right to receive such payment.[51] Although issues undoubtedly arise in applying the all events tests to any situation, the efforts of contracting parties to self-regulate amplify the challenges of determining when rights and liabilities become fixed and for holding the parties responsible for making that determination.[52]

A. The Absolute Standard for Fixed Rights and Liabilities

The fixed prongs of the all events tests contemplate that taxpayers will only take into account unconditional rights to income and unconditional liabilities to pay.[53] The tests ostensibly impose an absolute standard that rejects accruals based on likely, probable, or expected outcomes.[54] The unconditional standard of

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[48] *See* Treas. Reg. §§ 1.446-1(c)(1)(ii)(A), 1.461-1(a)(2)(i). The all events test determines when a taxpayer may take a liability into account, and the taxpayer might account for the liability as an expense or capital expenditure. *See* Treas. Reg. § 1.446-1(c)(1)(ii)(B). Accordingly, a taxpayer might take into account and capitalize the cost of acquired inventory. *See id.* To improve readability, the following discussions about timing will generically reference deducting an item as an expense even though a taxpayer might account for the liability differently.

[49] *See* Treas. Reg. §§ 1.446-1(c)(1)(ii)(A), 1.461-1(a)(2)(i).

[50] *See id.*

[51] *See* Rev. Rul. 98-39, 1998-2 C.B. 198, 199.

[52] *See infra* Section I.A.

[53] *See* United States v. Hughes Props., Inc., 476 U.S. 593, 600–01 (1986).

[54] *See id.*

> Thus, to satisfy the all-events test, a liability must be "final and definite in amount," *Security Flour Mills Co.* v. *Commissioner*, 321 U.S. 281, 287 (1944), must be "fixed and absolute," *Brown* v. *Helvering*, 291 U.S., at 201, and must be "unconditional," *Lucas* v. *North Texas Lumber Co.*, 281 U.S. 11, 13 (1930). And one may say

the tests had originated when many trading arrangements were more straightforward than the complex contractual and business relationships seen today, such as those in modern global supply chains.[55] As a result, the standard's application has become less certain and less workable as taxpayers operate in increasingly complex environments.[56]

1. Conditional Payment Obligations

Conditions might affect whether a taxpayer has a fixed right or liability for purposes of the all events tests. A condition precedent represents an uncertain event that must occur before a right or liability can become fixed.[57] Conditions precedent might include a third party's approval of a sale or a creditor's submission of a claim form.[58] In contrast, a condition subsequent is an uncertain event that, upon its occurrence, extinguishes a previously fixed right or liability.[59] Thus, a return of goods by a customer

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> that "the tax law requires that a deduction be deferred until 'all the events' have occurred that will make it fixed and certain." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 543 (1979).

Id.

[55] *Cf.* Cathy Hwang & Matthew Jennejohn, *Deal Structure*, 113 NW. U. L. REV. 279, 283 (2018) ("[M]odern contracts are fundamentally different from the relatively simple contracts that motivated classic questions. A growing body of empirical scholarship has noted that modern contracts have grown substantially in complexity. They are longer, tackle more difficult issues, and are harder to read and understand." (footnotes omitted)); Franklin G. Snyder & Ann M. Mirabito, *The Death of Contracts*, 52 DUQ. L. REV. 345, 376–81 (2014) (describing contract law as better suited for the 1850–1950 period, rather than modern times, because it presupposes resolving conflicts only through court systems, often with lay juries, and using rules and principles designed for irregular and informal contracting processes where "[p]arties routinely enter into agreements in careless, sloppy, and idiosyncratic ways, so that it is frequently difficult to tell if they have made a contract and, if so, what it requires").

[56] *See* Glenn Walberg, *Just Enough: Substantial Performance, Ministerial Acts and the All Events Tests for Income and Expense Accruals*, 10 FLA. TAX REV. 459, 460 (2010) [hereinafter *Just Enough*].

[57] *See* Charles Schwab Corp. v. Comm'r, 107 T.C. 282, 293 (1996) (income accrual), *aff'd*, 161 F.3d 1231 (9th Cir. 1998); Mass. Mut. Life Ins. Co. v. United States, 782 F.3d 1354, 1364–65 (Fed. Cir. 2015) (expense accrual).

[58] *See* Rosenthal v. Comm'r, 32 T.C. 225, 229 (1959) (third-party approval); United States v. Gen. Dynamics Corp., 481 U.S. 239, 244–45 (1987) (claim form submissions).

[59] *See Charles Schwab*, 107 T.C. at 293 ("conditions subsequent ... will terminate an existing right to income, but the presence of which does not preclude

might represent a condition subsequent that would eliminate an existing right to income that arose from the sale of those goods to the customer.[60] The all events tests generally defer recognition for a right or liability until the satisfaction of a condition precedent because the final event must have occurred to fix the right or liability.[61] The tests then expect a taxpayer to account for the occurrence of any condition subsequent as a separate transaction that causes the loss of a fixed right or release of a fixed liability.[62]

The all events tests generally rely on a conceptual distinction between conditions precedent and conditions subsequent, and the satisfaction of either type of condition seemingly depends on the occurrence of isolated events.[63] The tests are best suited for a single agreement that clearly identifies the effect of a condition on a payment obligation where an identifiable event either establishes a right or liability (e.g., a third-party approval) or extinguishes a right or liability (e.g., a product return).[64] But taxpayers usually must apply the tests under less straightforward

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accrual of income"); Cooper Cmtys., Inc. v. United States, 678 F. Supp. 1408, 1412 (W.D. Ark. 1987) ("This liability, however, is subject to being cut off by the default of the purchaser .... This type of 'condition' or 'contingency' could more appropriately be termed a condition subsequent acting to divest or terminate payments.").

[60] *See* Newhouse Broad. Corp. v. Comm'r, 80 T.C.M. (CCH) 178 (2000).

[61] *See* Burnham Corp. v. Comm'r, 90 T.C. 953, 956 (1988), *aff'd*, 878 F.2d 86 (2d Cir. 1989).

> If existence of a liability depends on satisfaction of a condition precedent, the liability is not unconditionally fixed as required by the first requirement of the all events test. Liability does not in fact arise until the condition is satisfied. A taxpayer is, therefore, prevented from obtaining the benefit of a deduction for an expense that he has *no* liability to pay until some event, other than the passage of time, occurs. A liability subject to a condition subsequent, however, is definitely fixed, subject only to a condition which may cut off liability in the future. An accrual basis taxpayer having such a liability may deduct an expense for which it is presently liable.

Id. (emphasis in original).

[62] *See* United States v. Hughes Props., Inc., 476 U.S. 593, 606 (1986); J.J. Little & Ives Co. v. Comm'r, 25 T.C.M. (CCH) 372, 392–93 (1966).

[63] *See Charles Schwab*, 107 T.C. at 293.

[64] *See* Rosenthal v. Comm'r, 32 T.C. 225, 228–29 (1959); *see also Charles Schwab*, 107 T.C. at 293–94.

circumstances, especially if they layer self-regulation onto their relationships.[65]

To the extent self-regulation imposes conditions on payment obligations,[66] those conditions might not fit neatly within the condition precedent or condition subsequent schemes.[67] Unlike a clear triggering event that creates or extinguishes a right or liability, a regulatory provision describes expectations about the manner of performance and often lacks an explicit connection to a payment obligation.[68] Payment obligations usually arise under contracts when parties perform as promised, and contracts often do not address the consequences of nonperformance.[69] But the connection between a regulatory provision and payment obligation becomes most apparent in the event of noncompliance.[70] For example, consider a regulatory provision that prohibits a seller of goods from using child labor.[71] A contract would likely state the prohibition and the buyer's obligation to pay for goods without revealing a connection between the prohibition and obligation even though the obligation to pay presumably depends,

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[65] *Cf.* Snyder & Mirabito, *supra* note 55, at 387 (describing modern commerce as differing from the "one-shot, quasi-commercial relationships" of the past, from which contract law developed, where "individuals haggled with shop owners over prices and terms of sale, with idiosyncratic terms relating to payment, warranties, rights of return, and so on").

[66] *See id.* at 372 ("When and how a term in a contract becomes a condition is matter of subtle reasoning ....").

[67] *See Charles Schwab*, 107 T.C. at 293.

[68] *See* Cafaggi, *supra* note 12, at 1568–69.

[69] *See* ZACHARY WOLFE, FARNSWORTH ON CONTRACTS § 7-184 (4th ed. 2019).

> The law ... requir[es] that the parties express their expectations as to performance with considerable definiteness .... But the law does not require the parties to state what their expectations are in the event of breach and other remote contingencies, and such matters are often omitted from the agreement.

Id.

[70] *See, e.g.*, Omri Ben-Shahar & James J. White, *Boilerplate and Economic Power in Auto Manufacturing Contracts*, 104 MICH. L. REV. 953, 965 n.42 (2006) (describing how General Motor's general terms and conditions require suppliers "to refrain from engaging in 'corrupt business practices' such as using child and prisoner labor." (citation omitted)).

[71] *Id.*

as a condition precedent or condition subsequent, on the type of labor used.[72]

The conditional nature of a payment obligation, for tax purposes, might depend on whether a regulatory provision functions as an express warranty or a performance obligation.[73] For example, the seller above could commit to the labor standard with respect to the sale of goods as an express warranty about the quality of the goods.[74] Goods carrying a warranty of being child labor free have a quality that can competitively distinguish them from other goods in the marketplace.[75] The seller could breach that express warranty only if the buyer first accepts the goods,[76] and the buyer's acceptance would establish its obligation to pay the agreed upon contract price for the goods.[77] The buyer could then offset the contract price or seek repayment for damages resulting from the breach of warranty.[78] Therefore, a regulatory provision functioning as an express warranty looks like a condition subsequent for tax purposes because a failure to comply reduces or extinguishes the payment obligation established by acceptance.[79] Acceptance fixes the payment obligation irrespective of the seller's compliance with the regulatory provision; the sale is completed albeit with goods of an inferior quality.[80]

In contrast, compliance with a regulatory provision might become necessary to fix a payment obligation. As a performance obligation, the seller would commit to delivering goods that conform to the regulatory standard.[81] Goods manufactured with child labor

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[72] *See* Burnham Corp. v. Comm'r, 90 T.C., 956 (1988), *aff'd*, 878 F.2d 86 (2d Cir. 1989).

[73] *See* Cafaggi, *supra* note 12, at 1586–88 (describing how regulatory provisions can function as express warranties as opposed to performance obligations).

[74] *See* U.C.C. § 2-313(1)(a) (AM. L. INST. & UNIF. L. COMM'N 2017) (describing how "[a]ny affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.").

[75] *See* Cafaggi, *supra* note 12, at 1586–87.

[76] *See* U.C.C. § 2-714(1); *id.* § 2-714 cmt. 1; Timothy Davis, *UCC Breach of Warranty and Contract Claims: Clarifying the Distinction*, 61 BAYLOR L. REV. 783, 789–91 (2009).

[77] *See* U.C.C. § 2-607(1).

[78] *See* U.C.C. § 2-717.

[79] *See* Davis, *supra* note 76, at 789–90.

[80] *See id.*

[81] *See* Cafaggi, *supra* note 12, at 1586.

differ from goods manufactured without child labor, and the seller could not substitute one for the other in fulfilling its promise.[82] A delivery of unaccepted, nonconforming goods would thus create a breach of contract claim.[83] Because the seller's tendering of nonconforming goods would not fulfill its promised performance, the seller could not hold the buyer to its promises in the contract, and the buyer would have no obligation to pay for the goods.[84] For tax purposes, a regulatory provision functioning as a performance obligation looks like a condition precedent if the seller must deliver conforming goods in order to fix the payment obligation.[85] Therefore, very different tax consequences might arise depending on whether the buyer accepts or rejects goods[86] and whether the contract establishes a regulatory provision as a warranty or performance obligation.[87] Unfortunately, the contract would likely state the prohibition without clarifying its status as an express warranty or performance obligation given that contracts frequently incorporate a variety of regulatory standards, such as a corporate code of conduct, by reference.[88]

Self-regulation also creates ongoing process-related expectations for contracting parties that differ from the isolated events often associated with conditions under the all events tests.[89] Parties

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[82] *Cf.* Margaret Jane Radin, Commentary, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, 104 MICH. L. REV. 1223, 1229–30 (2006) (noting the collapse of any distinction between a physical product and a contract governing its exchange insofar as, from an economic perspective, the contract terms become part of "a unified set of disparate features" of the product).

[83] *See* U.C.C. § 2-711(1); *id.* § 2-711 cmt. 1 ("The remedies listed here are those available to a buyer who has not accepted the goods or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in [U.C.C. § 2-714] dealing with breach in regard to accepted goods.").

[84] *See id.* § 2-711(1); *id.* § 2-607 cmt. 1; Davis, *supra* note 76, at 792–94.

[85] *See* Davis, *supra* note 76, at 794–96.

[86] *See id.*

[87] *See* Cafaggi, *supra* note 12, at 1585–86.

[88] *See id.*; *see generally* U.C.C. § 2-313(2) ("It is not necessary to the creation of an express warranty that the seller use formal words such as 'warrant' or 'guarantee' or that he have a specific intention to make a warranty ....").

[89] *See* Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. LEGAL ANALYSIS 561, 566–68 (2015) [hereinafter *Beyond Relational Contracts*].

might enter into a legally unenforceable long-term supply agreement, for example, to establish an overall framework for a relationship and then create enforceable obligations by executing purchase orders for smaller transactions within that relationship.[90] A buyer's willingness to continue a long-term relationship generally depends on its overall satisfaction with the supplier's performance rather than the supplier's fulfillment of its legal obligations under a specific purchase order.[91] If a long-term supply agreement prohibits any use of child labor at the supplier's facilities even in fulfilling orders from the supplier's other customers, then the buyer would likely expect ongoing compliance by the supplier.[92] But the all events tests might look for a connection between compliance and the payment obligation under a specific purchase order. Whether a condition might depend on compliance before, during, or after performance remains unclear because the purchase order is just part of a complex, long-term relationship.[93]

A long-term relationship could further complicate any conditional relationship between a compliance expectation and a payment obligation.[94] Because a claim of breach often ends a trading relationship, a buyer is less likely to assert a right to monetary damages from a long-term supplier than from a seller in a one-off transaction.[95] Generally, in long-term relationships, a preferred strategy might leave some portion of nonconforming performances unpunished due to the potential for mistakes in attributing deviations to opportunistic behavior and the likelihood of retaliation for imposing undeserved sanctions.[96] More specifically, when regulatory expectations are not met, a buyer is often more concerned about correcting the process than imposing a penalty for noncompliance.[97] As a result, what ostensibly

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[90] *See id.*

[91] *See id.* at 567.

[92] *See id.* at 566.

[93] *See id.*

[94] *See id.* at 570.

[95] *See id.*

[96] *See* Gilson et al., *supra* note 24, at 1395.

[97] *See* Cafaggi, *supra* note 12, at 1611 ("[T]he main objective of remedies [for regulatory noncompliance] is to restore compliance rather than to provide compensation. Cooperative remedies for regulatory non-compliance may therefore also affect the resolution of strictly commercial disputes." (footnote omitted));

looks like a condition on payment in a contract might actually operate as a condition for continued participation in an overall trading relationship.[98] So contracting parties might not allow events, which could otherwise affect entitlements to payments, to actually change payment obligations because the parties prefer to use regulatory provisions to shape and reinforce desirable outcomes in long-term relationships.[99]

2. Performance Under a Contract

Performance plays an outsized role in the administration of the all events tests.[100] A party's performance under a contract often serves as the event that arguably fixes a right or liability.[101] For instance, the Internal Revenue Service (Service)—with some acceptance by the courts[102]—characterizes a right to income as fixed upon the earliest of when required performance occurs, payment becomes due, or payment is made.[103] Similarly, the Service regards a liability as fixed upon the earliest of when an event, such as required performance, occurs to fix the liability or when payment becomes due.[104] Consequently, for purposes of

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Lin, *supra* note 20, at 726 ("Implementation of vendor codes ... does not only have a remedial dimension but a preventative one."); *see also Beyond Relational Contracts*, *supra* note 89, at 583–84.

> The reason for a breach influences [an original equipment manufacturer's] response. Breaches due to one-off manufacturing glitches are largely ignored, unless they are frequent. Breaches due to systematic production problems (even large ones) that the buyer thinks can be remedied are initially met with offers of technical assistance, sometimes at the buyer's expense. And opportunistic breaches or breaches caused by operational difficulties that cannot be remedied are typically met with the harshest responses, including termination for cause.

Id. (footnote omitted).

[98] *See Beyond Relational Contracts*, *supra* note 89, at 584.

[99] *See id.*

[100] *See* Rev. Rul. 74-607, 1974-2 C.B. 149, 150; Rev. Rul. 2007-3, 2007-1 C.B. 350, 351.

[101] *See* Rev. Rul. 74-607, 1974-2 C.B. 150; Rev. Rul. 2007-3, 2007-1 C.B. 351.

[102] *See, e.g.*, Charles Schwab Corp. v. Comm'r, 107 T.C. 282, 292 (1996) ("The taxpayer's right to receive income is fixed upon the earliest of (1) the taxpayer's receipt of payment, (2) the contractual due date, or (3) the taxpayer's performance."), *aff'd*, 161 F.3d 1231 (9th Cir. 1998).

[103] *See, e.g.*, Rev. Rul. 74-607, 1974-2 C.B. 150.

[104] *See, e.g.*, Rev. Rul. 2007-3, 2007-1 C.B. 351.

the all events tests, the performance of contractual obligations fixes many rights to income and liabilities to pay.[105] So taxpayers should presumably anticipate a straightforward application of the all events tests that often fixates on when parties have performed.

