22 T.C. 21 (1954)

A change in the method of accounting, for tax purposes, occurs when there is a change in the accounting treatment of income or deductions, which requires consent of the Commissioner of Internal Revenue.

Summary

The case involved a taxpayer, Western Vegetable Oils, Inc., who changed its method of accounting for copra sales contracts from accruing the full invoice amount in the year of the contract to only including 95% of the invoice amount. The IRS challenged this change, arguing it represented a change in accounting method requiring prior consent. The Tax Court agreed with the IRS, holding that the new system was a change in accounting method because it altered the accounting treatment of income. The court emphasized that the taxpayer's right to receive income was fixed at the time of sale. The court's decision reinforced the principle that taxpayers must consistently follow their chosen accounting methods and obtain the Commissioner's permission before making changes.

Facts

Western Vegetable Oils, Inc., sold copra and used the accrual method of accounting. Prior to 1949, it accrued the entire invoice amount for copra sales in the year the contracts were executed. However, in 1949, it began including only 95% of the invoice amount for year-end contracts where the landed weights had not been determined by year-end. The remaining 5% was considered an estimate for potential adjustments after the final weight determination. The IRS determined this change was a change in accounting method requiring prior consent, and therefore, disallowed the exclusion of 5% of the invoice prices. Western Vegetable Oils did not seek or obtain permission for the change.

Procedural History

The case was heard before the United States Tax Court. The IRS determined a tax deficiency, which Western Vegetable Oils challenged. The Tax Court sided with the IRS, upholding the determination that a change in accounting method had taken place, requiring consent from the Commissioner.

Issue(s)

1. Whether the new accounting system adopted by Western Vegetable Oils in 1949, of including only 95% of the invoice price of year-end copra sales, constituted a change in accounting method requiring the Commissioner's consent?

Holding

1. Yes, because the new system represented a change in the method of accounting

for income, requiring the Commissioner’s permission.

Court’s Reasoning

The court focused on whether Western’s new method constituted a change in its accounting method, which would require the Commissioner’s consent. The court referred to Regulations 111, section 29.41-2, which mandated that a taxpayer obtain the Commissioner’s consent before changing its accounting method. The court emphasized that the new system changed the accounting treatment of income. The court stated the right to receive income, not its actual receipt, determines when it should be accrued and included in gross income. The court determined that the right to the income, in this case, was established when the copra contracts were executed and the goods were shipped, not when the final weights were determined. The adjustment of the invoice price was contingent and the court stated, “the amounts of future adjustments in the invoice prices were contingent and liability for them did not accrue in the taxable year 1949.” The court found the Commissioner’s determination was proper and that the taxpayer did not prove the determination was erroneous.

Practical Implications

This case highlights the importance of consistency in accounting methods for tax purposes. Businesses must adhere to their chosen accounting methods and obtain the IRS’s permission before making any changes. If a change alters the accounting treatment of income or deductions, even slightly, it may be considered a change in accounting method. The decision reinforces the broad discretion afforded to the Commissioner in determining whether an accounting method accurately reflects income. It also illustrates the importance of accurate record keeping and the need for taxpayers to support their accounting practices with sufficient evidence, particularly when dealing with complex transactions. Finally, the case highlights that a taxpayer’s right to receive payment, not the actual receipt of income, determines when that income is accrued.

