34 T.C. 156 (1960)

When a taxpayer uses the unit-livestock-price method to inventory livestock, the inventory basis of culled breeding stock must be removed from opening inventory when calculating long-term capital gains, and the net operating loss carryback is reduced by the untaxed portion of capital gains.

Summary

The U.S. Tax Court addressed two issues in Little v. Commissioner. First, the court considered whether taxpayers who used the unit-livestock-price method to inventory livestock could use a zero basis or the adjusted inventory basis when calculating long-term capital gains from the sale of culled breeding stock. The court held that the adjusted inventory basis must be used or, alternatively, be removed from opening inventory. Second, the court determined whether the net operating loss carryback from 1952 to 1951 should be reduced by 50% of the 1951 net long-term capital gains in accordance with Section 122(c) of the 1939 Code, where the tax for 1951 was calculated using the alternative tax computation method. The court ruled that the reduction was proper and consistent with the statute.

Facts

Andrew Little, Jr., and his wife, Myrn Little, filed a joint income tax return for 1951. Andrew Little, Jr., had been in the sheep and cattle business since 1942, using an accrual method of accounting and the unit-livestock-price inventory method. Breeding animals were included in inventory. The petitioners sold raised lambs, steers, and wool, and culled breeding stock. They consistently reported proceeds from the sale of culled breeding stock as ordinary income through 1952. In 1951, they realized long-term capital gains from the sale of breeding stock held for more than six months. A net operating loss carryback from 1952 to 1951 was also at issue.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioners' income tax for 1951. The case was brought before the United States Tax Court to determine the proper tax treatment of the sale of culled breeding stock and the net operating loss carryback. The Tax Court adopted a stipulation of facts provided by the parties and rendered its decision based on those agreed-upon facts.

Issue(s)

1. Whether the petitioners must use the adjusted inventory basis or are entitled to use a zero basis in computing the long-term capital gains from the sale of raised breeding stock.

2. Whether the 1952 net operating loss carryback to 1951 must be reduced by 50% of the 1951 long-term capital gains, where the tax for 1951 was computed using the

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alternative tax method.

Holding

1. No, because the adjusted inventory basis should be used to compute the long-term capital gains, or, if the livestock were improperly included in inventory, the amount of the basis should be removed from opening inventory.

2. Yes, because Section 122(c) of the 1939 Code requires the reduction of the net operating loss carryback by 50% of the capital gains of the tax year.

Court's Reasoning

The court first addressed the proper basis for calculating the gain from the sale of culled breeding stock. The court held that the adjusted inventory basis should be used. The court noted that the petitioners had consistently used the unit-livestock-price method, including breeding animals in their inventory. The court reasoned that if the inventory method was proper, the adjusted inventory basis should be used. The court also noted that if the inventory method was improper, the inventory basis would need to be removed from the opening inventory. The Tax Court clarified that the Commissioner's computation arrived at the correct amount of tax, regardless of the taxpayer's theory of either including or excluding the breeding animals from inventory. The court cited the stipulation of the parties concerning the inventory basis and the amount that would otherwise be a double deduction if the inventory method was proper.

The second issue involved the net operating loss deduction. The court cited Section 122(c), which dictates that the net operating loss carryback must be reduced by the amount of the taxpayer's net income, calculated with certain exceptions and limitations, including a reduction for the untaxed portion of capital gains. The court found that the Commissioner properly followed these provisions in calculating the net operating loss deduction and that it was

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