Unfortunately, existing authorities and guidance provide little indication about what constitutes performance for purposes of the all events tests.[106] In particular, they do not clarify when "close enough" to contractual promises is sufficient for performance to occur under the tests.[107] This lack of clarity becomes significant for agreements with regulatory provisions because they often task contracting parties with additional responsibilities or subject them to certain limitations, which might redefine performance expectations.[108] For example, as part of a buyer's initiative to become carbon neutral, a regulatory provision might require its supplier to manufacture goods using only electricity from renewable sources.[109] Whether and how this requirement might affect the supplier's performance (and correspondingly, the satisfaction of the all events tests for the buyer and supplier) remains unclear.

A seller can tender goods or services as generally described in a contract without fulfilling all process-related requirements.[110] For example, the supplier above could deliver goods that meet their required physical specifications, even if the supplier used electricity from nonrenewable sources.[111] Whether the supplier has a fixed right to income, and the buyer has a fixed liability to

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[105] *See* Schneer v. Comm'r, 97 T.C. 643, 650 (1991) ("[T]he prerequisite of performance of the services prior to any liability on the part of the obligor is an essential to satisfying the all-events test. The right to receive income cannot become fixed before the obligor has an obligation to pay.").

[106] *See* Snyder & Mirabito, *supra* note 55, at 390–92.

[107] *See id.* at 391–92 (noting how an assumption that parties are satisfied with "close enough" under the substantial performance doctrine of contract law does not fit with "demands [for] absolute, strict adherence to standards" in modern lean production systems and supply chains).

[108] *See Private Environmental Governance*, *supra* note 11, at 156–58.

[109] *See id.* at 156–57 (explaining Wal-Mart's energy efficiency requirements for its suppliers); Verónica H. Villena & Dennis A. Gioia, *A More Sustainable Supply Chain*, HARV. BUS. REV., Mar.–Apr. 2020, https://hbr.org/2020/03/a-more-sustainable-supply-chain [https://perma.cc/2HEY-NWTK].

[110] *See Just Enough*, *supra* note 56, at 460, 470.

[111] *See, e.g.*, Villena & Gioia, *supra* note 109 (confirming that many companies may meet cost, quality, and delivery goals, but not social or environmental standards).

pay might depend on whether the delivery of those nonconforming goods constitutes performance under the all events tests.[112]

The all events tests never specify whether the focus on required performance means the parties must satisfy all contractual obligations in order to fix their respective rights and liabilities.[113] Theoretically, the tests could assess the occurrence of required performance in a manner akin to either the exactness of the perfect tender rule of the Uniform Commercial Code (UCC),[114] the reasonableness of the substantial performance and material breach doctrines of the common law,[115] or the tolerance of a more forgiving

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[112] With respect to the liability to pay, the economic performance rules might regard simply delivering the physical items as sufficient for economic performance to occur. *See* Treas. Reg. § 1.461-4(d)(2)(i) ("[E]conomic performance occurs as the services or property is provided."). Those rules complement the all events test and generally try to prevent a deduction before a taxpayer economically incurs a liability rather than identify the particular events that make the taxpayer liable. *See* STAFF OF J. COMM. ON TAX'N., 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 (Comm. Print 1984). The rules could reasonably meet that objective by postponing a deduction for an otherwise *fixed* future performance obligation until services or property are provided, *see* H.R. REP. NO. 98-861, at 871 (1984) (Conf. Rep.), even if certain other contractual obligations remain unfulfilled at that later date. Consequently, the "as provided" standard of section 461(h) suggests the economic performance rules can accept something less stringent than the required performance expected under the all events tests. *See* Rev. Rul. 74-607, 1974-2 C.B. 150; Rev. Rul. 2007-3, 2007-1 C.B. 350.

[113] *See* Treas. Reg. §§ 1.461-1(a)(2)(i)–(ii).

[114] *See* Midwest Mobile Diagnostic Imaging, L.L.C. v. Dynamics Corp., 965 F. Supp. 1003, 1010–11 (W.D. Mich. 1997) *aff'd*, 165 F.3d 27 (6th Cir. 1998).

> Under § 2-601 [of the Uniform Commercial Code], a buyer has the right to reject, "if the goods or tender of delivery fail in any respect to conform to the contract ...." Known as the "perfect tender" rule, this standard requires a very high level of conformity. Under this rule, the buyer may reject a seller's tender for any trivial defect, whether it be in the quality of the goods, the timing of performance, or the manner of delivery.

Id.; *accord* H.J. Heinz Co. v. Granger, 147 F. Supp. 664, 671 (W.D. Penn. 1956) ("[T]he principle is clear that where the parties to a contract have really made payment dependent upon the happening of some condition, their agreement should not be disregarded for tax purposes.").

[115] *See* RESTATEMENT (SECOND) OF CONTS. § 237 cmt. d (AM. L. INST. 1981) (noting the similarity of asking whether a material failure of performance has occurred or whether substantial performance has occurred); *accord* Levert v. Comm'r, 57 T.C.M. (CCH) 910, 917 (1989).

standard.[116] Without having endorsed a specific approach, applications of the tests indicate a willingness to accept some deviations from contract terms in evaluating whether performance has occurred.[117] Consequently, unless a party asserts that a particular deviation nullifies its liability under an agreement,[118] the all events tests might disregard some degree of noncompliance in finding that a party performed as required.

If a party tenders goods or services but deviates from requirements imposed through self-regulation efforts, then an all events test might justify its disregard for certain unfulfilled contractual obligations by characterizing them as ministerial, procedural, or mechanical acts (collectively 'ministerial acts').[119] For purposes of applying the all events tests, courts and the Service have dismissed the nonperformance of ministerial acts in finding fixed rights and liabilities.[120] Unfortunately, their findings provide little explanation about how tests purporting to demand the occurrence of "all events" can ignore unfulfilled contractual obligations.[121] Occasionally, they instead rationalize that ministerial

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> [P]etitioners did not become unconditionally liable for the full amounts of the contract prices until the contractor completed, at least in substantial part, its duties under the contracts. Until that time, the possibility remained that a "material failure" of performance would excuse petitioners' refusal to pay .... We find that the parties contemplated significant performance by the contractor prior to the time petitioners were required to make full payment of the contract prices.

Id.

[116] *Accord* I.R.S. Field Serv. Adv. 1999-1134 (undated) (describing a disagreement within the Service, in the context of claim submissions for cooperative advertising, about satisfying the all events test through the compliance with all terms of a contract versus through the performance of the designated services in the contract).

[117] *See, e.g.*, Rev. Rul. 2003-10, 2003-1 C.B. 289 (Situation 3) (finding a fixed right to income upon the mistaken shipment of the wrong quantity of goods).

[118] *See* Dixie Pine Prods. Co. v. Comm'r, 320 U.S. 516, 519 (1944) (holding that a taxpayer cannot claim a deduction for a "fixed and certain" liability while simultaneously contesting the fact of its liability).

[119] *Just Enough*, *supra* note 56, at 473.

[120] *See, e.g.*, Exxon Mobil Corp. v. Comm'r, 114 T.C. 293, 314 (2000) ("A liability can be fixed even if there are procedural or ministerial steps that still have to occur before payment."), *aff'd*, 484 F.3d 731 (5th Cir. 2007).

[121] *See Just Enough*, *supra* note 56, at 473–80.

acts deal with minor,[122] insubstantial,[123] or nonessential[124] matters that—unlike the primary[125] or substantial[126] actions contemplated by agreements—cannot prevent the fixing of a right or liability even though they remain unperformed.[127] In essence, courts and the Service often allow the events most directly related to providing goods or services to drive income and expense recognition.[128]

As a result, a taxpayer might have a fixed right to receive or liability to make payment under a contract despite the nonperformance of a ministerial act that the contract expressly designates as a term and condition for payment.[129] Thus, one might expect a ministerial act characterization for a boilerplate, compliance-with-laws

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[122] *See Exxon Mobil*, 114 T.C. at 319 (regarding a lease provision as "ministerial and perfunctory"); Schneider v. Comm'r, 65 T.C. 18, 28 (1975) ("only the ministerial act of computation remained to be done"), *acq*., 1976-2 C.B. 2; I.R.S. Tech. Adv. Mem. 2009-03-079 (Oct. 8, 2008) ("[R]emaining minor or ministerial duties ... do not delay accrual.").

[123] *See* I.R.S. Priv. Ltr. Rul. 81-29-114 (Apr. 27, 1981) ("[m]inisterial functions are not substantial conditions"); I.R.S. Field Serv. Adv. 1992 WL 1354886 (Mar. 14, 1992) ("no substantive contingency remains").

[124] *See* I.R.S. Field Serv. Adv. 2001-04-011 (Oct. 19, 2000) ("The claim filing itself is ministerial, that is, it is not essential to the process of fixing the liability."); I.R.S. Field Serv. Adv. 1993 WL 1468075 (Apr. 30, 1993).

[125] *See* Charles Baloian Co. v. Comm'r, 68 T.C. 620, 627 (1977) (distinguishing an approval, as "simply a ministerial act," from the "primary substantive considerations and decisions"), *nonacq*., 1978-2 C.B. 3; I.R.S. Priv. Ltr. Rul. 81-29-114 (Apr. 27, 1981) ("not substantial conditions").

[126] *See* Hallmark Cards, Inc. v. Comm'r, 90 T.C. 26, 33 (1988) ("Far from being a ministerial act, the passage of title and risk of loss to the buyer constitutes the very heart of the transaction and is the sine qua non to petitioner's right to receive payment."); Challenge Publ'ns, Inc. v. Comm'r, 845 F.2d 1541, 1544 (9th Cir. 1988) (describing a non-ministerial contractual requirement as a "legally significant moment"); Rev. Rul. 2003-3, 2003-1 C.B. 252 (noting how the approvals of tax refunds "involves substantive review"); I.R.S. Chief Couns. Mem. 2013-43-01F (Sept. 18, 2013) ("A ministerial act is one 'performed without the independent exercise of discretion or judgement.'" (quoting BLACK'S LAW DICTIONARY (9th ed. 2009))).

[127] *See* Dally v. Comm'r, 227 F.2d 724, 727 (9th Cir. 1955).

[128] *See Hallmark Cards*, 90 T.C. at 33; I.R.S. Chief Couns. Mem. 2013-43-01F (Sept. 18, 2013).

[129] *See* I.R.S. Tech. Adv. Mem. 2003-10-003 (Oct. 30, 2002) ("Even if the terms of the sales agreement made acceptance of the system a condition precedent to the right to receive income, ... [it] is merely a ministerial act, and is not required to establish Taxpayer's right to the income under the all-events test.").

provision, which requires contracting parties to obey local, state, and federal laws.[130] Such legal compliance might appear of minor importance when compared to providing the goods or services specified by the contract. Accordingly, the all events tests might reasonably treat required performance as occurring when such goods or services are provided even if a party has violated a local noise ordinance, state zoning law, or federal tax regulation.

However, as contracting parties assume responsibility to self-regulate their activities, it becomes more difficult to dismiss their obligations as ministerial acts.[131] Instead of broadly referencing compliance with laws, contracts frequently require compliance with specific laws, industry standards, codes of conduct, quality manuals, and environmental handbooks.[132] In particular, procurement contracts of multinational companies often rely on specific compliance obligations to impose international or home-country laws and standards on members of global supply chains.[133] For example, many buyers require their global suppliers to adhere to environmental requirements, including obligations to reduce emissions and energy usage.[134] Although a buyer might only require its suppliers to comply with their respective local environmental laws, many contractual requirements exceed those of domestic laws and adopt the standards of the buyer's home-country laws or of private standard setters, such as the International Organization for Standardization.[135] Notably, the decision and effort to self-regulate a specific activity or behavior suggests

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[130] *See, e.g.*, Doshi v. Gen. Cable Corp., 386 F. Supp. 3d 815, 829 (E.D. Ky. 2019) ("The vague nature of this sentence and its borderline boilerplate quality" states "compliance ... with federal, state and local laws."); *accord* Morning Star Packing Co. et. al, v. Comm'r, T.C. Memo 2020-142 ("The credit agreements[, with covenants to comply with all laws, do not] specify which laws or regulations must be complied with .... Accordingly, we conclude that the generalized obligations found in the credit agreements do not establish the fact of the partnerships' liability [under the all events test] ....").

[131] *See Implications*, *supra* note 6, at 121, 129–30 (providing examples of how companies are self-regulating).

[132] *See* Lin, *supra* note 20, at 720–22; *Beyond Relational Contracts*, *supra* note 89, at 567–68.

[133] *See* Lin, *supra* note 20, at 715–16.

[134] *See Private Environmental Governance*, *supra* note 11, at 156–57.

[135] *See id.* at 156.

that at least one party finds the obligation important rather than an insubstantial or nonessential ministerial act.[136]

As the terms and conditions of contracts move from general to specific compliance obligations, they start aligning more closely with basic expectations about performance.[137] Multinational companies regard vendor-conduct obligations as valuable tools for satisfying consumer demands about social and environmental aspects of goods and services and for managing costs and risks associated with the threat posed by disreputable behavior within a global supply chain.[138] Thus companies enjoy considerable benefits from marketing items produced, for example, through sustainable processes and prefer to avoid the considerable risks presented by processes that employ sweatshop practices.[139] Moreover, a supply chain's adoption of specific regulatory requirements can help differentiate its products from those of competing supply chains.[140] These benefits suggest that a taxpayer might pursue self-regulation efforts in furtherance of its profit-seeking activities, rather than for purely benevolent reasons.[141] Thus, a specific compliance obligation might be closely tied to a "primary" activity of providing goods or services and potentially inseparable from the performance evaluated under the all events tests.

For example, a taxpayer's contract for the delivery of goods might obligate a supplier to abide by ethical standards, as specified in a code of conduct, for the treatment of its production-line employees.[142] In that situation, the all events test would need to

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[136] *See id*. at 173.

[137] *See, e.g.*, Lin, *supra* note 20, at 717–19 (describing codes of vendor conduct that require certain labor standards to be upheld during production processes).

[138] *See id*. at 717–20.

[139] *See id.* at 718–19.

[140] *See* Cafaggi, *supra* note 12, at 1564.

[141] *See Implications*, *supra* note 6, at 123–25; *see also Private Environmental Governance*, *supra* note 11, at 147 (characterizing standard setting as private environmental guidance "so long as it induces a private entity to achieve a traditionally governmental objective ... or to serve a traditionally governmental function" regardless of the motivation for doing so).

[142] *See* Lin, *supra* note 20, at 717 (noting how code of conduct standards for labor "generally include topics concerning child labor, forced labor, health and safety measures in workplaces, freedom of association and right to collective bargaining, discrimination, working hours, and compensation"); *id.* at 720 (describing frequent references to International Labor Organization Labor

determine whether the taxpayer could have a fixed liability to pay if the supplier delivered goods but violated a standard during production.[143] That determination depends in part on the scope of required performance, which might include perceptions of separate performance obligations (e.g., performance required two activities: the ethical treatment of employees and the delivery of the goods), comprehensive performance obligations (e.g., performance through the delivery of goods could only occur if the goods met both physical specifications and intangible ethical-production attributes), significant relationships between obligations (e.g., nonperformance of the ethical treatment is excused as a ministerial aspect of a primary activity rather than as a freestanding secondary activity), etc. In short, the taxpayer must confront a fundamental question about what constitutes required performance under the all events test even though existing authorities and guidance provides little help in evaluating how integral regulatory provisions are to performance expectations.[144]

Unfortunately, responses to noncompliance might indicate that regulatory provisions have varying connections to performance.[145] For example, a discovery that toxic substances were used by a supplier in the processing of food items, where such use was legal but violated the safety requirements established in codes of conduct or industry standards, might lead a buyer to demand product withdrawals or other corrective actions for delivered items.[146] In that instance, the buyer's response indicates that regulatory compliance was integral to performance.[147] On

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Conventions, the Universal Declaration of Human Rights, and the UN Convention on the Rights of the Child in codes of vendor conduct).

[143] *See* Rev. Rul. 2007-3, 2007-1 C.B. 350 ("[A]ll the events have occurred that establish the fact of the liability when (1) the event fixing the liability, whether that be the required performance or other event, occurs ...."); Villena & Gioia, *supra* note 109 (describing a study that discovered many suppliers in the networks of sustainability leaders supply chains "were violating the standards that the MNCs expected them to adhere to").

[144] *See Just Enough*, *supra* note 56, at 480 ("[T]he anomaly provides little guidance but awkwardly forces taxpayers to decide what contractual requirements, which were important enough to include in the contract, are too insubstantial to take into account in applying the all events tests.").

[145] *See* Cafaggi, *supra* note 12, at 1576–77.

[146] *See id.* at 1596.

[147] *See id.*

the other hand, the supplier could have alternatively violated working conditions standards, such as having employees exceed a maximum number of working hours in a week during the processing of the items. In that event, the buyer would more likely seek process-related changes for future production without insisting that the supplier take corrective actions, like product withdrawals, for the delivered items.[148] The forward-looking response suggests a weaker connection between the regulatory provision and the performance expectations for the delivered items.[149]

Performance could also depend on the extent of regulatory compliance. A contract might incorporate regulatory aspects by requiring a supplier's certification under standards established by a third party.[150] Some certification schemes, like those in the field of food safety, "identify different levels of compliance by using a metric, which correlates the choice of remedies to the seriousness of non-compliance."[151] The varying degrees of compliance identifiable by a certifier stands in contrast to the all-or-nothing approach that a court follows in distinguishing between a material and immaterial breach while assessing performance under a contract.[152] No guidance indicates whether the all events tests would assess performance from a degree-of-compliance or an all-or-nothing approach in identifying fixed rights and liabilities for tax purposes.[153]

Finally, considerations of performance might note that contracting parties sometimes tolerate or make off-contract adjustments for deviations from regulatory obligations.[154] In preserving an ongoing relationship, a party might willingly make these adjustments on certain occasions even if the party were unwilling to commit itself in a contract to make them.[155] The all events tests arguably might find tolerance or adjustments for noncompliance

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[148] *See id.* at 1596–97.

[149] *See id.* at 1596–99.

