21 T.C. 147 (1953)

To adopt the last-in, first-out (LIFO) method of inventory valuation, a taxpayer must strictly comply with the statutory requirements and file the necessary application, even if the business is a successor to a company that previously used the method.

Summary

In this case, the Textile Apron Company, Inc. (Taxpayer) acquired the assets and business of three proprietorships that had been using the last-in, first-out (LIFO) inventory valuation method. The Taxpayer continued to use LIFO but failed to file a Form 970 to request permission as required by the Internal Revenue Code. The Commissioner of Internal Revenue (Commissioner) disallowed the use of LIFO and recomputed the Taxpayer's income using the first-in, first-out (FIFO) method. The court agreed with the Commissioner, holding that the Taxpayer, as a new taxpaying entity, was required to file an application to use the LIFO method. The court also held that the Commissioner could not use different inventory valuation methods for opening and closing inventories in determining the deficiency for 1947.

Facts

Textile Apron Company, Inc. was incorporated in Georgia on December 19, 1945. It took over the assets and business of three sole proprietorships on January 2, 1946. The prior businesses, owned by J.B. Kennington, Sr., had used the LIFO inventory method from 1942 to 1945, after properly filing Form 970. The Taxpayer continued to use the LIFO method for its 1946 through 1949 tax returns and on its inventory ledger without filing Form 970. The Commissioner disallowed the use of LIFO, requiring the use of FIFO. The Commissioner employed LIFO for the opening inventory and FIFO for the closing inventory to determine the deficiency for 1947.

Procedural History

The Commissioner issued a notice of deficiency to Textile Apron Company, Inc. on February 14, 1951, disallowing the use of the LIFO method. The Taxpayer contested this determination in the United States Tax Court. The Tax Court upheld the Commissioner's decision. The court found that the Taxpayer was a new entity and did not follow the necessary steps to use the LIFO method of inventory valuation.

Issue(s)

1. Whether the Taxpayer was authorized to report its inventories on the LIFO method under section 22(d)(1) of the Internal Revenue Code.

2. If not, whether the Commissioner could require that the valuation of the Taxpayer's opening inventory for 1947 remain on the LIFO method while changing the closing inventory method to FIFO.

Holding

1. No, because the Taxpayer failed to file the required application (Form 970) to use the LIFO method.

2. No, because the Commissioner could not employ different inventory valuation methods for the opening and closing inventories.

Court's Reasoning

The court focused on the statutory requirements for using the LIFO method. The court cited Section 22(d)(1) of the Internal Revenue Code which allows the LIFO method and Section 22(d)(3) which states:

"The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income."

The court determined that because the Taxpayer did not file Form 970, it could not use the LIFO method. The court reasoned that the Taxpayer, as a newly incorporated entity, was separate from the predecessor proprietorships. The Court highlighted the importance of strict adherence to the regulations, emphasizing that Congress delegated broad discretion to the Commissioner to control the adoption and use of the LIFO method.

Regarding the second issue, the court found that the Commissioner could not require the Taxpayer to use different valuation methods for its opening and closing inventories. The court noted the inconsistent application and that the Commissioner's action to use the LIFO method for the opening inventory in 1947 and the FIFO method for the closing inventory was improper. It also cited the fact that the statute of limitations had expired for the tax year 1946.

There was a dissenting opinion arguing that the strict technicality of failing to file Form 970 was unreasonable, particularly since the Taxpayer was fully qualified to use LIFO.

Practical Implications

This case underscores the importance of strict compliance with tax regulations and the need for new entities to independently satisfy requirements, even if predecessors met them. It means that when a business changes its form (from a sole proprietorship to a corporation), it needs to re-establish its compliance. Attorneys advising businesses must ensure they file all required forms and adhere to any relevant regulations, especially when a business is acquired or undergoes a significant change in structure. The case is a reminder of how important it is to obtain necessary approvals from the IRS, even if a business has a history of tax compliance.