

*RONNING V. COMMISSIONER*: ELEVENTH CIRCUIT FINDS PLAINTIFF DID NOT  
PROVIDE SUFFICIENT EVIDENCE TO SHOW HE WAS AN  
ACCRUAL-METHOD TAXPAYER

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In *Ronning v. Commissioner*,<sup>1</sup> the U.S. Court of Appeals for the Eleventh Circuit addressed the differences between an accrual-method taxpayer and a cash-method taxpayer.<sup>2</sup> After the IRS determined that a taxpayer, Scott Ronning (“Ronning”), owed a significant amount in back taxes and penalties, the Tax Court calculated the amount owed based on a finding that Ronning was a cash-method taxpayer.<sup>3</sup> The Eleventh Circuit, after reviewing the legal conclusions of the Tax Court de novo and its factual findings for clear error, ultimately held that Ronning failed to provide sufficient evidence to establish himself as an accrual-method taxpayer.<sup>4</sup>

Based on tax and business records, the Tax Court determined after a trial that Scott Ronning had an income tax deficiency and owed an underpayment penalty.<sup>5</sup> The IRS determined that Ronning had income tax deficiencies for the years of 2005 to 2008 and associated penalties for 2007 and 2008.<sup>6</sup> A primary point of contention between Ronning and the IRS related to the cost of goods sold for one of Ronning’s businesses, Atlanta Site Consultants, LLC (“ASC”).<sup>7</sup> Ronning claimed that his 2007 tax return correctly reported this cost, which was in excess of \$7 million, resulting in a significant net operating loss for ASC and net loss for Ronning.<sup>8</sup> As a result, Ronning carried back portions of the loss to his 2005 and 2006 returns and carried forward a portion to his 2008 return.<sup>9</sup> By carrying back or carrying forward a loss to offset income, Ronning would owe less taxes in those years.<sup>10</sup> The IRS disagreed with Ronning’s assertion regarding the cost of

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<sup>1</sup> *Ronning v. Comm’r*, 830 F. App’x 279 (11th Cir. 2020).

<sup>2</sup> *Id.* at 282.

<sup>3</sup> *Id.* at 280–81.

<sup>4</sup> *Id.* at 281–82.

<sup>5</sup> *Id.* at 280.

<sup>6</sup> *Id.*

<sup>7</sup> *Ronning*, 830 F. App’x at 280. Ronning was deceased before this appeal, and the personal representative of his estate was substituted as petitioner and is referred to by the court as Ronning. *Id.* at 280 n.1.

<sup>8</sup> *Id.* at 280.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

goods sold for ASC, finding the cost was \$0 rather than in excess of \$7 million, and therefore concluded he “owed income tax for 2005, 2006, 2007, and 2008, as well as associated accuracy-related penalties.”<sup>11</sup>

In 2009, Ronning’s business records, including those pertaining to ASC, were destroyed after he failed to pay fees at the storage facility housing the files.<sup>12</sup> Based on bank records, the IRS found Ronning was able to substantiate an additional “\$4.1 million in expenses that offset his income for 2007 and reduced his income tax deficiency.”<sup>13</sup> In addition to his bank records, Ronning also attempted to utilize a personal bankruptcy petition from 2009 to support his claim of business expenses.<sup>14</sup> However, the “IRS objected to the use of the bankruptcy petition to substantiate any portion of ASC’s 2007 cost of goods sold.”<sup>15</sup>

At trial, Ronning argued that the bankruptcy petition substantiated business expenses in the form of interest accrued from twelve bank loans.<sup>16</sup> However, the Tax Court ultimately determined that Ronning had failed to substantiate costs of goods sold for ASC in 2007 beyond the \$4.1 million that the IRS acknowledged.<sup>17</sup> This decision resulted in a reduced 2007 income tax deficiency for Ronning and a related penalty for inaccurate information.<sup>18</sup> Ronning appealed this determination, bringing his case to the Court of Appeals in the Eleventh Circuit.<sup>19</sup>

On appeal, Ronning’s sole argument was that the Tax Court erred in finding that he was a cash-method taxpayer.<sup>20</sup> As a cash-method taxpayer, Ronning could not deduct the interest on the twelve bank loans.<sup>21</sup> The Eleventh Circuit reviewed the legal conclusions of the Tax Court “*de novo*, and its factual findings for clear error.”<sup>22</sup> Citing *Champions Retreat Golf Founders, LLC v. Commissioner*, the court noted that a factual finding is “clearly erroneous if the record lacks substantial evidence to support it, such that our review of the entire evidence leaves us with the definite and firm conviction that a mistake has been committed.”<sup>23</sup> Additionally, the court

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<sup>11</sup> *Id.*

<sup>12</sup> *Ronning*, 830 F. App’x at 280.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 280–81.