[150] *See id.* at 1601.

[151] *Id.* at 1607.

[152] *See id.*

[153] *See Just Enough*, *supra* note 56, at 460–61, 471.

[154] *See* Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1808 (1996) [hereinafter *Merchant Law*].

[155] *See id.*

throughout a course of dealings as an indication that nonconforming performance can establish fixed rights and liabilities for tax purposes.[156] However, it is difficult to justify how occasional informal actions, which contradict contract terms, might establish fixed rights and liabilities for this purpose if the parties could only seek enforcement of their actual contractual obligations.[157]

As taxpayers continue to self-regulate the processes employed to produce goods and provide services, the all events tests will need to address how performance occurs under self-imposed regulatory provisions.[158] In some respects, clarification is needed about whether, in finding fixed rights and liabilities, the tests will treat a taxpayer's failure to perform as promised as being equivalent to a taxpayer's fulfillment of its promises.[159] In the

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[156] *See* Rev. Rul. 2003-10, 2003-1 C.B. 290 (questioning how a course of dealings might affect an analysis under the all events test with respect to defective products).

[157] *See* Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1781 (2001) [hereinafter *Cotton Industry*].

> There is suggestive evidence that cotton transactors may view themselves as conducting their everyday interactions according to a set of flexible understandings that requires them to make many adjustments, and ignore minor deviations in ways not required by their contract's written provisions, yet preserves their unfettered right to insist on strict performance of their contract when they think their contracting partner is behaving badly.

Id.; *Merchant Law*, *supra* note 154, at 1800 (explaining how a party might invoke the dispute-resolution terms in a written contract, which were intended for a neutral third party to apply, if the parties cannot preserve their relationship by cooperatively resolving the dispute themselves).

[158] *See* Glenn Walberg, *Constructive Conditions and the All Events Test*, 62 TAX LAW. 433, 438 [hereinafter *Constructive Conditions*] (noting the unclear history behind the due, paid, or earned standard for a taxpayer's fixed right to income).

[159] *Cf.* Snyder & Mirabito, *supra* note 55, at 409.

> A party who wants to be paid even though it has installed the wrong brand of product can protect itself by inserting a clause that says "or equivalent." Parties are free to include clauses that allow them to be paid even though there are defects. If parties choose not to indicate when they will be happy to agree to something less than what was bargained for, it is difficult to see why courts should bail them out ....

Id.

meantime, taxpayers have little guidance about when performance occurs if contracting parties voluntarily regulate their activities.

3. Virtual Certainty About Obligations

The all events tests obsess over certainty in a taxpayer's rights and liabilities irrespective of their legal enforceability.[160] For example, in the context of deductions, the all events test distinguishes certainty about the taxpayer's liability to pay from certainty about whether the taxpayer will make payment.[161] By emphasizing the fact of liability, the all events test prevents a taxpayer from claiming a deduction if doubt exists that the taxpayer will ever become liable.[162] However, if liability is certain, then the test allows a deduction despite questions about whether the taxpayer might ever pay as a result of factors such as unenforceability.[163] The all events test thus seeks to identify an obligation where the fact of liability is certain even if not supported by a legally enforceable claim.[164]

This approach deals with unenforceable obligations that arise in various contexts.[165] For instance, it helps taxpayers account

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[160] *See* TransCalifornia Oil Co. v. Comm'r, 37 B.T.A. 119, 127 (1938) ("The accruability test of a debt is not certainty of payment, but rather certainty of its liability ...."), *nonacq. in part*, 1941-2 C.B. 24.

[161] *See id.*

[162] *See* Mooney Aircraft, Inc. v. United States, 420 F.2d 400, 406 (5th Cir. 1969); S. Pac. Transp. Co. v. Comm'r, 75 T.C. 497, 634 (1980) ("This requirement prevents the deduction of an expenditure that might never be made.").

[163] *See* Helvering v. Russ. Fin. & Constr. Corp., 77 F.2d 324, 327 (2d Cir. 1935) ("The existence of an absolute liability is necessary; absolute certainty that it will be discharged by payment is not.").

[164] *See* Eastman Kodak Co. v. United States, 534 F.2d 252, 257 (Ct. Cl. 1976) (en banc), *acq*., 1996-2 C.B. 1; Champion Spark Plug Co. v. Comm'r, 30 T.C. 295, 298 (1958), *nonacq*., 1958-2 C.B. 9, *aff'd*, 266 F.2d 347 (6th Cir. 1959); Burlington N.R.R. Co. v. Comm'r, 82 T.C. 143, 151 (1984), *acq*., 1996-2 C.B. 1.

[165] *See, e.g.*, Flamingo Resort, Inc. v. United States, 664 F.2d 1387, 1390 (9th Cir. 1982) (finding a fixed right to receive income attributable to gambling markers that, as instruments to advance money for betting, were void under state law); Volvo Cars of N. Am., Inc. v. United States, 80 A.F.T.R.2d (RIA) 6094 (M.D.N.C. 1997) *vacated and remanded on other issues*, 571 F.3d 373 (4th Cir. 2009).

> The court acknowledges that the agreement was unenforceable without the requisite signatures .... The court finds, however, that whether the settlement was legally binding does not necessarily govern whether all events necessary to establish liability had occurred in 1990 such that Volvo could claim the deduction in 1990.

for income and expense items that arise from unenforceable obligations in illegal or invalid agreements.[166] In that context, the all events tests might find a fixed right or liability based upon the occurrence of agreed upon events even though no court would compel a party to perform as promised.[167]

The focus on certainty in rights and liabilities similarly enables the tests to account for unenforceable obligations under valid statutory provisions and lawful agreements.[168] For example, the tests might recognize fixed rights or liabilities that are legally unenforceable because they are not yet payable (i.e., amounts due but not payable).[169] But the tests can also recognize fixed rights and liabilities that are unenforceable because no legal obligation exists yet.[170] Essentially the occurrence of certain events might make a right or liability certain, although those events

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Id.; I.R.S. Chief Couns. Adv. 2002-36-007 (May 23, 2002) (noting how, "in the absence of such executed forms, there must be some act or acts on the part of taxpayer that clearly evidence its intent to fix its tax liability").

[166] *See, e.g.*, *Flamingo Resort*, 664 F.2d at 1390; *Volvo Cars*, 80 A.F.T.R.2d (RIA) 6094; I.R.S. Chief Couns. Adv. 2002-36-007.

[167] *See* I.R.S. Gen. Couns. Mem. 38,536 (Oct. 15, 1980) ("[I]f the parties agree that the obligation will be fixed when an event happens, the obligation will be fixed when the event happens even though it is not legally enforceable.").

[168] *See* Grand Ave. Motor Co. v. United States, 124 F. Supp. 423, 425 (D. Minn. 1954) (noting certainty of liability as the standard of the accruability test of a debt).

[169] *See id.* ("It is also clear that the terms 'fixed' and 'determined', as so used are not synonymous with 'presently payable.'").

[170] *See* Houchin v. Comm'r, 91 T.C.M. (CCH) 1248 (2006).

> Assuming arguendo that delivery is required for a contract to take effect under Colorado law and that delivery did not occur until 1999, the above-mentioned provisions of the settlement agreement cause the effective date of the contract to be in 1998, and therefore the all-events test was satisfied in 1998.

Id.; Mooney Aircraft, Inc. v. United States, 420 F.2d 400, 406 (5th Cir. 1969).

> There is no contingency in this case as to the *fact* of liability itself; the only contingency relates to *when* the liability will arise. To be sure, technically, the [legal] liability is 'created' by the event of the retirement of a particular plane; if a plane lasted forever there would be no liability. But taxation has been called a 'practical field'.... If there is any doubt whether the liability will occur courts have been loath to interfere with the Commissioner's discretion is disallowing a deduction .... But here there is no doubt at all that the liability will occur since airplanes, like human beings, regrettably must cease to function.

Id. (emphasis in original) (citations omitted).

are not sufficient to create a legally recognized right or liability.[171] Therefore, a taxpayer might account for rights and liabilities established for tax purposes before they come into legal existence.[172]

Accounting for unenforceable rights and liabilities presents a challenge, particularly where they exist for tax purposes before they arise under a contract or statute.[173] Whereas legal enforceability evokes a seemingly bright-line standard, questioning the certainty of legally unenforceable rights and liabilities invites an ambiguous search for practical solutions.[174] As explained by the Court of Claims:

> The "all events" test thus allows deductions when the taxpayer has a special kind of knowledge which gives him enough facts to demonstrate the absolute necessity of paying an expense at some future date without regard to such matters as actual payment taking place, existence of legal liability, or accrual.[175]

Essentially, the all events tests occasionally direct taxpayers to account for rights and liabilities about which they are certain but for which they have no legal entitlement or responsibility.[176]

Questions about taxpayer certainty have cropped up most prominently with respect to deducting payroll taxes for earned, but unpaid, compensation.[177] An employer might become unconditionally liable to pay employees for work performed during Year 1.[178] But the employer's responsibility to remit payroll taxes might not legally arise until the employer actually pays the employees in Year 2.[179] Given its fixed liability in Year 1 to pay the employees,

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[171] *See Houchin*, 91 T.C.M. (CCH) 1248 (finding that a settlement agreement's date of effectiveness satisfied the all events test regardless of the legally enforceable delivery date).

[172] *See id.*

[173] *See* Eastman Kodak Co. v. United States, 534 F.2d 252, 273 (Ct. Cl. 1976) (en banc) (Hastie, J., concurring) (criticizing the majority for disregarding statutes and regulations when applying the case to unenforceable liabilities).

[174] *See id.* (noting the difficulty in establishing certainty of tax liability).

[175] *Id.* at 257.

[176] *See id.*

[177] *See id.* at 266 (Skelton, J., dissenting).

[178] *See* I.R.C. § 3102(b) ("Every employer required so to deduct the tax shall be liable for the payment of such tax ....").

[179] *See, e.g.*, I.R.C. § 3111(a) (employer portion of FICA taxes for old age, survivor, and disability insurance (i.e., Social Security taxes)).

the employer might ask whether it also had a fixed liability in Year 1 for the associated payroll taxes. In these situations, courts and eventually the Service have applied the all events test by ignoring the fact that the payroll taxes would only become legally enforceable in Year 2.[180] Instead, they have applied the all events test by looking for certainty at the end of Year 1.[181]

The courts have found that certainty for payroll taxes depends on any wage ceiling (i.e., maximum salary base) used in computing the taxes.[182] The courts reasoned that, if an employee's wages were to exceed the ceiling when payment occurs in Year 2, the employer would have no payroll tax obligation and therefore could not have had a fixed liability for the tax at the end of Year 1.[183] The courts accordingly envisioned that factors, such as conceivable pay raises and unscheduled time off, could affect the employer's future obligation for payroll taxes on earned, but unpaid, compensation.[184] Consequently, for earned bonuses and vacation pay, courts found employers too uncertain in Year 1 about whether wages would exceed the ceilings by the time they disburse delayed bonuses or vacation pay in Year 2; therefore, the courts held that such uncertainty prevented the associated payroll tax liabilities from being fixed in Year 1.[185] In contrast, the courts attributed a payroll tax obligation to an "automatic consequence" of having wages earned in the last days of Year 1 and paid on the first scheduled payday of Year 2 (year-end wages).[186] They found that the virtual certainty of a payroll tax obligation on year-end wages creates a fixed, but legally unenforceable, liability for purposes of the all events test.[187]

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[180] *See, e.g.*, *Eastman Kodak*, 534 F.2d at 257; Rev. Rul. 96-51, 1996-2 C.B. 36, 36–37.

[181] *See Eastman Kodak*, 534 F.2d at 257; Rev. Rul. 96-51, 1996-2 C.B. 36, 36–37.

[182] *See Eastman Kodak*, 534 F.2d at 259 (noting the complicated nature of wage ceilings as a factor of the all events test).

[183] *See id.*

[184] *See id.* at 260.

[185] *See id.*; S. Pac. Transp. Co. v. Comm'r, 75 T.C. 497, 634–35 (1980).

[186] *Eastman Kodak*, 534 F.2d at 259–60.

[187] *See id.* at 260; Burlington N.R.R. Co. v. Comm'r, 82 T.C. 143, 148 (1984), *acq.*, 1996-2 C.B. 1.; Rev. Rul. 96-51, 1996-2 C.B. 36, 36–37.

The willingness to accept virtual certainty, instead of demanding inevitability, presents an administrative challenge.[188] Avoiding a wage ceiling is more probable for the beginning-of-year payments of year-end wages than avoiding the ceiling for the deferred payments of some bonuses and vacation pay.[189] However, the liability for year-end wages at the end of Year 1 only creates a logical expectation rather than an absolute obligation to pay payroll taxes.[190] Nevertheless, courts and eventually the Service found the virtual certainty of the obligation sufficient to satisfy the all events test for payroll taxes on year-end wages.[191] Yet it remains unclear what "special kind of knowledge" a taxpayer must possess to determine the "absolute necessity" of satisfying a legally unenforceable obligation for this purpose.[192]

The vague notion of virtual certainty continues to influence the application of the all events test for payroll taxes.[193] For example, the Service recently suggested a broader scope of virtual certainty by alluding to employers with fixed obligations for payroll taxes attributable to earned bonuses, vacation pay, and forms of compensation other than year-end wages.[194] The Service has

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[188] *See Eastman Kodak*, 534 F.2d at 260–61 (specifying certainty as the determinative factor to the all events test).

[189] *See id.* at 259.

[190] *See id.* at 266–68 (Skelton, J., dissenting) (rejecting a deduction for payroll taxes that remain contingent before the prerequisite event of paying wages occurs).

[191] *See* I.R.S. Field Serv. Advisory, 1994 WL 1725365 (Apr. 15, 1994) (acknowledging the concession due to litigation hazards).

[192] *See* I.R.S. Gen. Couns. Mem. 38,155 (Nov. 7, 1979), *clarified by* Gen. Couns. Mem. 38,536 (Oct. 15, 1980); *cf.* S. Pac. Transp. Co. v. Comm'r, 75 T.C. 497, 636 (1980) ("Regardless of the close relationship between the two items, we have concluded that the contingencies and uncertainties associated with petitioner's estimated liability for the payroll taxes at issue are too great to permit their deduction.").

[193] *See* Rev. Rul. 2007-12, 2007-1 C.B. 685, 686 (noting the troubles of applying the all events test based on past regulation); Rich Godshalk, *Accelerating FICA and FUTA Tax Deductions for Vacation and Bonus Pay*, 39 TAX ADVISER 136, 136 (Mar. 2008) ("Unfortunately [§ 404] does not address the issue of when the all-events test is satisfied with respect to payroll taxes on deferred compensation.").

[194] *See* Rev. Rul. 2007-12, 2007-1 C.B. 685, 686.

> If the all events test ... [is] otherwise met, an accrual basis taxpayer may treat its payroll tax liability as incurred in Year 1, regardless of whether the compensation to which the liability

also recognized that, as a result of factors such as the substantial increases in wage ceilings since the courts initially considered payroll tax liabilities,[195] employers might now have greater certainty about their upcoming payroll tax obligations.[196] For instance, an employer of a low-wage employee could seem virtually certain at the end of Year 1 of its payroll tax liability for earned compensation regardless of whether the employee might receive a modest raise in Year 2 or when the employee might use vested vacation time in Year 2.[197] Consequently, for purposes of the recurring item exception, the Service introduced a safe-harbor method to reduce administrative burdens and controversy by deeming the all events test for a payroll tax liability satisfied in the same year that an employer satisfies the all events test for the related compensation liability.[198]

Outside the context of payroll taxes, it remains unclear how this notion of virtual certainty for legally unenforceable obligations works.[199] Many buyers and sellers, especially those in long-term

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> relates is deferred compensation [(i.e., paid more than 2 ½ months after the end of Year 1)] that is deductible under § 404 in Year 2.

Id. A commentator noted:

> Because Rev. Rul. 2007-12 provides no analysis of the satisfaction of the all-events test for the deduction of the payroll taxes on vacation and bonus pay expense, but merely stipulates that "if" the all-events test is satisfied, it is not clear how the IRS will apply the "payment is certain" criteria in *Eastman Kodak* to current payroll tax wage ceilings. Rev. Rul. 2007-12 revoked Rev. Rul. 69-587, which held that payroll taxes on vacation and bonus pay expenses are not deductible until the tax year the underlying compensation is paid. In light of this, the IRS will presumably allow the deduction of the payroll taxes on vacation and bonus pay expense under certain circumstances for the tax year in which the underlying compensation is earned.

Godshalk, *supra* note 193, at 138.

[195] *Compare* Eastman Kodak Co. v. United States, 534 F.2d 252, 259 (Ct. Cl. 1976) ($4,800 annual FICA wage ceiling in 1965) *with* Press Release, Soc. Sec. Admin., *Social Security Announces 1.6 Percent Benefit Increase for 2020* (Oct. 10, 2019), https://www.ssa.gov/news/press/releases/2019/#10-2019-1 [https://perma.cc/RG9S-J59W] ($137,700 annual FICA wage ceiling in 2020).

[196] *See* Rev. Proc. 2008-25, 2008-1 C.B. 686 § 2.09.

[197] *See id.* § 4.02.

[198] *See id.* § 4.01.

[199] *See Beyond Relational Contracts*, *supra* note 89, at 568–69 (illustrating the nature of long-term contracts).

relationships, presumably operate with the "special kind of knowledge" that provides certainty about the "absolute necessity" of respecting rights and liabilities regardless of legal enforceability.[200] The buyers and sellers develop knowledge from their prior experiences together, industry practices and norms, certifications of operations from third parties, due diligence conducted before entering into supply agreements, etc.[201] The ongoing relationships that provide this special kind of knowledge also influence the contracts that they execute and the manner in which they conduct business.[202] Taxpayers thus need clarification about how certainty from actual business dealings affects accruals under the all events tests.[203]

Buyers and sellers in long-term relationships might know their rights and liabilities relative to performance obligations even if their contracts cannot express expectations in readily enforceable terms. Sometimes contracts in these relationships define performance in general terms, such as "best efforts," rather than stating specific performance obligations because parties are unsure about future operating conditions and appropriate responses to those conditions.[204] Vagueness about certain aspects of a contractual arrangement can provide needed flexibility for dealing with future events.[205] Nevertheless, based on industry

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[200] *See* I.R.S. Gen. Couns. Mem. 38, 155 (Nov. 7, 1979).

