10 T.C. 328 (1948)

A taxpayer can use the last-in, first-out (LIFO) method for inventory valuation across a chain retail grocery business, grouping merchandise into classifications and valuing increases using a dollar-value method, provided that this method is applied consistently and reasonably reflects income.

Summary

Edgar and Carrie Basse, operating a chain of retail grocery stores, sought to use the LIFO method for inventory valuation in 1941. They grouped their merchandise into 27 classifications and applied LIFO, but the Commissioner of Internal Revenue rejected their method. The Tax Court held that the Basses could use LIFO with the dollar-value method for warehouse inventory, but that their method for applying LIFO to the retail stores was flawed due to inconsistent application of cost increase percentages. Additionally, the court upheld the disallowance of certain travel expense deductions due to insufficient substantiation and the personal nature of some trips.

Facts

The Basses owned and operated a retail chain grocery business. Prior to 1941, they used the cost method for inventory. In 1941, they elected to use the LIFO method, excluding the meat market departments. They grouped their merchandise into 27 classifications (e.g., canned vegetables, canned meats) and determined the LIFO value for both warehouse stock and store inventories. For the store inventories, they used a retail method to determine cost, then applied an average percentage increase based on warehouse stock costs. They also deducted travel expenses for several trips, some of which had personal elements.

Procedural History

The Commissioner determined a deficiency in the Basses' income tax, disallowing the use of LIFO and a portion of their travel expense deductions. The Basses petitioned the Tax Court, contesting the Commissioner's determinations.

Issue(s)

1. Whether the petitioners were entitled to report their inventory on the elective last-in, first-out basis authorized by Section 22(d) of the Internal Revenue Code.
2. Whether the Commissioner erred in disallowing a portion of the deduction taken for traveling expenses incurred in the conduct of business.

Holding

1. Yes, because the petitioners' method of applying LIFO to their warehouse inventory, using a dollar-value approach with reasonable classifications, was

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permissible under Section 22(d).
2. No, because the petitioners failed to adequately substantiate the business purpose of certain trips and the allocation of expenses between personal and business activities, thus the Commissioner's disallowance was upheld, except for adjustments to the store inventory calculation.

Court's Reasoning

Regarding the LIFO inventory, the court relied on its prior decision in *Hutzler Brothers Co.*, stating that a physical matching of goods was not required, and a matching of dollar values was sufficient. The court found the Basses' method of grouping merchandise into classifications and applying LIFO to the warehouse inventory acceptable. However, the court determined that the Basses' method of applying an average cost increase percentage from the warehouse to the retail store inventories was flawed because it didn't account for differing turnover rates and cost fluctuations among classifications in the stores. The court, applying the rule from *Cohan v. Commissioner*, estimated a more reasonable cost increase factor for the retail store inventories. Regarding travel expenses, the court found the Basses' substantiation inadequate, relying heavily on estimates rather than detailed records. The court noted the personal element in several trips and upheld the Commissioner's disallowance, finding insufficient evidence to demonstrate that the expenses were primarily business-related.

Practical Implications

This case clarifies the permissibility of using the dollar-value LIFO method for valuing inventories in a retail business, allowing for reasonable classifications of goods. However, it emphasizes the importance of applying LIFO consistently and accurately across different segments of the business (e.g., warehouse vs. retail stores). It also serves as a reminder of the taxpayer's burden to maintain adequate records to substantiate business expenses, particularly when travel involves a mix of personal and business activities. Later cases cite *Basse* for its discussion of dollar-value LIFO and the need for reasonable methods of inventory valuation. It also underscores the continuing importance of the *Cohan* rule in situations where exact expense records are unavailable, though taxpayers must still provide a reasonable basis for estimation. The case also demonstrates that generalized testimony regarding business purpose, without detailed records, is unlikely to overcome a Commissioner's disallowance of deductions.

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