<sup>16</sup> *Id.* at 281.

<sup>17</sup> *Id.*

<sup>18</sup> *Ronning*, 830 F. App’x at 281.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* (citing *Highpoint Tower Tech. Inc. v. Comm’r*, 931 F.3d 1050, 1056 (11th Cir. 2019)).

<sup>23</sup> *Id.* (quoting *Champions Retreat Golf Founders, LLC v. Comm’r*, 959 F.3d 1033, 1035 (11th Cir. 2020)).

noted that the taxpayer bears the burden of proving that the IRS's determination of a tax deficiency is "arbitrary or erroneous."<sup>24</sup>

As a cash-method taxpayer in the eyes of the IRS, Ronning's expense deductions would be "taken in the taxable year *when paid*."<sup>25</sup> In contrast, if he was able to provide sufficient evidence to establish himself as an accrual-method taxpayer, he would be able to deduct the expense in the tax year *when the expense was incurred*.<sup>26</sup> It was undisputed that Ronning had never paid the interest expenses on the twelve loans he wanted to deduct.<sup>27</sup> As such, Ronning was "required to show that he used the accrual method of accounting in order to deduct the interest that accrued during the relevant tax years."<sup>28</sup>

Ronning argued that the Schedule C filed with his 2007 tax return for ASC indicated he followed the accrual-method of accounting, establishing himself as an accrual-method taxpayer.<sup>29</sup> However, ASC's use of the accrual method of accounting does not automatically show that Ronning used the accrual method as an individual taxpayer.<sup>30</sup> Ronning provided no specific evidence that he individually acted as an accrual-method taxpayer.<sup>31</sup> Additionally, when the IRS stated at trial that Ronning was a cash-method taxpayer, Ronning did not contest that description.<sup>32</sup> Considering this evidence, the Eleventh Circuit held that the "Tax Court's finding that Ronning was a cash-method taxpayer was not clearly erroneous."<sup>33</sup>

Ronning also attempted to argue that the accrued interest on ASC's Schedule C should be categorized as a business expense for ASC and therefore should be deducted.<sup>34</sup> Once again, the Eleventh Circuit held that the Tax Court's contrary finding was "not clearly erroneous."<sup>35</sup> The court emphasized the bankruptcy petition, which "listed eight different businesses, none of which was ASC, as the borrowers on the loans."<sup>36</sup> At trial, Ronning had contended that ASC was responsible for all of the loans, but Ronning's own bankruptcy petition indicated that ASC was not.<sup>37</sup> The court further

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<sup>24</sup> *Ronning*, 830 F. App'x at 281.

<sup>25</sup> *Id.* at 282 (emphasis added) (quoting *Frysinger v. Comm'r*, 645 F.2d 523, 526 (5th Cir. Unit B May 1981)).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Ronning*, 830 F. App'x at 282.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Ronning*, 830 F. App'x at 282.

<sup>37</sup> *Id.* at 283.

concluded that even if some of the interest on the loans accrued to ASC was a deductible business expense, “Ronning did not meet his burden of showing the amount of such interest.”<sup>38</sup> In sum, Ronning relied on numerous assumptions and “pure speculation,” which the court found to be insufficient to establish him as an accrual-method taxpayer.<sup>39</sup>

The final segment of the court’s analysis focused on the characterization of the borrowers of several of the relevant loans.<sup>40</sup> In Ronning’s tax returns, many of the entities listed as borrowers were identified as partnerships for tax purposes.<sup>41</sup> In a partnership, each partner “calculates its income tax based on its distributive share of the partnership’s income, losses, and deductions.”<sup>42</sup> Furthermore, “a ‘partner’s distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner’s interest in the partnership’ for the relevant tax year.”<sup>43</sup> Unfortunately for Ronning, neither his tax returns nor the bankruptcy petition listed the partners in each entity or listed the partners’ distributive shares in the partnership.<sup>44</sup> The court found that because of this omission, even under the assumption that ASC was a partner in any relevant partnership, it was impossible to determine how much accrued interest constituted ASC’s derivative share or “whether any net loss to ASC was limited by ASC’s basis in the partnership.”<sup>45</sup>

With their decision in *Ronning*, the court showed deference to the decision of the Tax Court. However, in its step-by-step analysis, the Eleventh Circuit made clear that a taxpayer could provide sufficient evidence for the court to determine the Tax Court erred in its determination of a taxpayer’s methodology. Unfortunately for Ronning, the evidence he provided was simply insufficient. A plaintiff will need to provide detailed, clear, and convincing evidence to overturn a decision made by the Tax Court.

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<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Ronning*, 830 F. App’x at 283 (citing 26 U.S.C. § 702).

<sup>43</sup> *Id.* (quoting 26 U.S.C. § 704(d)).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*