[201] *See Beyond Relational Contracts*, *supra* note 89, at 566–67.

[202] *See* Patience A. Crowder, *Impact Transaction: Lawyering for the Public Good Through Collective Impact Agreements*, 49 IND. L. REV. 621, 661 (2016) ("[R]elational contracts have come to be identified by a list of characteristics that include: indefiniteness about duration; informality of language; incompleteness; imprecise performance standards; expectations of the role for social norms and social control; reference to industry standards; and gaps in risk allocation." (footnotes omitted)).

[203] *Cf. Constructive Conditions*, *supra* note 158, at 463 (noting the oversimplistic nature of Revenue Ruling 2007-3 on how to handle certainty).

[204] *See* Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1092–93 (1981); Scott Baker & Albert Choi, *Contract's Role in Relational Contract*, 101 VA. L. REV. 559, 579–80 (2015); Gilson et al., *supra* note 24, at 1391 ("Uncertainty about the future makes specifying most future states—let alone the appropriate action that is to be taken if they occur—prohibitively costly or impossible."); WOLFE, *supra* note 69, § 7-183 ("The parties have failed to reach the illusory goal of the 'perfectly contingent contract' ....").

[205] *See* Stewart Macaulay, *Non-contractual Relations in Business: A Preliminary Study*, 28 AM. SOCIO. REV. 55, 64 (1963) ("Businessmen may welcome a measure of vagueness in the obligations they assume so that they may negotiate matters [during performance] in light of the actual circumstances.").

norms and common experiences, a buyer and seller presumably "can develop a shared and unambiguous understanding of what counts as contract performance, even if they cannot convert their definition of performance into a verifiable contract term enforceable by a court."[206] Thereafter, the parties themselves might need to determine whether performance has occurred under these imprecise requirements[207] because industry insiders, rather than courts or other outsiders, can most easily discern if expectations were met.[208] Even if certain industries or organizations—particularly those operating in environments with rapid innovation—might face considerable challenges in finding mutually agreed upon expectations upfront, the contracting parties in those contexts still likely know whether performance has occurred.[209]

Regulatory provisions in contracts might also rely on the shared understandings of contracting parties to make sense of incomplete contract terms about performance. Because regulatory provisions usually address process-related concerns, they can lack the detail expected, for instance, in the physical specifications for manufactured goods.[210] For example, buyers and sellers might agree to follow sustainability principles, treat animals humanely, or procure materials with ethical practices. The fulfillment of these commitments might be difficult to assess objectively; however, each party might be virtually certain about the expected performance and whether it occurred as promised. It seems necessary to account for such virtual certainty if performance will continue to serve as an event that often fixes rights and liabilities for purposes of the all events tests.

Even if a contract defines performance obligations and consequences of breach in detail, the stated terms might not compel conforming performance or establish the real payment obligations.[211] Studies have observed that, after parties execute contracts, they frequently operate without regard to contractual

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[206] Hadfield & Bozovic, *supra* note 23, at 984; *see* Macaulay, *supra* note 205, at 62 (noting how "usually there is little room for honest misunderstanding or good faith differences of opinion about the nature and quality of a seller's performance").

[207] *See* Goetz & Scott, *supra* note 204, at 1093–94.

[208] Hadfield & Bozovic, *supra* note 23, at 984.

[209] *See id.* at 986.

[210] *See id.*

[211] *See* Macaulay, *supra* note 205, at 61.

terms.[212] As a result, parties likely understand that the real obligations differ from the stated rights and liabilities, which creates questions about whether the all events tests would account for the certain or the enforceable obligations.[213] For example, a buyer and long-term supplier might both realize that the buyer lacks a credible threat to invoke its contractual right to damages for a failure to comply with a regulatory provision because a damages claim would end their relationship.[214] Even with a pattern of nonconforming performance, the buyer might become reluctant to terminate their relationship due to high costs of switching suppliers and risks of developing a reputation among other suppliers as an undesirable trading partner.[215] The buyer's practical situation could, therefore cause it to bear losses from the supplier's noncompliance despite the buyer's contractual entitlement to compensation.[216] The contract might attempt to mitigate this problem by providing the buyer with an explicit right to withhold payment or impose fines for noncompliance.[217] However, the buyer might still decide to invoke this self-regulated remedy only after repeated nonconforming performances in order to avoid developing a heavy-handed reputation among suppliers.[218] In these situations, it is unclear if a buyer and seller should account for the enforceable obligations stated in a contract or the virtually certain fact of liability drawn from their practical experiences.[219]

Regulatory provisions can also increase interactions between buyers and sellers in ways that potentially enhance certainty about rights and liabilities.[220] For example, some original equipment manufacturers use process-related provisions in contracts to increase the likelihood of receiving conforming performance.[221]

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[212] *Id.*; *Merchant Law*, *supra* note 154, at 1787 (describing a documented observation "that the contours of transactors' contracting relationship may not be the same as the scope of the rights and duties memorialized in their written, legally enforceable contract").

[213] *See Merchant Law*, *supra* note 154, at 1787–88.

[214] *See Beyond Relational Contracts*, *supra* note 89, at 569–70.

[215] *See id.* at 570–71.

[216] *See id.* at 570–72.

[217] *See id.* at 571.

[218] *See id.* at 570–71.

[219] *See id.*

[220] *See id.* at 572–76.

[221] *See id.*

These provisions might require the supplier to adhere to certain production or quality standards, allow the manufacturer to oversee the supplier's operations, or grant the manufacturer with certain decision-making authority over the supplier's operations.[222] These process-related provisions are necessary in dealing with suppliers because manufacturers,

> many of whom operate on a just-in-time inventory basis, do not simply contract, wait for delivery, accept or reject, and then sue if cure is not forthcoming. Rather, they interact with their suppliers throughout the production, delivery, and quality assessment process to try and catch problems sooner rather than later and work together to solve problems rather than threatening one another with lawsuits.[223]

The process-related provisions provide a structure that promotes conforming performance as the parties navigate through a seemingly informal and cooperative relationship to achieve these objectives rather than rely on the enforcement of formal contractual obligations.[224] The interactions and cooperation in these relationships undoubtedly influence their certainty about the receipt of expected performances and the absoluteness of entitlements and responsibilities regardless of the formal terms of their agreements.[225]

Existing authorities and guidance have not explained the extent to which virtual certainty establishes fixed rights and liabilities for purposes of the all events tests. Contracting parties undoubtedly understand their dealings in ways that contractual language does not always convey.[226] As process-related provisions increase interactions between parties and their reliance on shared understandings of performance,[227] the all events tests will need to clarify how the parties' virtual certainty about their rights and liabilities affect tax accruals.

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[222] *See id.*

[223] *Id.* at 576.

[224] *See id.*

[225] *See id.* at 578, 588–89.

[226] *See Merchant Law*, *supra* note 154, at 1788 ("If transactors either act or intend to act in ways that differ from their understanding of the express terms of their written contract, their actions are no longer ... an accurate guide to their view of the meaning of their written agreements."); *see also* Hwang & Jennejohn, *supra* note 55, at 287 (noting how standards are easy to draft into a contract but difficult to enforce due to difficulties in interpretation).

[227] *See Beyond Relational Contracts*, *supra* note 89, at 572–76.

B. Known vs. Knowable Information About Regulatory Compliance

The all events tests, which trace their origin to *United States v. Anderson*,[228] identify a fixed and determinable right or liability from events that occur by year-end regardless of whether a taxpayer actually knows that the events occurred.[229] The Court in *Anderson* had required a corporation to compute its taxable income from all expenses accrued on its books because the Code, at that time, had permitted a taxpayer to use an accrual method only if the taxpayer prepared its tax return in the same manner as it kept its books.[230] The presence of book accruals in *Anderson* implied that the corporation knew about the underlying events; however, the strict book-conformity requirement made actual knowledge irrelevant to the Court's holding.[231] But later, as the conformity requirement relaxed,[232] questions about knowledge emerged as taxpayers, the Service, and courts tried to follow *Anderson*'s dictum of accruing items when "all the events ... occur" that satisfy both prongs of the all events tests.[233]

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[228] 269 U.S. 422, 441 (1926); *see* I.R.S. Tech. Adv. Mem. 2010-06-031 (Sept. 30, 2009) (describing *Anderson* as the origin for the all events tests now contained in the regulations); I.R.S. Tech. Adv. Mem. 78-31-003 (Apr. 13, 1978) (describing the regulations as "merely a regulatory paraphrasing of a Supreme Court mandate").

[229] *See* I.R.S. Tech. Adv. Mem. 92-29-007 (Apr. 13, 1992).

[230] *See Anderson*, 269 U.S. at 440–42; *cf.* Niles Bement Pond Co. v. United States, 281 U.S. 357, 360 (1930).

> Under the 1916 Act where the taxpayer's books are kept and his returns made on the accrual basis, taxes charged on the books as they accrue must be deducted when accrued, if true income is thus reflected .... Even if not so charged, it was competent for the Commissioner ... to correct the taxpayer's return by deducting the payments in the year in which they accrued so as to reflect true income by conforming to the dominating or controlling character of the taxpayer's system of accounts.

Id. (citations omitted).

[231] *See Anderson*, 269 U.S. at 439, 441.

[232] *See* STEPHEN F. GERTZMAN, FEDERAL TAX ACCOUNTING ¶ 4.02[3] (2d ed. 1993) (describing how book and tax accounting diverged).

[233] *Anderson*, 269 U.S. at 441. The Court described a proper accrual for a munitions tax expense where, "in advance of the assessment of [the] tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it." *Id.*

Those questions asked what effect a taxpayer's knowledge about the occurrence of relevant events might have in determining the appropriateness of an accrual.[234] Case law responded with a general expectation that taxpayers should base accruals on knowable information.[235] So taxpayers must accrue items arising from knowable, rather than known, events for tax purposes even though the taxpayers' books would not reflect the yet unknown events.[236] A knowable standard has practical appeal because it prevents, for example, a taxpayer from relying on a lack of actual knowledge—"I didn't know and didn't care to ask"—as an excuse for failing to report income.[237] Even so, questions persist about whether the knowable standard applies to one or both prongs of the all events tests.[238]

The knowable standard plainly applies to the amount prongs.[239] In that context, the standard accepts that the ability to determine an amount with reasonable accuracy depends on knowable facts.[240] The concept of reasonable accuracy contemplates

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[234] *See* I.R.S. Tech. Adv. Mem. 78-31-003 (Apr. 13, 1978).

[235] *See id.* (describing judicial developments related to knowable information).

[236] *See* Uncasville Mfg. Co. v. Comm'r, 55 F.2d 893, 895 (2d Cir. 1932).

[237] *See* Camilla Cotton Oil Co. v. Comm'r, 31 T.C. 560, 568 (1958), *acq.*, 1959-2 C.B. 3.

[238] *See* I.R.S. Tech. Adv. Mem. 80-23-008 (Mar. 12, 1980).

[239] *See id.*

[240] *See id.* ("A number of authorities base ascertainability on the facts which the taxpayer knew or could reasonably be expected to know ...."). The Service clearly associated knowable facts with the amount prong while addressing accruals for entitlements arising under a Department of Energy ("DOE") program during an oil crisis. *See id.* The program sought to allocate equitably the benefits of certain price-controlled oil by generally requiring refiners, which purchased a greater portion of price-controlled oil than the national average, to buy entitlements for processing such oil from other refiners, which purchased a lesser portion of price-controlled oil. *See id.* The DOE collected nationwide oil purchase information each month and, approximately two months after the month of the oil purchases, published a notice that named the refiners and specified the dollar amounts of their respective obligations to buy or sell entitlements. *See id.* The Service found that the refiners had fixed rights and liabilities for the entitlements in the month of the oil purchases—even though a particular refiner could not have known if it had a right or liability until the publication of the notice—because the oil purchases, which gave rise to the entitlements, occurred during those months. *See id.* But, the Service found that the amounts were not determinable with reasonable accuracy until the publication of the notice. *See id.* With respect to the amount prong, the Service noted that the calculation of the amount depended on information that was

measuring amounts from facts or with computational methods within a taxpayer's reach even if a different amount would have been determined with the advantage of perfect knowledge.[241] Consequently, where a taxpayer can ascertain an amount from available facts, the taxpayer should do so.[242] In contrast, where a taxpayer could not have known the amount of an otherwise acknowledged right or liability, the knowable standard would reject guesses about its amount and would excuse its nonaccrual.[243] The taxpayer would thereafter account for refinements to the amount of the fixed right or liability by reporting or adjusting its income in future periods as better information becomes available.[244]

Similarly, a taxpayer's actual knowledge of relevant events cannot effect whether a fixed right or liability exists.[245] The fixed prongs of the all events tests focus on the occurrence of events that "fix the right" to income or "establish the fact" of liability.[246] A taxpayer's rights and liabilities exist independently of the taxpayer's actual knowledge about them.[247] Accordingly, the fixed

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knowable only after the DOE published its notice, including the national average for purchases of price-controlled oil. *See id.*; *see also* I.R.S. Gen. Couns. Mem. 38, 287 (Feb. 21, 1980).

[241] *See* Frost Lumber Indus. v. Comm'r, 128 F.2d 693, 696 (5th Cir. 1942) (concluding that an unalterable method of computing a purchase price at $6.25 per acre rendered the gain from the sale of land determinable with reasonable accuracy despite potential uncertainty about the number of acres sold); Comm'r v. Old Dominion S.S. Co., 47 F.2d 148, 150 (2d Cir. 1931) (finding the amount of a conceded liability to pay "just compensation" determinable from past facts and established principles).

[242] *See* Keller-Dorian Corp. v. Comm'r, 153 F.2d 1006, 1007 (2d Cir. 1946) (holding that the correct amount of custom duties for goods were ascertainable in the year when the goods were imported, despite an erroneous initial computation and acceptance of the duties that required eventual reappraisals, because the basis for the computation did not change).

[243] *See, e.g.*, United Dairy Farmers, Inc. v. United States, 107 F. Supp. 2d 937, 948 (S.D. Ohio 2000) (finding that a taxpayer could not determine its liability with reasonable accuracy until a service provider supplied an itemized invoice for services rendered in a prior year), *aff'd on other issues*, 267 F.3d 510 (6th Cir. 2001).

[244] *See* Treas. Reg. §§ 1.451-1(a), 1.461-1(a)(2)(ii).

[245] *See id.* § 1.446-1(c)(1)(ii)(A).

[246] *Id.*

[247] *See* Harrisburg Steel Corp. v. United States, 142 F. Supp. 626, 630 (M.D. Pa. 1956) ("I do not feel that knowledge is a necessary ingredient in the ascertainment of the time of income accrual for tax purposes.").

prongs resemble the amount prongs insofar as neither requires actual knowledge.[248]

For example, the Service has ruled that a taxpayer would improperly accrue income for mistakenly billed service charges if the taxpayer lacked an actual right to receive them.[249] The ruling involved a taxpayer that had unknowingly billed its customer for services provided to a third party as a result of the third party's unsanctioned use of the customer's authorization code (i.e., a form of identity theft).[250] After the customer notified the taxpayer about the potential code abuse, the taxpayer investigated the situation and found that the customer had no liability for the charges.[251] Even though the taxpayer discovered the mistaken charges after it had already reported them as income on a return prepared from information available at year-end, the Service found the original income accrual improper.[252] The Service concluded that the taxpayer never satisfied the all events test because "events ... determine whether a taxpayer has a fixed right ... irrespective of when the taxpayer has actual knowledge of the events fixing the right."[253] Consequently, the Service accepted that unknown events, which at best are knowable only through investigation, control whether a fixed right or liability exists for purposes of the all events tests.[254]

Although disregarding actual knowledge seems unremarkable in evaluating the need for accruals, the extent to which a knowable standard and its implicit limitation apply to the fixed prongs is unclear.[255] By expecting taxpayers to account for knowable information, the knowable standard implicitly recognizes that some unknown information might prove incapable of being known by year-end.[256] To the extent unknowable information rules out an accrual,[257] it matters whether the knowable

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[248] *See* I.R.S. Tech. Adv. Mem. 80-23-008 (1980); Treas. Reg. § 1.446-1(c)(1)(ii)(A).

[249] *See* I.R.S. Tech. Adv. Mem. 92-29-007 (Apr. 13, 1992).

[250] *See id.*

[251] *See id.*

[252] *See id.*

[253] *Id.*

[254] *See id.*

[255] *See* I.R.S. Tech. Adv. Mem. 80-23-008; Treas. Reg. § 1.446-1(c)(1)(ii)(A).

[256] *See id.*

[257] *See* GERTZMAN, *supra* note 232, ¶ 4.03[1][a][ii].

standard applies to determining the amount of a right or liability and in identifying the existence of that right or liability.[258]

The frequent application of a knowable standard to the amount prongs means that limits on knowability can clearly affect the amount of an accrual.[259] Consistent with the annual accounting concept, the knowable standard reflects a long-standing notion that taxable income should account for facts that a taxpayer knew or could reasonably have known at year end.[260] Rather than expecting perfectly informed taxpayers, courts have invoked practical approaches for determining an amount with reasonable accuracy based on data within a taxpayer's possession.[261] Thus taxpayers generally must accrue amounts determinable from the information they actually possess or could obtain with reasonable efforts.[262] In contrast, the standard neither requires nor permits accruals for fixed rights and liabilities of amounts determinable only through unreasonable efforts (i.e., unknowable amounts).[263] For example, the Tax Court found that a contracting party's concealment of relevant information from a taxpayer prevented the amount of income from being knowable at year-end and precluded its accrual.[264]

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[258] *See id.*

[259] *See* Camilla Cotton Oil Co. v. Comm'r, 31 T.C. 560, 568 (1958), *acq.*, 1959-2 C.B. 3.

