1954 Tax Ct. Memo LEXIS 200

A farmer seeking to change from the cash receipts and disbursements method of reporting income to the farm inventory method must strictly comply with the requirements of Treasury Regulations, including filing an adjustment sheet for the preceding taxable year and paying any tax due, before the change is effective.

Summary

The petitioner, a farmer, attempted to change his method of reporting income from the cash basis to the farm inventory (accrual) method without securing formal permission from the Commissioner. He filed adjustment sheets for several prior years, resulting in a net overpayment claim. The Tax Court held that the petitioner failed to comply with the regulatory requirements for changing accounting methods because he did not properly file and pay the tax due on an adjustment sheet for the immediately preceding year. Therefore, the Commissioner's determination to compute the petitioner's net income on the cash basis was upheld.

Facts

The petitioner had consistently used the cash receipts and disbursements method for reporting farm income. In 1947, the petitioner attempted to switch to the farm inventory method and used inventory values in computing his net farm profit. He had a farm inventory valued at $23,130.69 at the beginning of 1947. Because he previously used the cash method, he had already deducted the expenses related to producing the inventory in prior years.

Procedural History

The Commissioner determined a deficiency for 1947, disallowing the change in accounting method. The petitioner argued that the years 1944 and 1945 were also at issue because the Commissioner denied his refund claims for those years. The Tax Court noted it only had jurisdiction over 1947, as that was the only year a deficiency was determined. The case proceeded in the Tax Court on the validity of the Commissioner's deficiency determination for 1947.

Issue(s)

Whether the petitioner, beginning in 1947, could change from the cash receipts and disbursements method of reporting income to the farm inventory method without securing the formal permission of the Commissioner and without strictly following the procedure outlined in the applicable Treasury Regulations.

Holding

No, because the petitioner failed to comply with the mandatory procedures outlined in the applicable Treasury Regulations for changing accounting methods,

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specifically by failing to file an adjustment sheet for the immediately preceding year (1946) and paying the tax shown to be due thereon.

Court’s Reasoning

The court relied heavily on Section 29.22(c)-6 of Regulations 111, which provided specific options for farmers seeking to change from the cash to the accrual basis with an inventory on hand. The petitioner attempted to use Option 1, which required submitting an adjustment sheet for the *preceding* taxable year (1946) with the return for the current taxable year (1947) and paying any tax due on that adjustment. The court noted that the petitioner filed an adjustment sheet for 1946 showing a tax due of $2,328.36 but did not pay it. Instead, he filed adjustment sheets for 1944 and 1945, resulting in a net overpayment claim. The court stated, “When a taxpayer has filed his return and otherwise complied with the aforesaid requirements of the regulations he has completed the first step in changing his basis of reporting income.” Because the petitioner failed to complete this first step, the Commissioner was justified in computing the petitioner’s 1947 income using the cash basis, consistent with prior years.

Practical Implications

This case underscores the importance of strict compliance with tax regulations, particularly when changing accounting methods. It illustrates that taxpayers cannot selectively comply with regulatory requirements to their advantage. Farmers, and by extension, other taxpayers seeking to change accounting methods must follow the prescribed steps precisely to ensure the validity of the change. This includes accurately preparing and submitting required adjustment sheets and remitting any resulting tax liabilities. Later cases will look to whether the taxpayer completely followed the required steps to change accounting methods. This case serves as a caution against attempts to circumvent clear regulatory procedures and emphasizes the Commissioner’s authority to enforce consistent accounting practices when taxpayers fail to adhere to these procedures. The case also highlights the importance of carefully considering all tax years potentially affected by a change in accounting method.

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