Frost v. Commissioner, 28 T.C. 1118 (1957)

A taxpayer who has consistently inventoried breeding livestock under the unit-livestock-price method cannot unilaterally change to a depreciation method without the Commissioner of Internal Revenue's consent.

Summary

The case involves Jack and Ruby Frost, ranchers who had consistently used the unit-livestock-price method to account for their breeding herd in their farming business. In 1951, without seeking the Commissioner's consent, the Frosts removed part of their breeding herd from inventory and began depreciating them. The IRS disallowed the depreciation deductions, arguing that the change in accounting method required prior approval. The Tax Court sided with the IRS, holding that the Frosts were bound by their initial choice of accounting method, and that any subsequent changes needed the Commissioner's consent. The Court relied on prior cases and regulations which establish consistency in accounting practices.

Facts

Jack and Ruby Frost, farmers and ranchers in Texas, had been in the business since 1936 and breeding cattle since 1938. Prior to 1951, they used the "unit-livestock-price" method for inventorying their breeding herd. On January 1, 1951, they moved part of their breeding herd from inventory to a depreciation schedule and claimed deductions. They did not seek or receive the Commissioner's approval for this change in accounting method. The IRS subsequently disallowed the depreciation deduction.

Procedural History

The IRS determined a deficiency in the Frosts' 1951 taxes, disallowing their claimed depreciation. The Frosts challenged this determination in the United States Tax Court. The Tax Court ultimately sided with the IRS, upholding the disallowance of the depreciation deduction. The decision was based on the consistency of the taxpayer's accounting method and the regulations requiring IRS approval to change it.

Issue(s)

1. Whether the Frosts, having previously inventoried their breeding herd under the unit-livestock-price method, could remove the herd from inventory and depreciate it without the Commissioner's prior consent?

Holding

1. No, because taxpayers are bound by their initial choice of accounting method and must obtain the Commissioner's approval before switching.

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Court’s Reasoning

The Court relied on existing Treasury Regulations (Regs. 111, secs. 29.22 (c)-6 and 29.41-2) and prior case law, specifically Elsie SoRelle, which states that, once a farmer chooses to inventory breeding stock, he is bound by that method unless he obtains permission from the Commissioner to change. The regulations state that livestock acquired for breeding purposes can be included in inventory or treated as capital assets and depreciated, but not both simultaneously. If inventory is used, no depreciation is allowed. The Court emphasized that the regulations in question had been in place for a long time and had received legislative sanction through repeated reenactments of the relevant statutory provisions. The Court found no reason to distinguish the present case from the SoRelle case.

Practical Implications

This case emphasizes the importance of consistent accounting methods in tax reporting and the need to obtain the IRS’s consent before making a material change to these methods. Taxpayers in the farming and ranching businesses, or any business that uses inventories, must carefully choose their accounting methods for livestock, and must adhere to that method unless a change is authorized by the IRS. It also highlights the deference courts give to established IRS regulations and prior case law. Accountants and tax lawyers should advise clients about the necessity of seeking IRS approval before changing their method for valuing livestock or any inventory.

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