[260] *See* Balt. Transfer Co. v. Comm'r, 8 T.C. 1, 7 (1947), *acq.*, 1947-2 C.B. 1.

[261] *See, e.g.*, Cont'l Tie & Lumber Co. v. United States, 286 U.S. 290, 296 (1932) (addressing "whether the taxpayer had in its own books and accounts data to which it could apply the calculations required by the statute and ascertain the *quantum* of the award within reasonable limits" (emphasis in original)).

[262] *See* Resale Mobile Homes, Inc. v. Comm'r, 965 F.2d 818, 824 (10th Cir. 1992) (finding an amount of participation interest income determinable with reasonable accuracy from amortization schedules reflecting assumed payments from borrowers despite the fact that the finance company, which owned the commercial paper, had the actual payment information); Schneider v. Comm'r, 65 T.C. 18, 23–24 (1975) (expecting the awareness of a liability to prompt efforts to secure an estimate about its amount from the debtor, which possessed the data needed for the calculation), *acq.*, 1976-2 C.B. 1. *But see* United Dairy Farmers, Inc. v. United States, 107 F. Supp. 2d 937, 948 (S.D. Ohio 2000) (deferring the accrual of a liability until a service provider supplied an invoice showing the amount due for services, which the taxpayer knew were rendered to the taxpayer in a prior year), *aff'd on other issues*, 267 F.3d 510 (6th Cir. 2001).

[263] *See* Camilla Cotton Oil Co. v. Comm'r, 31 T.C. 560, 568 (1958), *acq.*, 1959-2 C.B. 3.

[264] *Id.*

Unfortunately, the potential application of a knowable standard to the fixed prongs remains unclear.[265] Despite occasional references to accounting for rights and liabilities *reasonably certain* in fact,[266] the tests emphasize unconditional rights and obligations that exist because particular events occurred.[267] It remains unclear whether this emphasis on the existence or nonexistence of rights and liabilities[268] might even entertain the idea of basing accruals on what is reasonably knowable to a taxpayer.

For example, the all events tests do not explicitly address how certain a taxpayer must be about the consequences of known events.[269] One might hold taxpayers to a knowable standard that makes them responsible for figuring out the effects of known events.[270] Thus, even if one might expect lengthy court proceedings would be needed to determine that a taxpayer became legally liable as a result of the earlier occurrence of known events,[271] the liability

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> If accrual is not to be required where a taxpayer's books and accounts, through no fault of the taxpayer, fail to supply the data needed to make reasonable calculations, *a fortiori*, accrual is not to be required when the taxpayer has no knowledge of the underlying obligation or debt due him.

Id. The Tax Court drew a comparison to the "usual impossibility of accounting for [an embezzlement] loss in the year of concealment" in employing a practical solution of not requiring an accrual for concealed income. *Id.*

[265] *See infra* notes 266–68 and accompanying text.

[266] *See, e.g.*, C.A. Durr Packing Co. v. Shaughnessy, 81 F. Supp. 33, 35 (N.D.N.Y. 1948).

[267] *See* I.R.S. Tech. Adv. Mem. 78-46-082 (July 21, 1978) ("The fact of the liability is not permitted to be determined using the same reasonable accuracy standard that is permitted in determining the amount of the expense.").

[268] *See* Hallmark Cards, Inc. v. Comm'r, 90 T.C. 26, 34 (1988) ("The all-events test is based on the existence or nonexistence of legal rights or obligations at the close of a particular accounting period, not on the probability—or even absolute certainty—that such right or obligation will arise at some point in the future." (citing United States v. Gen. Dynamics Corp., 481 U.S. 239, 243–44 (1987) and Brown v. Helvering, 291 U.S. 193, 201 (1934))).

[269] *See* United States v. Gen. Dynamics Corp., 481 U.S. 239, 243 (1987).

[270] *Cf.* Uncasville Mfg. Co. v. Comm'r, 55 F.2d 893, 895 (2d Cir. 1932) (finding that a computation may be unknown but that does not mean that it is unknowable).

[271] A bona fide dispute represents a condition precedent to a fixed right or liability and would prevent its accrual. *See* Lucas v. Am. Code Co., 280 U.S. 445, 451–52 (1930). A taxpayer nevertheless might not definitely know about a contractual liability even if the contracting parties never dispute it.

arguably was equally determinable and knowable to the taxpayer as soon as the relevant events occurred.[272] The taxpayer could have known the consequences by "correctly" applying the law.[273] Conversely, one might admit that certainty about a liability—the "fact of the liability" referenced in the regulations[274]—can remain elusive and accept instead that reasonably knowable consequences should determine the satisfaction of the all events tests.[275] Both perspectives have some merit, but no guidance clarifies whether the fixed prongs incorporate a knowable standard that might account for how well a taxpayer appreciates the consequences of known events.

More importantly for purposes of this Article, existing guidance does not adequately address how the potential to know about the occurrence of particular events might affect the satisfaction of the fixed prongs.[276] A taxpayer might understand the consequences of events but could remain uncertain about whether

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[272] *Cf. Uncasville*, 55 F.2d at 895.

> All the facts upon which the calculation [of a state tax, which was deductible on a federal return,] depended had been fixed before the expiration of the year 1918. Differences could arise, and did, as to the amount of the company's income for that year, but they were due to the proper appraisal of its property, and possible disputes as to the meaning of the law. The computation was uncertain, but its basis was unchangeable; it was unknown, not unknowable on December 31, 1918.

Id.; Keller-Dorian Corp. v. Comm'r, 153 F.2d 1006, 1007 (2d Cir. 1946) ("[A] legal error [in applying an unchanged statute to facts] cannot be used by a taxpayer as a basis for saying that he could not have known the correct amount of the [expenses] in the earlier years when they accrued.").

[273] *Cf.* I.R.S. Tech. Adv. Mem. 78-31-003 (Apr. 13, 1978) ("These facts might not be know[n], i.e., a taxpayer improperly computed its profits, but such facts were knowable, i.e., it was possible for the taxpayer to compute its profits correctly.").

[274] Treas. Reg. § 1.461-1(a)(2)(i)(2019).

[275] *See* Balt. Transfer Co. v. Comm'r, 8 T.C. 1, 9 (1947) ("Changes in law and in official interpretation of law, particularly if not reasonably expectable, must ... be regarded as independent operative facts for accounting purposes."), *acq.*, 1947-2 C.B. 1; Comment, *Contested Tax Liabilities and the Annual Accounting Concept—The* Japanese Trading Co. *Application*, 115 U. PA. L. REV. 961, 970 n.56 (1967) (criticizing the knowable approach of *Uncasville* as "unrealistic in assuming that the taxpayer can predict the results of litigation of questions of either fact or law").

[276] *See* United States v. Gen. Dynamics Corp., 481 U.S. 239, 243 (1987) (laying out the all-events test but not addressing how the potential to know about the occurrence of particular events might affect the test).

the events occurred or could assume incorrectly the events occurred. In those situations, should taxpayers determine their rights and liabilities from what they think occurred, what they could have discovered occurred, or what actually occurred regardless of the potential for discovery?

The few rulings in this area show, at times, a surprising tolerance for oblivious taxpayers and at other times, undue confidence in finding omniscient taxpayers.[277] In some instances, rights or liabilities were considered fixed based on taxpayers' perceptions of events regardless of the actual occurrence of events.[278] For example, the Service held that a manufacturer, which mistakenly shipped the wrong mix of products to a customer, had a fixed right to income in the year of shipment.[279] The Service apparently believed that the mistaken shipment satisfied its performance obligation and fixed the manufacturer's right to income.[280] The ability to look at the products and learn about the mistake, which the customer actually discovered in the following year, played no apparent role in determining whether the events occurred to fix the manufacturer's right to income.[281]

But with respect to other taxpayers, the fixed nature of rights or liabilities has seemed to turn on the occurrence of inconspicuous or even unknowable events.[282] Thus, in the ruling

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[277] *See infra* notes 278–81 and accompanying text.

[278] *See, e.g.*, Frost Lumber Indus., Inc. v. Comm'r, 128 F.2d 693, 696 (5th Cir. 1942) (finding a closed sale transaction and fixed right to income, despite the formal acceptance of title in a later year, from the conduct of the parties and noting a title attorney being "practically certain" of good title and the seller having "a reasonable expectancy of payment").

[279] *See* Rev. Rul. 2003-10, 2003-1 C.B. 288, 289.

[280] *See id.* The Service required the manufacturer to recognize income, computed from the incorrect product mix, in the year of shipment. *Id.*

[281] *See id.*; *accord* Celluloid Co. v. Comm'r, 9 B.T.A. 989, 1005–06 (1927) (rejecting a proposed adjustment to accrued income to account for the delivery of defective products, which customers returned after year end, because the taxpayer only had an anticipatory "liability" for the returned items, but not considering whether the taxpayer had a right to receive income from delivering items with known defects), *acq.*, 1928-1 C.B. 6.

[282] *See* I.R.S. Tech. Adv. Mem. 80-23-008 (Mar. 12, 1980). As discussed above, *see* I.R.S., *supra* note 238, the Service found that rights or liabilities to buy or sell entitlements existed under a DOE program in the month during which refiners purchased oil because nothing occurring thereafter could affect the number or price of the entitlements. *See id.* But the Service concluded that information about the rights and liabilities, including whether a particular

described above, the Service found a taxpayer had no right to income for mistaken service charges arising from a third party's unauthorized use of an access code.[283] The Service based its conclusion on the fact that the necessary event—actual usage by the customer—never occurred.[284] Instead of allowing the taxpayer to report billed income in a manner consistent with its understanding of fulfilled performances, the Service expected the taxpayer to discern the event's nonoccurrence even though it had no reason to suspect the unauthorized access prior to the customer's discovery of the mistaken charges.[285]

Yet, on occasion, the Service has departed from these extreme positions and indicated a willingness to determine fixed rights and liabilities from the occurrence of reasonably knowable events.[286] For example, in recent Chief Counsel Advice, the Service focused on unknowable information to conclude that a participant in a shared savings program should not report income in the year it rendered medical services to Medicare beneficiaries.[287] The program generally allows an Accountable Care Organization (ACO) to receive a portion of earned cost savings if it meets quality performance standards and generates sufficient savings while providing medical services.[288] The Service pointed to programmatic factors, including retroactive assignments of Medicare beneficiaries and retrospective determinations of cost benchmarks, which prevent an ACO from having access to knowable facts at year end.[289] Without knowable facts, the Service justifiably concluded that the ACO could not determine the amount of income with reasonable accuracy.[290] But the lack of knowable facts clearly

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refiner was obligated to buy or to sell, was not knowable until two months later when the DOE published the information. *See id.* The Service held that the lack of available information prevented the amount, rather than the existence, of a right or liability from being knowable. *See id.* Accordingly, the Service accepted that rights and liabilities could become fixed before they become knowable. *See id.*

[283] *See supra* text accompanying notes 249–53.

[284] *Id.*

[285] I.R.S. Tech. Adv. Mem. 92-29-007 (Apr. 13, 1992).

[286] *See* I.R.S. Chief Couns. Adv. 2016-07-026 (Feb. 12, 2016).

[287] *See id.*

[288] *See id.*

[289] *See id.*

[290] *See id.*

influenced the Service's approach to the fixed right prong of the all events test too.[291] The Service found that the programmatic factors left the ACO "unable to determine if it will have achieved the necessary savings to participate" in the program's shared savings and accordingly deprived the ACO of a fixed right to income.[292] Thus, rather than emphasize the performance of the services, which established the quality and costs measured by the program, the Service considered only facts knowable at year end to determine whether the events had occurred to fix the taxpayer's right.[293]

The potential thus exists to determine the existence of fixed rights and liabilities under a knowable standard.[294] That approach might reasonably address the practical difficulty of determining the occurrence of some events with certainty.[295] The all events tests would then preclude accruals based on unknowable events, which might require unreasonable efforts to discover. Unfortunately, existing authorities and guidance have inconsistently approached knowable events and have rarely characterized fixed rights and liabilities as being knowable, which makes the applicability of a knowable standard uncertain.[296]

To the extent the fixed prongs of the all events tests rely on a knowable standard, self-regulation efforts might significantly

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[291] *See id.*

[292] *Id.* (highlighting that beneficiary information was "knowable only after" their assignment and that "ACO practitioners may not have knowledge" of all costs). The Service stated that "[t]he amount is not fixed," *id.*, which raises a question about whether the fixed prong might apply to a right to income generally or to a right to a specific amount of income. *Compare* Rev. Rul. 2003-10, 2003-1 C.B. 288, 289 (concluding that a taxpayer could not accrue an improper amount due to a clerical mistake because the taxpayer "[did] not have a fixed right to that amount"), *with* Comm'r v. Terre Haute Elec. Co., 67 F.2d 697, 699 (7th Cir. 1933) (finding a lessor's fixed right to income from the terms of a lease that obligated the lessee to pay income taxes imposed on the lessor even though "[t]he amount of the taxes may be clouded in doubt" by litigation over the amount of the imposed taxes).

[293] *See* I.R.S. Chief Couns. Adv. 2016-07-026 (Feb. 12, 2016).

[294] *See id.*

[295] *Cf.* I.R.S. Tech. Adv. Mem. 78-46-082 (July 21, 1978) (finding no fixed liability where "the taxpayer is not in a position to determine as a fact" its liability to pay costs attributable to covered medical treatment for employees without the filing and examination of appropriate documentation).

[296] *See supra* notes 265–68 and accompanying text.

affect many accruals because those efforts will change the knowable information of taxpayers.[297] Regulatory provisions often impose process-related obligations, which create credence qualities in goods and services.[298] These credence qualities arise from the use of preferred processes, such as following fair labor practices in the manufacturing of goods; however, the qualities often "do not inhere in the goods and cannot be observed in the end product."[299] For example, employees benefiting from a fair wage policy could manufacture goods that are identical to the goods manufactured by employees without such benefit.[300] If a regulatory provision in a supply agreement requires compliance with the fair wage policy, then the buyer might find compliance impossible or exceedingly difficult to assess with respect to delivered goods.[301] Where compliance with the policy represents a condition on the obligation to pay or a performance obligation for purposes of the all events tests,[302] the buyer would normally lack a supportable basis for concluding that the unobservable compliance either did or did not occur.[303] But self-regulation also frequently introduces monitoring aspects, which have the potential to convert previously unknowable information, such as compliance with the fair wage policy, into something knowable.[304]

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[297] *See infra* notes 303–14.

[298] *See* Tracey M. Roberts, *The Rise of Rule Four Institutions: Voluntary Standards, Certification and Labeling Systems*, 40 ECOLOGY L. Q. 107, 123–24 n.78 (2013). For example, fair labor regulations lead to fair labor practices which lead to goods that have been produced with an ethical provenance, a credence quality. *See id.*

[299] *Id.*

[300] *See id.* ("Examples of goods with this type of credence quality include goods that are ... manufactured using fair labor practices.").

[301] *See id.* ("Even where desirable qualities might inhere in the end product, consumers may also be unable to determine whether their preferences are being met because testing for these desirable qualities would be prohibitively expensive.").

[302] *See supra* Sections I.A.1 and I.A.2.

[303] *See* Cafaggi, *supra* note 12, at 1604 (noting that breaches of regulatory provisions are often first discovered during inspections and audits).

[304] *See id.* (explaining how, with commercial contracts, the supplier may be monitored for breaches and, if found, the previously unknown information is communicated to the buyer who can take corrective action).

Monitoring regulatory compliance becomes necessary because having a contract impose process-related obligations is not enough to ensure compliance.[305] Companies might ignore their obligations in the absence of verification and enforcement because the beneficial activities required by many regulatory standards increase the costs of these profit-maximizing companies.[306] For example, numerous multinational buyers have discovered that the actual conduct of their suppliers has deviated greatly from the suppliers' contractual promises to abide by particular codes of conduct.[307] Due to the economic and reputational risks associated with having such conduct exposed publicly, many buyers take measures to verify and enforce compliance within a supply chain in addition to seeking the promises of their suppliers to comply.[308]

In many instances, buyers secure inspection rights in order to verify compliance with regulatory and other standards.[309] The master supply agreements of original equipment manufacturers, for example, "give buyers the right to: inspect the supplier's plant with or without notice, review and audit its quality control systems and quality control reports, and audit its books and/or other records."[310] Regardless of whether performed by a buyer or a third party, an audit of a supply chain provides a confidential mechanism for monitoring conduct proactively and determining appropriate safeguards before unfavorable conduct becomes publicly known.[311]

The audits and other mechanisms used for inspection provide buyers with access to considerable amounts of information.[312] An audit of suppliers, for example, should provide a buyer with information about compliance with regulatory provisions and often will provide information about compliance with

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[305] *See* Lin, *supra* note 20, at 723 (having a contract or code of compliance does not mean compliance is guaranteed).

[306] *See* Graeme Auld et al., *Transnational Private Governance Between the Logics of Empowerment and Control*, 9 REG. & GOVERNANCE 108, 111 (2015).

[307] *See* Lin, *supra* note 20, at 723.

[308] *See id.* at 727.

[309] *See id.* at 726 (noting a preference for verification through auditing).

[310] *Beyond Relational Contracts*, *supra* note 89, at 583 (footnotes omitted).

[311] *See* Lin, *supra* note 20, at 726–27.

[312] *See Beyond Relational Contracts*, *supra* note 89, at 583.

general performance obligations too.[313] Information about events within the supply chain then would become known, as a result of the audit, or could become reasonably knowable, as a result of the inspection right (even if not exercised).[314]

The consequence of having additional information made available to taxpayers through rights of inspection depends on whether the fixed prongs of the all events tests follow a knowable standard.[315] At a minimum, taxpayers presumably could not ignore known information discovered through audits.[316] For example, if an audit reveals noncompliance with regulatory provisions, then the taxpayer should determine a fixed right or liability by accounting for the effect of known noncompliance on any conditions or performance obligations.

