Gus Blass Co. v. Commissioner, T.C. Memo. 1953-168

A taxpayer's established method of accounting, when accurately reflecting income on their books, should be followed for tax reporting, necessitating the inclusion of freight charges in inventory costs as per standard accounting principles.

Summary

Gus Blass Co., a department store, consistently excluded freight costs from its inventory for income tax purposes, despite including these costs in its book inventories. While the Commissioner initially accepted this method, a later audit for excess profits tax purposes insisted on including freight in base period inventory calculations. The Tax Court upheld the Commissioner's adjustment, reasoning that the company's book inventory, which included freight, more accurately reflected income. The court determined that excluding freight for tax purposes was erroneous and that the Commissioner was correct to adjust base period income for excess profits tax credit calculation, even though the statute of limitations prevented direct income tax adjustments for those earlier years. This case underscores the importance of aligning tax reporting with a taxpayer's regular accounting method when it clearly reflects income and clarifies the treatment of freight costs in inventory.

Facts

Petitioner, Gus Blass Co., operated a department store and historically excluded freight costs from its inventory valuation for income tax purposes, using the cost or market, whichever is lower, method. Although their books consistently included freight in inventory costs, for tax returns from 1933 to 1936, and again in 1939-1941, freight was excluded. Initially, revenue agents reviewed and approved this exclusion for the 1933 and 1934 tax years. However, for fiscal years 1937 and 1938, when the petitioner included freight, the Commissioner adjusted the returns to exclude it, citing consistency with prior years. For 1942 and subsequent years, the petitioner included freight in both book and tax inventories. During a re-examination of the 1940 and 1941 returns in 1943, the Commissioner adjusted closing inventories to include freight, aiming to eliminate "troublesome adjustments." For excess profits tax calculations for fiscal years 1943-1945, the Commissioner used inventories that included freight, consistent with the petitioner's book inventories.

Procedural History

The Commissioner determined deficiencies in excess profits taxes for fiscal years 1943, 1944, and 1945, and in declared value excess-profits tax for 1944. The core issue was whether the Commissioner properly used opening and closing inventories, including freight, when computing the petitioner's net income for base period years to determine its excess profits credit. The Tax Court was tasked with reviewing the

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Commissioner's determination.

Issue(s)

1. Whether the Commissioner correctly adjusted the petitioner's inventories for the base period years to include freight when computing the excess profits credit?
2. Whether the petitioner's method of excluding freight from inventories in reporting income for the base period years was correct for tax purposes?

Holding

1. Yes, because the petitioner's book inventories included freight, and excluding it for tax purposes did not accurately reflect income, contradicting established accounting principles and IRS regulations.
2. No, because excluding freight from inventories for tax purposes was inconsistent with the petitioner's own books and standard accounting practices, thereby incorrectly reporting income for tax purposes.

Court's Reasoning

The Tax Court relied on Treasury Regulations and established case law to reach its decision. Regulation 111, sec. 29.22(c)-3, specifies that inventory cost should include transportation charges. Section 41 of the Internal Revenue Code mandates that income be computed according to the taxpayer's regular accounting method if that method clearly reflects income. The court emphasized that when a taxpayer's books clearly reflect income, that accounting method should govern tax reporting. Quoting *Commissioner v. Mnookin's Estate*, the court stated, "The taxpayer's method of accounting will control the time as of which income must be reported and deductions allowed." The court found that Gus Blass Co.'s books, which included freight in inventory, accurately reflected income. Therefore, excluding freight for tax purposes was deemed incorrect and a distortion of income. While acknowledging that the statute of limitations barred direct adjustments to income tax for the base period years, the court cited *Leonard Refineries, Inc.* and *Rosemary Manufacturing Co.* to support the Commissioner's authority to correct base period income for excess profits credit calculations. Finally, the court affirmed the Commissioner's action under Section 734 of the Internal Revenue Code, which allows for adjustments when an item is treated inconsistently between income tax and excess profits tax calculations, referencing *Zellerbach Paper Co.* and *Rosemary Manufacturing Co.*

Practical Implications

Gus Blass Co. reinforces the principle that tax reporting should align with a taxpayer's regular accounting method, especially when that method clearly reflects income as per their books. It clarifies that freight and transportation costs are

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integral components of inventory cost for tax purposes, consistent with standard accounting practice and IRS regulations. The case also demonstrates the Commissioner's ability to adjust base period income for excess profits tax credit calculations, even when direct income tax adjustments are barred by the statute of limitations. This ruling emphasizes the importance of consistent accounting methods for tax purposes and the potential for adjustments under Section 734 to ensure consistent treatment of items across different tax regimes. Practically, this case advises businesses to ensure their tax reporting of inventory consistently includes freight costs if their book accounting does, and it alerts them to the Commissioner's power to correct base period income for excess profits tax purposes, even years later, to ensure a consistent and accurate tax liability calculation.

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