Unknown, but knowable, information would cause more problems if fixed rights and liabilities are determined from knowable events. A right of inspection could place a taxpayer in an unenviable position where a supplier's noncompliance was reasonably knowable, but not yet known. Expecting the taxpayer to account for unknown information can seem unrealistic and unfair; however, allowing the taxpayer to account for only known information can create opportunities for abuse and runs counter to the idea that events—rather than knowledge—fix rights and liabilities.[317] As noted above, authorities and guidance have yet to definitively state whether a knowable standard applies to the fixed prongs of the all events tests.[318] Without such clarification, taxpayers have little indication about how to account for the increasing amount of information becoming knowable through the insertion of inspection rights into many regulatory provisions.[319]

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[313] *See* Cafaggi, *supra* note 12, at 1611 ("While the main focus [of monitoring] is on the regulatory compliance, clearly the overall contractual performance is subject to more intense monitoring than the ordinary commercial contract.").

[314] *Cf. Beyond Relational Contracts*, *supra* note 89, at 583; Lin, *supra* note 20, at 727 (audit produced information).

[315] *See supra* notes 265–68 and accompanying text.

[316] *See Beyond Relational Contracts*, *supra* note 89, at 583; Cafaggi, *supra* note 12, at 1611 (addressing information discovered from audits and monitoring).

[317] *See* United States v. Gen. Dynamics Corp., 481 U.S. 239, 243–44 (1987).

[318] *See supra* Section I.B.

[319] *See id.*

II. ACCEPTANCE REQUIREMENTS AS CONDITIONS UNDER THE ALL EVENTS TESTS

The all events tests can and should accommodate self-regulation in sales and other transactions better. The concerns expressed above about conditions, performance, virtual certainty, and knowable information admittedly indicate that someone needs a hobby. But the all events tests should provide a sound basis for tax accruals regardless of the complexity of a transaction. That basis is lacking insofar as the tests emphasize the significance of contractual promises for determining rights and liabilities,[320] but applications of the tests can simultaneously gloss over uncertainty about the fulfillment of those promises.[321] The applications look haphazard in the selection of only certain aspects of complex relationships in determining what events might affect rights and liabilities. Busy practitioners might understandably determine accruals for sales of goods and services by ignoring the requirements of increasingly common regulatory provisions;[322] however, the all events tests should provide a sound basis for such accruals apart from practical needs to file timely returns. This Part explores how the all events tests could regain soundness by recognizing implied acceptance requirements as conditions to rights and liabilities.

A. Acceptance as a Condition

An express requirement for customer acceptance has generally been regarded as an event that must occur before a right or liability can become fixed under the all events tests.[323] For example, the Service has found that a seller lacked a fixed right

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[320] *See, e.g.*, Decision, Inc. v. Comm'r, 47 T.C. 58, 63 (1966) (noting how a taxpayer lacked a fixed right to receive income, after changing terms in its contracts with customers, under the all events test), *acq*., 1967-2 C.B. 2.

[321] *See, e.g.*, Harkins v. Comm'r, 81 T.C.M. (CCH) 1547, 1551 (2001) (finding a fixed right to income, where payments were "earned under the agreement only if the [taxpayer] was in full compliance with the performance requirements," because "[t]here is no evidence in the record indicating that the [taxpayer] did not perform as called for in the agreement"); GERTZMAN, *supra* note 232, ¶ 4.03[1][b] (noting that courts require accruals because "the taxpayer's compliance with its agreement will generally be presumed").

[322] *See* Cafaggi, *supra* note 12, at 1571–72.

[323] *See also infra* note 325 and accompanying text.

to amounts billed by the seller—but withheld by a buyer—for delivered goods where such amounts were not payable under their contract until the buyer accepted the goods.[324] Required acceptance, which completes a sale, thus can function as a condition precedent to a fixed right or liability.[325]

Yet the Service has minimized the significance of express acceptance in certain severable service contracts.[326] The Service had examined a corporation's milestone-based contracts that obligated the federal government to make individual milestone payments only after the government inspected and accepted each completed severable service.[327] Despite recognizing acceptance as a condition precedent to each payment (i.e., a condition to an amount becoming due), the Service noted how the corporation completed the milestone services and earned the corresponding portions of its income before the government accepted the completed work.[328] Under the Service's formulaic approach of identifying a fixed right to income upon the earliest of it being due, paid, or earned,[329] the Service found that the rights to income were fixed when earned through the completion of each severable, but unaccepted, performance obligation in the contacts.[330]

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[324] *See* Rev. Rul. 69-314, 1969-1 C.B. 139; *accord* Rev. Proc. 2019-43, 2019-48 I.R.B. 1107 § 16.09 (listing, among the methods eligible for automatic consent, a change in the treatment of retainages to a method consistent with the holding of Revenue Ruling 69-314 with respect to receivables or payables).

[325] *See, e.g.*, Ringmaster, Inc. v. Comm'r, 1962 T.C.M. (P-H) ¶ 62-187, at 1134 ("A sale contract which makes acceptance of the subject matter dependent upon inspection or testing by the purchaser creates such a condition precedent and prevents accrual of the purchase price by the seller until such tests and inspections have been made."), *dismissed per curiam*, 319 F.2d 860 (8th Cir. 1963); Webb Press Co., v. Comm'r, 3 B.T.A. 247, 253 (1925) (finding the completion of a sale contingent on the purchaser's testing and acceptance of a good), *acq*., 1927-1 C.B. 6; Priv. Let. Rul. 2003-10-003 (Mar. 7, 2003); *cf.* Priv. Let. Rul. 98-23-003 (Feb. 18, 1998) (finding no fixed right to income until customers choose to purchase acceptable goods under the taxpayer's policy that creates no obligation to purchase a finished good "with which the customer is not completely satisfied").

[326] *See* Tech. Adv. Mem. 2009-03-079 (Jan. 16, 2009).

[327] *See id.*

[328] *See id.*

[329] *See supra* note 103 and accompanying text.

[330] *See* Tech. Adv. Mem. 2009-03-079 (Jan. 16, 2009).

This approach toward milestones is generally troubling for all taxpayers and especially problematic in the context of self-regulated relationships.[331] It is troubling because the Service found an unconditional right to receive income while simultaneously recognizing a conditional obligation to pay it.[332] That odd result flows from approaching the fixed prong with a formula[333] without appreciating that acceptance was an event that ultimately determined the corporation's right to receive the income.[334] Acceptance constrained the right, which is the focus of the all events test, even though the corporation could do the work to earn the income before acceptance occurred.[335] An approach for accruals that relies on activities targeted by a formula, rather than assessing rights established by events, leads to troubling results.[336]

More importantly, for self-regulated relationships, the willingness to rely on performance for identifying a fixed right placed too much emphasis on the corporation's purported completion of its work.[337] The parties expressed their mutual intention to regulate certain obligations through acceptance.[338] The all events tests should not discount that intention and regard the corporation's tendered performance as sufficient to fix their respective rights and liabilities. The tendering of performance conveys nothing more than a unilateral assertion of compliance with required performance obligations.[339] The all events tests should not elevate the significance of that unilateral act where the parties explicitly made it subject to acceptance by the buyer. Otherwise, the tests would invite speculation about the virtual certainty of compliance,[340] knowable aspects of noncompliance,[341] and other complications in deciding whether the seller had completed

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[331] *See Constructive Conditions*, *supra* note 158, at 443 (2009).

[332] *See id.*

[333] *See id.* at 438–63 (2009) (describing the Service's oversimplified standards for income and expense recognition under the all events tests).

[334] *See id.* at 443.

[335] *See id.*

[336] *See id.*

[337] *See id.* at 448–52.

[338] *See id.* at 350.

[339] *See id.* at 350–51.

[340] *See supra* Section I.A.3.

[341] *See supra* Section I.B.

its performance as promised.[342] Regrettably, the current tendency to associate fixed rights and liabilities with unilateral acts of asserted performance is incompatible with the increasing efforts of contracting parties to regulate often-unobservable aspects of their relationships.

In any event, the Service's peculiar approach to express acceptance requirements for severable services remains at odds with the significance attached to such requirements for sales of goods.[343] In both contexts, prior to a buyer's acceptance, the seller's right to income should remain contingent on acceptance occurring even if the seller has tendered performance. But the approach taken for severable services mistakenly suggests that express acceptance requirements produce different consequences for sales of services than for sales of goods.[344]

Despite permitting an express acceptance requirement to operate as a condition, the all events tests have evolved without attributing similar significance to implied acceptance requirements.[345] Reading implied conditions into agreements might seem unnecessary for tax purposes given that, if a party has performed as promised, the performance alone should fix associated rights and liabilities. However, the UCC[346]—and to some degree, the common law[347]—recognize acceptance as implied conditions

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[342] *See infra* Section II.B.

[343] *Cf.* IRS Field Serv. Adv. 1999 FSA LEXIS 382 (June 25, 1999) (distinguishing the permitted deferral of income recognition until a sale of merchandise, where such sale occurs upon the acceptance of the goods, from the required immediate recognition of income from sales of services because, "while ... customers may dispute the charges for the services, the services have been provided").

[344] *Id.*

[345] *See supra* Section I.A.2.

[346] *See infra* notes 350–65 and accompanying text.

[347] Courts insert constructive conditions into contracts to make, for example, a buyer's obligation to pay depend on a seller's completed performance. *See* RESTATEMENT (SECOND) OF CONTRACTS § 226; *id.* § 226 cmt. c. (AM. L. INST. 1981). These conditions help preserve expectations about the exchange such that the buyer would not have to pay unless the seller actually fulfills its promise. For this purpose, the seller's substantial performance is regarded as equivalent to full performance where the seller has deviated in only trivial, minor, or nonessential ways from its promise. *See id.* § 237 cmt. d. The doctrine of substantial performance thereby protects a seller that makes a good faith effort to perform against the potential forfeiture that could otherwise result if an unreasonable buyer would reject any performance falling short of an unobtainable

on payment obligations. Although legal enforceability might not serve as a touchstone for fixed rights and liabilities under the all events tests,[348] the tests should operate by consistently respecting the conditions expressed by contracting parties and those conditions implied by law.[349]

For example, Article 2 of the UCC, which applies to transactions in goods,[350] recognizes a seller's obligation to deliver goods and a buyer's obligation to accept the goods before paying for them as promised.[351] Rather than regarding the buyer's payment

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standard of perfection. *See* Larry A. DiMatteo, *Equity's Modification of Contract: An Analysis of the Twentieth Century's Equitable Reformation of Contract Law*, 33 NEW ENG. L. REV. 265, 299 (1999); *see also* William H. Lawrence, *Appropriate Standards for a Buyer's Refusal to Keep Goods Tendered by a Seller*, 35 WM. & MARY L. REV. 1635, 1640 (1994) (noting that the substantial performance doctrine does not apply to the sale of goods under the UCC, which uses the perfect tender rule, because a breaching seller can often avoid forfeiture by reselling nonconforming goods whereas a seller of nonconforming services, for example, usually cannot resell the services). Therefore, insofar as the seller substantially performs, the constructive condition is deemed satisfied and the buyer becomes obligated to pay the contract price (albeit reduced by damages for any defective performance). The common law thus "provides that substantial performance mandates acceptance" by the buyer. DiMatteo, *supra*, at 299.

Conversely, if the seller materially breaches its performance obligation (i.e., fails to substantially perform as promised), then the unsatisfied constructive condition prevents the buyer from having an obligation to pay. *See* RESTATEMENT (SECOND) OF CONTRACTS § 237 (AM. L. INST. 1981). But the buyer could still accept—through word or deed—the seller's nonconforming performance. *See id.* §§ 246(1), 247. The buyer has discretion either to (1) assert that the seller breached the contract, which prevents the buyer's payment from becoming due, or (2) accept the otherwise defective performance, which waives the condition on the payment obligation. Because acceptance would waive an unsatisfied condition, the buyer's acceptance rather than the seller's performance would establish the obligation to pay the contract price (without forfeiting rights to damages for the defective performance). *See id.* § 246 cmt. b.

Therefore, the common law finds a payment obligation either where a buyer should accept full or substantial performance as a matter of course or where a buyer has accepted materially nonconforming performance. *See id.* § 246.

[348] *See supra* notes 163–72 and accompanying text.

[349] *See Constructive Conditions*, *supra* note 158, at 469–70.

[350] *See* U.C.C. § 2-102 (AM. L. INST. & UNIF. L. COMM'N 2017).

[351] *See id.* § 2-301. The parties' obligations should consider "usage of trade, course of dealing and performance, and the general background of circumstances." *Id.* § 2-301 cmt.

obligation as entirely independent of the seller's delivery obligation,[352] the UCC generally permits the buyer to inspect and accept the goods before the obligation to pay ripens.[353] The seller's right to receive and the buyer's obligation to make payment thus depend on an implied requirement of the buyer's prior acceptance.[354]

The implied acceptance requirement meshes with the perfect tender rule under the UCC.[355] The perfect tender rule permits a buyer to reject, in good faith, nonconforming goods, even where nonconformity results from a seller's trivial deviation from promised performance.[356] This rule incorporates "the proposition that the seller's complete performance is a warranty and a condition precedent to the buyer's obligation to pay."[357] The UCC implies an acceptance requirement to preserve a buyer's

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[352] *See id.* § 2-301 cmt. ("This section uses the term 'obligation' in contrast to the term 'duty' in order to provide for the 'condition' aspects of delivery and payment ....").

[353] *See id.* §§ 2-513(1), 2-607(1).

[354] *See id.* § 2-607 cmt. 1 ("[O]nce the buyer accepts a tender the seller acquires a right to its price on the contract terms.").

[355] *See infra* note 356 and accompanying text.

[356] *See* U.C.C. §§ 2-601, 2-106 cmt. 2 (describing a "policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance"). The perfect tender rule does not apply to goods delivered pursuant to an installment contract. *See id.* § 2-601. An installment contract authorizes or requires the delivery of goods in separate lots, where the buyer can accept each lot separately. *See id.* § 2-612(1). A buyer can reject an individual installment only where nonconformity "substantially impairs the value of that installment and cannot be cured." *Id.* § 2-612(2). Consequently, unless the nonconformity "substantially impairs the value of the whole contract," the buyer must accept the nonconforming installment upon receiving the seller's adequate assurances of its cure. *Id.* §§ 2-612(2)–(3). The heightened standard of substantial impairment arguably helps preserve a long-term contractual relationship that might break down if a buyer could reject an installment for trivial deviations, *see* Lawrence, *supra* note 347, at 1654–56, or if the buyer seeks to benefit from market prices that declined over the period between contract execution and the delivery of the installment, which might exceed a comparable period for a single-delivery contract. *See* George L. Priest, *Breach and Remedy for the Tender of Nonconforming Goods Under the Uniform Commercial Code: An Economic Approach*, 91 HARV. L. REV. 960, 972 (1978).

[357] Steven W. Feldman, *Recession, Restitution, and the Principle of Fair Redress: A Response to Professors Brooks and Stremitzer*, 47 VAL. U. L. REV. 399, 413 (2013).

right to reject tendered goods under this rule and to establish acceptance as the conditional event for an obligation to pay for goods that have not been rejected.[358] To achieve these objectives in the absence of a buyer's explicit approval, the UCC will infer acceptance from the buyer's conduct, which might include failing to reject goods after having a reasonable opportunity to inspect them or acting in a manner contrary to the seller's ownership of the goods.[359] Implied acceptance requirements thereby help establish a mutually acknowledged payment obligation insofar as the actions of both parties appear consistent with their understanding that performance has occurred as promised.[360]

Significantly, acceptance under the UCC can establish an unconditional payment obligation for nonconforming goods.[361] A buyer can knowingly or unknowingly accept—expressly or implicitly—nonconforming goods tendered by a seller where the goods were otherwise rejectable under the perfect tender rule.[362] Such acceptance gives the seller a right to the agreed upon price[363] even though the buyer may still seek damages related to the nonconformity.[364] Acceptance thus establishes a payment obligation for goods as tendered regardless of whether the seller performed as promised.[365]

Because current applications of the all events tests fail to recognize implied acceptance requirements, they allow a unilateral

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[358] *See* U.C.C. § 2-601.

[359] *See id.* §§ 2-606(1)(b)–(c); *see also id.* § 2-606 cmt. 1 (using a buyer's "words, action, or silence when it is time to speak" as the basis for finding acceptance).

[360] *See id.* §§ 2-607(1)–(2).

[361] *Id.*

[362] *See id.* § 2-601; *see also id.* § 2-602 cmt. 1 ("A tender or delivery of goods made pursuant to a contract of sale, even though wholly non-conforming, requires affirmative action by the buyer to avoid acceptance.").

[363] *See* U.C.C. § 2-607(1); *see also* Justin Sweet, *Completion, Acceptance and Waiver of Claims: Back to Basics*, 17 FORUM 1312, 1314 (1982) (analogizing a tender of nonconforming goods to an offer of a lesser amount in full satisfaction of a debt, which the creditor could choose to accept).

[364] *See* U.C.C. §§ 2-714(1), 2-601 cmt. 1 ("A buyer accepting a non-conforming tender is not penalized by the loss of any remedy otherwise open to him."). A buyer must notify the seller within a reasonable time after the buyer discovers or should have discovered the nonconformity; otherwise, the buyer's claim for damages is barred. *See id.* § 2-607(3).

[365] *Id.* § 2-607(1).

assertion of compliance with a performance obligation to fix a right to income and liability to pay.[366] These performance-focused applications favor an approach whereby one party's claimed performance is regarded as enough to fix the rights and liabilities under an agreement.[367] If the other party objects to the performance, current applications of the tests view a resulting dispute—which necessarily arises after performance has occurred—as giving rise to an unsatisfied condition precedent that prevents or postpones an accrual of income or deduction.[368] In essence, the tests

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[366] *See supra* Section I.A.2.

[367] *See supra* notes 100–05 and accompanying text.

[368] Existing authorities and guidance find performance sufficient to fix an associated right to income and liability to pay. *See supra* Section I.A. Inexplicably, they also construe a post-performance dispute as giving rise to an unsatisfied condition precedent that leaves the right and liability unsettled, even though the earlier performance should have presumably fixed them. *See* Lucas v. American Code Co., 280 U.S. 445, 451–52 (1930). One might instead question whether a legitimate dispute between the parties makes evident that a party failed to perform as promised and that such failure—rather than the dispute—prevents each party from having a fixed right or liability.

Nevertheless, this approach of constructing a dispute-resolution condition offers a practical way to deal with questionable performance. For example, if a seller unknowingly tendered nonconforming performance and the buyer rightfully rejected the performance, then the condition precedent approach easily and properly postpones accruals until the resolution of any resulting dispute. *See supra* Section I.A. The construction of a condition produces a manageable deferral by shifting the focus of the all events tests to the observable unresolved status of the dispute and away from the contested fulfillment of the promise. Conversely, where a dispute arises from the buyer's wrongful rejection of the seller's conforming performance, the condition precedent approach thankfully avoids dealing with unknown, but potentially knowable, facts about performance. *See supra* Section I.A. Although a performance-focused all events test might justifiably find the occurrence of knowable performance sufficient to fix a right or liability, the condition precedent approach understandably opts for the ease of just postponing accruals until resolution of the dispute

The recognition of implied acceptance requirements under the all events tests could offer a similarly useful but theoretically preferable approach for accruals. Like dispute resolution, acceptance works as a readily identifiable marker of the event needed to fix a right or liability. *See supra* notes 323–25 and accompanying text. However, acceptance provides a uniform, principled marker for both conforming and nonconforming performances. This consistency is lacking in applications of the all events tests that initially link rights and liabilities to performances but eventually couple them with the resolution of

get applied by fabricating a condition tied to resolving a dispute about performance and simultaneously ignoring the legally implied requirement to have such performance accepted.[369] In short, current applications of the tests do not require acceptable performance to fix a right or liability; however, they will abandon their performance-focused approaches[370] if someone actually objects to the performance.[371]

If parties were assured of receiving promised performances, then the all events tests could justifiably and feasibly treat the completion of those performances as fixing rights and liabilities.[372] However, taxpayers know that performances vary from promises, and promises often address expectations about far-ranging operational activities that provide many opportunities for noncompliance.[373] As a result, the difficulty of applying a performance-focused all events test where, for example, delivered goods fail to meet agreed upon physical specifications (e.g., goods fabricated with substandard steel) starts to compound where goods meet physical specifications but conflict with process-related performance expectations (e.g., goods fabricated under prohibited, abusive labor practices).[374] Moreover, where the parties seek to preserve relationships and work together to resolve nonconformity issues, a performance-focused analysis would become administratively complex if consideration is given to the parties' willingness to tolerate certain performance deviations in order to sustain the relationship.[375] It is foreseeable that these

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disputes as if performance has lost its relevance. Moreover, the approach of constructing dispute-resolution conditions has yet to explain how to account for nonconforming performance if a dispute (i.e., the unsatisfied condition precedent) does not arise until a subsequent taxable year. *See* Rev. Rul. 2003-10, 2003-1 C.B. 289. An acceptance-based approach could find a fixed right or liability upon the acceptance of nonconforming performance even if a dispute might arise later.

[369] *Cf.* Dravo Corp. v. United States, 348 F.2d 542, 545 (Ct. Cl. 1965).

[370] *Id.* (noting a departure from traditional accrual accounting for contested liabilities).

[371] *Id.*

[372] *See* Rev. Rul. 98-39, 1998-2 C.B. 199.

[373] *See* Rev. Rul. 2003-10, 2003-1 C.B. 288–89.

[374] *See supra* notes 81–82 and accompanying text.

[375] *See* Rev. Rul. 2003-10, 2003-1 C.B. 290 (questioning how a course of dealings might affect an analysis under the all events tests with respect to defective products).

difficulties could lead to a performance-focused analysis that finds a fixed right or liability from a semblance of performance cobbled together from the absence of a dispute and an assumed willingness to disregard nonconformity.[376] Ambiguity about how far parties can deviate from their promises and still fix rights and liabilities makes the continued devotion to performance-focused applications perplexing.[377] The all events tests could instead operate more soundly by asking whether the buyer accepted performance in whatever manner tendered.

By recognizing implied acceptance conditions, the all events tests could sidestep many complex issues in dealing with performance. Once acceptance occurs, it does not matter whether performance occurred as promised; what activities were ministerial; whether conformity or nonconformity was knowable to or virtually certain from either party; or how the parties might deal with nonconformity in ongoing relationships.[378] Like express acceptance, implied acceptance of tendered performance would serve as an identifiable event that can fix the rights and liabilities of contracting parties for tax purposes in self-regulated and other contexts.[379]

Furthermore, the recognition of implied acceptance requirements would better align the all events tests with the intentions of parties that self-regulate and the legal rights and liabilities of those parties.[380] Self-regulation involves important aspects of standard setting, compliance verification, and enforcement.[381] These efforts demonstrate an intention to define and control acceptable performance rather than to hope that a party will tender

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[376] *See id.* at 289 (finding that a manufacturer had a fixed right to income under the all events test in the year it shipped too many goods because, upon discovery in a subsequent taxable year, the customer did not dispute that the manufacturer had shipped the wrong quantity of items and the customer agreed to pay for the excess shipment). *But cf.* Van Dorn Co. v. Future Chem. & Oil Corp., 753 F.2d 565, 574 (7th Cir. 1985) (recognizing a buyer's legal obligation to pay for an excess quantity of delivered goods under the Illinois Commercial Code because the buyer had implicitly accepted them by failing to reject the nonconforming excess).

[377] *See* Rev. Rul. 2003-10, 2003-1 C.B. 289.

[378] *See Just Enough*, *supra* note 56, at 474.

[379] *See* Rev. Rul. 2003-10, 2003-1 C.B. 289.

[380] *See Constructive Conditions*, *supra* note 158, at 447–48.

[381] *See* McAllister, *supra* note 5, at 306–07.

conforming performance. The all events tests should likewise focus on rights and liabilities established by the acceptance of performance instead of looking for rights and liabilities under an assumption that parties might perform as promised. This approach of requiring acceptance would also provide a more logical connection between the unconditional rights and liabilities under the all events tests and the legal rights and liabilities of contracting parties. For instance, postponing a seller's accrual of income until the buyer accepts performance makes more sense than saying the seller's performance established an unconditional right to receive income for tax purposes despite the fact that the buyer has no legal obligation to pay for the performance (or possibly even accept the performance). The recognition of implied acceptance as conditions to rights and liabilities under the all events tests would better align tax accruals with the reality of many business transactions.

B. Disputes About Performance

In addition to recognizing that a buyer might accept either conforming or nonconforming performance, the all events tests must accommodate disputes about potentially nonconforming aspects of performance. Despite accepting a seller's tender, a buyer might assert that its payment obligation differs from the contract price because the seller did not fulfill its contractual promises.[382] Consequently, the all events tests must anticipate and account for disputes about nonconforming performance that might ultimately determine what, if anything, the buyer must pay for the seller's actual performance.

As noted above, current applications of the all events tests treat a bona fide dispute as establishing an unsatisfied condition precedent that generally prevents or postpones accruals of the promised payment by both the buyer and seller.[383] Therefore, a dispute about allegedly nonconforming performance presumably forestalls an accrual prior to its resolution.[384] Once, for example, the parties reach a settlement or a court enters a final judgment

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[382] *See* Rev. Rul. 2003-10, 2003-1 C.B. 289.
[383] *Id.*
[384] *Id.*

about the payment obligation, the resolution satisfies the condition precedent and establishes the amount and timing of accruals related to the tendered performance.[385]

By treating a dispute as an unsatisfied condition precedent, current applications of the all events tests might neglect obligations to pay that were fixed by acceptance. For example, a buyer's acceptance of nonconforming goods establishes the buyer's obligation to pay the full contract price under the UCC.[386] The acceptance compels the buyer to return performance through payment and precludes the buyer from rejecting the goods later due to the nonconformity.[387] The buyer can still seek a remedy, including damages, for the nonconformity;[388] however, the buyer must pay the agreed upon price for the accepted goods.[389] Therefore, a dispute about allegedly nonconforming performance for accepted goods will normally involve a buyer's entitlement to a remedy rather than the buyer's responsibility to pay the contract price.[390]

Therefore, even for disputed performance, the all events tests should take a payment obligation into account when goods or services are accepted.[391] Like the UCC, the all events tests should recognize that acceptance fixes the obligation to pay a determinable amount.[392] Any dispute about nonconforming aspects should

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[385] *See* H. Liebes & Co. v. Comm'r, 90 F.2d 932, 938–39 (9th Cir. 1937).

[386] *See* U.C.C. § 2-607(1) (AM. L. INST. & UNIF. L. COMM'N 2017).

[387] *See id.* § 2-607(2); *see also* Kalzip, Inc. v. TL Hill Constr., LLC, 80 U.C.C. Rep. Serv. 2d 832 (M.D. Fla. 2013) ("[E]ven if the delivery of conforming goods could be deemed a condition precedent, [the buyer] waived compliance with that condition precedent by accepting the goods. Since [the buyer] accepted the goods, it is limited to an action for breach.").

[388] *See* U.C.C. § 2-714(1) (AM. L. INST. & UNIF. L. COMM'N 2017).

[389] *See id.* § 2-607(1).

[390] *See id.*

[391] Under the common law, as long as either the buyer must accept the seller's immaterial deviations or the buyer has chosen to accept the seller's material breaches, the buyer becomes obligated to pay the contract price despite retaining the right to seek damages for nonconforming performance. *See* RESTATEMENT (SECOND) OF CONTRACTS § 246 (AM. L. INST. 1981).

[392] Current applications of the all events tests require parties to accrue the uncontested portion of a payment obligation. *See* Johnson v. Comm'r, 6 T.C.M. 255, 257–58 (1947). The partial accrual of a promised payment could contradict the fact that the buyer—without surrendering any right to a remedy—assumes legal

not delay accruals even though the dispute might result in an adjustment to the amount paid, such as through a setoff.[393] An unresolved dispute might affect the amount eventually paid; however, the possibility of adjustment does not change the need to account for rights and liabilities fixed by acceptance.[394]

The resolution of a dispute about nonconforming performance for accepted goods or services might accordingly require a post-acceptance adjustment.[395] When they eventually resolve their dispute, the contracting parties should preferably account for any difference between their prior accruals resulting from the acceptance and any modified obligation resulting from the dispute resolution.[396] This approach seems particularly desirable

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responsibility for the entire purchase price by accepting the tendered performance. *Cf.* PATRICIA F. FONSECA & JOHN R. FONSECA, WILLISTON ON SALES § 25:32, 820 (5th ed. 2006) ("Conformity of the goods tendered by the seller to the buyer will be presumed after the buyer has made an acceptance and the burden of establishing any breach is on that buyer.").

[393] *See, e.g.*, U.C.C. § 2-717 (AM. L. INST. & UNIF. L. COMM'N 2017) ("The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract."). Under the UCC, acceptance establishes a payment obligation of the contract price less any damages for nonconforming performance. *See* Tegrant Alloyd Brands, Inc. v. Merch. of Tennis, Inc., 73 U.C.C. Rep. Serv. 2d (Callaghan) 486 (Jan. 26, 2011) ("Although the seller's breach does not excuse the contractual obligations of the buyer, the buyer is permitted to withhold from the purchase price its actual damages and breaches its obligations only to the extent the amount withheld exceeds its damages." (citing Baccus Indus., Inc. v. Frontier Mech. Contractors, 36 S.W.3d 579, 585–86 (Tex. App. 2000))). Disputes about nonperformance relate to the amount of the payment obligation rather than the existence of the obligation. Accordingly, the parties should take the payment obligation into account when acceptance occurs and account for potential damages in determining the amount with reasonable accuracy. *See* Cont'l Tie & Lumber Co. v. United States, 286 U.S. 290, 295–96 (1932).

[394] *See* Pac. Vegetable Oil Corp. v. Comm'r, 26 T.C. 1, 19 (1956) ("[T]he contingency of having to make adjustments in invoice prices [due to differences between the weight of delivered items and the weight specified in a sales contract] does not prevent the accrual of income in the year in which the right to income under the sales contract became fixed." (citation omitted)), *rev'd on other issues*, 251 F.2d 682 (9th Cir. 1957).

[395] *See id.* at 18.

[396] *See id.*

> Although adjustment might be made in the amount of the invoice price after determination of [the delivered items'] weight,

given that parties might resolve certain claims about nonconforming performance through nonmonetary means.[397] For example, in lieu of monetary damages for an alleged breach, a buyer and seller might agree to operational changes that encourage future compliance with regulatory provisions and help preserve their long-term relationship. A post-acceptance adjustment would appropriately reflect any resolution about a payment obligation without altering the fact that acceptance fixed the underlying right or liability.[398]

A post-acceptance adjustment for the resolution of a dispute offers a straightforward way to apply the all events tests. The current approach of treating a dispute as a condition precedent introduces uncertainty, for example, where a claim of nonconforming performance arises from a discovery occurring in a year after goods or services were provided (i.e., how does a Year 2 dispute affect a right established by Year 1 performance?).[399] The all events tests should not have to resort to a post-year-end construction of unsatisfied condition precedent to address an alleged nonconformity. Instead, common sense suggests the parties should accrue income and expense items during the year goods

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> this was, we believe, only part of and due to the seller's warranty, specific or implied, that it would deliver the quantity called for by the sales contract[ ] and that ... the buyer would not be charged for more goods than he received.

Id.; David J. Joseph Co. v. Comm'r, 136 F.2d 410, 411 (5th Cir. 1943).

> In practically every contract of sale for merchandise there is an implied warranty of quality and quantity of the merchandise sold, for the breach of which the merchant would be liable to the buyer, but the breach would not develop prior to delivery, and the right to demand damages or a refund would not accrue until its discovery.

Id.

[397] *See Merchant Law*, *supra* note 154, at 1798.

[398] *See id.* at 1808.

[399] *See* Rev. Rul. 2003-10, 2003-1 C.B. 289 (requesting comments about the application of section 451 to shipments of defective products where disputes arise in a subsequent year). A condition precedent would not arise unless the parties dispute the nonconformity. *See supra* Section I.A.2. If the parties agree that nonconforming performance occurred (i.e., no dispute exists), then they must still determine whether the failure to perform as promised could have fixed rights and liabilities in an earlier year under the current performance-focused applications of the all events tests. *See id.*

or services are accepted (buyers must pay for what they accept) and report adjustments separately during any year disputes about nonconforming performance are resolved (the amounts owed might change even though the obligations to pay would not).

Finally, the all events tests should restrict the use of conditions for nonconforming performance to situations where nonconformities extinguish payment obligations. For example, the UCC permits a buyer of goods to revoke a prior acceptance if nonconformity substantially impairs the value of the goods to the buyer.[400] Unless the buyer reasonably but mistakenly assumed—prior to acceptance—that the seller would cure a known nonconformity, revocation is restricted to situations where the buyer's acceptance was reasonably induced by either the difficulty of discovering the nonconformity prior to acceptance or the seller's assurances about performance.[401] Upon a timely notification of revocation, the UCC treats a revocation of acceptance like a rejection of goods insofar as neither option creates an obligation to pay the contract price for the goods.[402] If the all events tests account for the rights and liabilities fixed by an initial acceptance, then the tests can easily account for the revocation as a condition subsequent that extinguishes those rights and liabilities regardless of the year during which the revocation occurs.[403] The all events tests could therefore use a simple approach of treating rights and liabilities as fixed by unrevoked acceptance even if a dispute exists about alleged nonconforming performance.[404]

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[400] *See* U.C.C. § 2-608(1) (AM. L. INST. & UNIF. L. COMM'N 2017). The substantial impairment requirement for revocation places a higher burden on a buyer, who seeks to revisit a completed transaction, for goods that the buyer could have initially rejected with relative ease. *See* Priest, *supra* note 356, at 972 (describing the higher burden as being sensitive to loss shifting where, due to the passage of time since acceptance, a buyer might otherwise attempt a revocation to benefit from changing market prices or to correct its selection of goods that later seem unsuitable).

[401] *See* U.C.C. § 2-608(1) (AM. L. INST. & UNIF. L. COMM'N 2017).

[402] *See id.* § 2-608(3).

[403] How contracting parties might account for the performance that preceded a disputed or undisputed revocation of acceptance under current performance-focused applications of the all events tests remains unclear. *See supra* note 368 and accompanying text.

[404] *See id.*

C. An Illustration of Implied Acceptance as a Condition

Gillis v. United States[405] supplies a context for illustrating the role that implied acceptance could fill as a condition precedent to the all events tests.[406] Although the case does not involve regulatory provisions governing process-related aspects of a business, *Gillis* applied the all events test to a supplier's liability in the cotton industry, where trading happens under significant private regulation.[407] The case helps highlight issues with nonconforming performance, knowledge, and disputes in a self-governing industry, and it provides a scenario for illustrating how acceptance could function as a condition precedent in determining fixed rights and liabilities.[408]

Within a single taxable year, the partnership in *Gillis* sold and shipped bales of cotton to a foreign buyer as well as received full payment of the contract prices from the buyer.[409] The contracts provided that the buyer could later make claims for breach if the buyer received cotton that varied from the specifications stated in the contracts.[410] The contracts further provided that the parties would settle any dispute over such claims through an arbitration procedure established for international cotton trade.[411]

The partnership in *Gillis* had knowingly shipped cotton grown in a region that experienced heavy rainfall, which meant the partnership knew—at the time of shipment—that it was using cotton of an inferior grade than promised in the contract and that the buyer would make claims against the partnership.[412] The buyer eventually made twelve claims against the partnership, and the partnership paid four claims immediately and refused

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[405] 402 F.2d 501 (5th Cir. 1968).

[406] *Id.* at 508–09.

[407] *See Cotton Industry*, *supra* note 157, 1726–45 (describing procedural rules, substantive rules, and adjudication in the cotton industry); *id.* at 1724 ("The cotton industry has almost entirely opted out of the public legal system, replacing it with one of the oldest and most complex systems of private commercial law.").

[408] *See generally*, *Gillis*, 402 F.2d at 501.

[409] *Gillis*, 402 F.2d at 508.

[410] *Id.*

[411] *Id.*

[412] *Id.*

the others.[413] After pursuing certain appeals, the partnership paid the amounts awarded at the conclusion of the designated arbitration procedures for the remaining eight claims[414]—notwithstanding that payment occurred after three more years of resistance and under a threat of judicial intervention.[415]

For the year of shipment, the accrual-method partnership in *Gillis* included the payments it received in gross income and concurrently took a deduction equal to the amount that the partnership calculated it would owe for all of the buyer's anticipated claims.[416] The Service sought to disallow the deduction by portraying the claims as contingent liabilities that, consistent with ample case law, could not become fixed prior to a final resolution of the disputes.[417] But the *Gillis* court found judicial contests of liability—such as the litigated claims regarded as contingent liabilities in the case law cited by the Service—"materially distinguishable" from the arbitration procedures applicable to the buyer's claims in *Gillis*.[418] The court described arbitration in the cotton industry as less adversative than traditional litigation and noted how such claims, which were routine under industry norms, "sting" less than disputes heard in judicial trials.[419] Those differences led the court to remark: "We do not see anticipated claims regularly disposed of by arbitration as the handmaiden of contingency."[420] As a result, the court refused to "penalize the partnership for using the arbitration procedure" and treated the claims submitted to arbitration as having been unconditionally fixed for tax purposes when the partnership shipped the inferior grade cotton.[421]

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[413] *Id.*

[414] *Id.*

[415] Gillis v. United States, 267 F. Supp. 547, 553 (S.D. Tex. 1966), *aff'd in part and rev'd in part*, 402 F.2d 501 (5th Cir. 1968).

[416] *Gillis*, 402 F.2d at 508 (describing the partnership's damage calculation as "the difference in the price paid [by the buyer] and the price of the cotton actually shipped").

[417] *Id.* at 509; *see also* 1968 A.O.D. Lexis 293 (Dec. 27, 1968) (finding that, when the partnership shipped the inferior cotton, "there existed only possible liabilities" for the buyer's claims).

[418] *Gillis*, 402 F.2d at 509.

[419] *Id.*

[420] *Id.*

[421] *Id.* at 510.

Gillis departs from a traditional application of the all events tests in two notable respects.[422] First, the case attaches significance to knowledge about nonconforming performance even though the case fails to explore the full import of such knowledge.[423] Other courts have denied deductions for anticipated claims arising from nonconforming performance where taxpayers lacked knowledge about their defective performances by year-end,[424] even where such defects were presumably knowable.[425] In contrast, the *Gillis* Court emphasized that the partnership knew its shipment of inferior goods established its liability despite its later refusal to pay some asserted claims.[426] In light of the private legal system that has largely governed the cotton trade since the mid-1800s,[427] one might infer that the partnership in *Gillis* knew of its fixed liability and merely contested the amount of liability. The partnership's contracts followed industry norms[428] by allowing the buyer's

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[422] *See* Recent Case, *Income Tax—When Items Become Deductible—Damage Claims Which Were Reasonably Estimated and Which Were Predictable with High Accuracy Could Be Accrued and Deducted Before Final Settlement*—Gillis v. United States*, 402 F.2d 501 (5th Cir. 1968)*, 83 HARV. L. REV. 1452, 1453 (1970) [hereinafter Recent Case].

[423] *See Gillis*, 402 F.2d at 508–10 (expressing repeatedly that the partnership knew the goods were nonconforming).

[424] *See, e.g.*, Challenge Publ'ns, Inc. v. Comm'r, 51 T.C.M. (CCH) 342, 349 (1986) (finding reliance on *Gillis* misplaced because being "virtually certain ... still falls short of the absolute certainty required in order for a liability to be fixed"), *aff'd*, 845 F.2d 1541 (9th Cir. 1988); W.J. Strickland Co. v. Comm'r, 33 T.C.M. (CCH) 484, 487 (1974) (finding *Gillis* distinguishable from a situation where the CEO was "shocked" to learn about the company's manufacturing defect); Gateway Transp. Co. v. United States, 39 A.F.T.R.2d 77-647, 77-654 (W.D. Wis. 1976) ("By contrast [to the situation in *Gillis*], there is no suggestion here that plaintiff knew ...."); 1994 F.S.A. LEXIS 283 (Mar. 23, 1994) (distinguishing *Gillis* from a situation where products were not sold with known defects).

[425] *See W.J. Strickland*, 33 T.C.M. (CCH) at 487 (manufacturing defect discovered on last day of tax year during product installation); *Gateway Transp.*, 39 A.F.T.R.2d 77-647, 77-655 ("[I]t cannot be said that plaintiff's liability was determinable by the plaintiff at the very times at which the critical events occurred.").

[426] *See Gillis*, 402 F.2d at 509.

[427] *See Cotton Industry*, *supra* note 157, at 1724–25.

[428] *See id.* at 1733 (contrasting the market-difference measurement of damages available to an aggrieved party in the cotton trade, which adjusts a contract price to market price, with the measurement of damages under the UCC, which protect expectancy interests).

claims to adjust the agreed upon contract prices to the prevailing market prices for the quality of cotton actually delivered.[429] When the partnership knowingly shipped inferior cotton, it was understood that the buyer became entitled to make claims.[430] However, the industry has traditionally graded cotton through a subjective process.[431] So the partnership would have been uncertain about the applicable market prices because the parties could have assigned different grades to the delivered cotton.[432] Accordingly, references in *Gillis* to determining an appropriate price for the cotton through arbitration proceedings indicate that the court accepted the partnership's unconditional liability for the claims and attributed the parties' dispute to the claim amounts.[433]

Knowledge helped identify the fixed liability because the partnership's contracts—following industry norms—established an adjustment procedure for nonconforming performance.[434] The parties had agreed on consequences for a delivery of inferior cotton, and the partnership's nonconforming performance was the event that fixed its liability under their agreement.[435] The partnership presumably should have accounted for its liability arising from its known nonconforming performance just like it would account for rights and liabilities fixed by other known events.[436]

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[429] *See Gillis*, 402 F.2d at 508.

[430] *Id.*

[431] *See Cotton Industry*, *supra* note 157, at 1745.

[432] *See id.* at 1773–74.

[433] *See also id.* at 1773 (describing how the cotton "industry has created a separate ... [arbitration board] to deal with the most common type of fact-based misunderstanding, namely disagreements over whether a delivery conforms to the contract's quality specifications").

[434] *See Gillis,* 402 F.2d at 508–09.

[435] Note that the liability became fixed in *Gillis* in the year before the buyer made its claims. *See id.* A claim submission can function as a condition precedent that can delay an accrual, particularly where the likelihood of a claim is uncertain, such as consumer claims under product warranties. *See* Chrysler Corp. v. Comm'r., 436 F.3d 644, 650–51 (6th Cir. 2006). Alternatively, a claim submission can represent a ministerial act that will not delay an accrual, such as in circumstances like *Gillis* where business interests motivate claim submissions. *See* Rev. Rul. 98-39, 1998-2 C.B. 198, 199 (distinguishing claim submissions made to receive payment for cooperative advertising services).

[436] *See Gillis,* 402 F.2d at 506–07 (citing several cases where parties preemptively accounted for known future liabilities).

Curiously, the actual knowledge of nonconforming performance did not prevent or alter the accrual of income in *Gillis*.[437] If the partnership knowingly failed to perform as promised, then how could the partnership have a fixed right to income from the deficient acts? Alternatively, if the partnership had a fixed right to income and the parties only needed to adjust the contract prices for the shipment of inferior cotton, then how could the partnership determine the amount of its income with reasonable accuracy without accounting for the buyer's anticipated claims? A taxpayer should not knowingly fail to perform as promised and yet accrue income as if it had.

Perhaps the *Gillis* court never questioned income recognition because the partnership received all of the payments in full and reported them as income even though they were not properly earned.[438] Elsewhere in its opinion, the court recited the mantra that taxpayers must recognize income upon receipt.[439] The Service likewise points to receipt as an event that fixes a taxpayer's right to income.[440] However, receipt seems ill suited to require income recognition attributable to a full performance where the taxpayer has knowingly failed to perform.[441] In particular, any

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[437] *See id.* at 508–10.

[438] *See Gillis*, 402 F.2d at 508.

[439] *Id.* at 506.

[440] *See supra* note 103 and accompanying text.

[441] One might question whether the partnership had to report the amounts received as income under the claim of right doctrine. That doctrine requires a taxpayer to report income received under a claim of right and without restriction on its use or disposition even though the taxpayer might face a contingent repayment obligation. *See* N. Am. Oil Consol. v. Burnet, 286 U.S. 417, 424 (1932). However, the doctrine does not apply to receipts that a taxpayer has an acknowledged, unconditional obligation to repay. *See* Ahadpour v. Comm'r, 77 T.C.M. (CCH) 1210, 1214 (1999) (refusing to apply the claim of right doctrine where the taxpayer had "an existing and fixed obligation ... to repay the deposits" under a contract for the sale of property). Because the *Gillis* court found that the partnership knew of its unconditional liability for the buyer's claims when it shipped the inferior cotton, the claim of right doctrine seems inapplicable to the claim amounts. *Compare Gillis*, 402 F.2d at 508 (finding that the partnership had a fixed liability to the buyer because the partnership knew its obligations under the contract and knew it shipped nonconforming cotton), *with Ahadpour*, 77 T.C.M. (CCH) at 1214 (refusing to apply the claim of right doctrine when a taxpayer knew it had an future obligation to repay received deposits).

inference that the partnership had a fixed right to the entire contract price promised for full performance—under the formulaic due-paid-or-earned approach to the all events test—does not accord with the court's finding that the partnership contemporaneously knew of its unconditional obligation to repay part of those amounts due to its failure to perform.[442]

In this situation, the satisfaction of an implied condition of acceptance would establish a sound basis for concluding that the partnership had a fixed right to receive the contract prices.[443] As discussed above, an acceptance of tendered goods commits a purchaser to pay the agreed upon purchase price regardless of whether the goods conform to their promised specifications.[444] Accordingly, once the buyer explicitly or implicitly accepted the inferior cotton, the partnership secured a fixed right to the contract prices despite its knowledge of its nonconforming shipments.[445] The partnership could later account for any of the buyer's claims, whether fixed or contingent at shipment, as adjustments to the amount recognized as a result of the buyer's acceptance.[446]

The other notable feature of *Gillis* was the influence that industry norms for handling nonconforming performance had on the court's application of the all events test.[447] The court justifiably took into account how private regulation, through international arbitration, operates in the cotton industry.[448] In addition to relying on arbitration for general disputes, trade associations in the industry have created a separate tribunal that makes binding determinations about whether delivered cotton meets the specifications in a contract.[449] The tribunal provides a neutral basis for grading cotton, which is otherwise subjectively graded

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[442] *See* Rev. Rul. 74-607, 1974-2 C.B. 149, 149–50 (requiring inclusion when performance fixes the right to receive income, unless payment is made or becomes due earlier).

[443] *See supra* text accompanying notes 361–65.

[444] *Id.*

[445] *See id.*

[446] *See Gillis*, 402 F.2d at 508.

[447] *See id.* at 508, 510.

[448] *See id.* at 509 (aspects of arbitration in international cotton industry); Recent Case, *supra* note 422, at 1454 (stating that the *Gillis* approach does not force a party to choose between arbitration and litigation and therefore does not penalize a party for utilizing arbitration).

[449] *See Cotton Industry*, *supra* note 157, at 1727.

by contracting parties and which is susceptible to damage (i.e., the cotton changes) after shipment and before delivery.[450] The tribunal provides such an efficient mechanism for dealing with routine questions about whether a delivery conforms to specifications that its use has become a normal business practice that does not damage trading relationships,[451] which presumably led the *Gillis* court to describe it as less adversative than traditional litigation.[452] The *Gillis* court accordingly found that the routine mechanism for implementing and the mutual expectation of having the market price paid for a delivery of inferior cotton fixed the partnership's liability for the claims at shipment without treating the liability as contingent on receiving a final adjustment through the arbitration proceedings.[453]

The routine use of nonjudicial mechanisms, including arbitration, to address nonconforming performance is not unique to the cotton industry.[454] Through self-regulation, contracting parties often seek to encourage conforming performances and address nonconforming aspects without relying on courts, without terminating agreements, and without imposing financial penalties.[455] These parties not only anticipate nonconforming performance but they develop mechanisms to address it.[456] *Gillis* pointed to aspects of finality in the cotton industry's arbitration procedures,

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[450] *See id.* at 1773–74.

[451] *See id.* at 1774 ("In general, transactors do not view asking for quality arbitration as damaging to their commercial relationship as long as it is not done too often.").

[452] Where parties cannot tell whether an instance of nonconforming performance or a claim of nonconformity results from unintentional causes or opportunistic motives, the tribunal prevents a breakdown of trade by providing a neutral determination of quality along with a nonpunitive adjustment to the appropriate market price. *See id.* at 1773–74. Without such measures, an instance of nonconforming performance or a claim of nonconformity, which would arise in an environment where the risk of inadvertent breach is high, would likely result in a termination of their relationship. *See id.* at 1775–77 ("[C]ooperation is more likely to be maintained if transactors do not respond to every bad outcome by inflicting a punishment.").

[453] *See* Gillis v. United States, 402 F.2d 501, 509–10 (5th Cir. 1968).

[454] *See* Hadfield & Bozovic, *supra* note 23, at 991–92 (analyzing twelve different businesses that rely more on trade-norms and informal processes to resolve dispute than litigation); Lin, *supra* note 20, at 714 (stating that international companies increasingly favor arbitration as a tool to resolve disputes).

[455] *See* Hadfield & Bozovic, *supra* note 23, at 991–92.

[456] *See Gillis*, 402 F.2d at 508.

which provided no judicial recourse, to "justify a tax treatment different from more porous and less final procedures of determining liability."[457] Other industries and taxpayers employ comparable self-contained mechanisms for addressing nonconforming performances, and these mechanisms deserve similar considerations in applying the all events tests.[458] *Gillis* appropriately emphasizes the need to take private regulation into account in determining fixed rights and liabilities; however, thoughtful consideration of applicable self-regulation efforts threatens to impose an administratively burdensome inquiry into the norms and practices of each industry or taxpayer as well as its mechanisms for resolving disputes.[459]

The recognition of implied acceptance requirements under the all events tests provides an opportunity to avoid the administrative burden of assessing the impact on rights and liabilities of industry- —and taxpayer- — specific mechanisms for addressing nonconforming performance.[460] Insofar as those mechanisms contemplate that parties will make price adjustments, follow corrective steps, or take other actions without rejecting nonconforming performance, the mechanisms exhibit tolerances—whether by industry custom or mutual agreement—for certain deviations from required performances.[461] The mechanisms effectively provide the means for dealing with nonconforming aspects of otherwise accepted performances.[462] Although unraveling self-regulating mechanisms to determine their potential effect on rights and liabilities presents a burdensome task, the all events tests could alternatively simply acknowledge that these mechanisms apply to accepted performance and that the acceptance of conforming or nonconforming performance establishes an unconditional obligation to pay the contract price. The use of arbitration, as in *Gillis*, or other mechanisms to address possible nonconforming aspects of performance would not make the obligation to pay the

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[457] *Id.* at 509.

[458] *See Enforceable Arbitration of Commercial Disputes in the Textile Industries*, 61 YALE L.J. 686, 687 (1952) (presenting information on rayon, silk, and wool industries and their reliance on arbitration over litigation).

[459] Recent Case, *supra* note 422, at 1454.

[460] *See id.* (expressing potential for high administrative burden under *Gillis* rule).

[461] *See Gillis*, 402 F.2d at 508.

[462] *Id.*

contract price contingent.[463] Instead, the mechanism might lead to an adjustment to the amount accrued for a right or liability otherwise fixed by acceptance.[464] In short, self-regulating mechanisms do not have to complicate applications of the all events tests because the mechanisms apply to accepted performance, and acceptance provides a rational basis for identifying fixed rights and liabilities for purposes of the all events tests.

CONCLUSION

The increasing use of self-regulation by buyers and sellers presents a challenge for the all events tests.[465] Self-regulation of process-related aspects of operations can enhance performance obligations, introduce credence qualities, and alter business relationships in ways that make the application of the all events tests uncertain.[466] The potential for conforming and nonconforming performance under a regulatory provision in a contract, for example, complicates efforts to identify a condition on payment obligations, the satisfaction of performance obligations, the certainty of rights and liabilities, and the knowable information about relevant events.[467] However, if the all events tests were to recognize an implied acceptance requirement as a condition on rights and liabilities for a sale of goods or services, then much of the uncertainty in self-regulated relationships and other situations would disappear.[468] This approach would acknowledge that a buyer's acceptance, rather than the seller's performance, establishes payment obligations. Therefore, acceptance could act as an identifiable event that fixes rights and liabilities for both conforming and nonconforming performances under the all events tests.

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[463] *See supra* notes 361–65 and accompanying text.
[464] *See Gillis*, 402 F.2d at 508.
[465] *See supra* text accompanying notes 1–4.
[466] *See supra* notes 11–16 and accompanying text.
[467] *See supra* Part I.
[468] *See supra* Part II.