Pursell v. Commissioner, 38 T.C. 263 (1962)

A change in accounting method for tax reporting purposes, even if the taxpayer's books are consistently kept on a different method, constitutes a taxpayer-initiated change requiring adjustments under Section 481 of the Internal Revenue Code to prevent income duplication or omission.

Summary

Fred Pursell, who maintained accrual-basis books for his wholesale electronics business, improperly filed cash-basis tax returns for several years. In 1954, he switched to accrual-basis tax reporting to align with his books. The IRS assessed deficiencies, adding to Pursell's 1954 income the opening inventory and accounts receivable from 1953 and deducting accounts payable. The Tax Court upheld the IRS, finding Pursell's tax reporting change was taxpayer-initiated, triggering Section 481 adjustments. The court rejected Pursell's arguments that the change wasn't taxpayer-initiated and that pre-1954 adjustments were improper, emphasizing the purpose of Section 481 to prevent income from escaping taxation due to accounting method changes initiated by the taxpayer.

Facts

Fred Pursell operated a wholesale radio and electronics business since 1933.
From at least 1949, Pursell maintained accrual-basis books for his business.
However, for tax years 1950-1953, Pursell filed cash-basis income tax returns, not using inventories, receivables, or payables.
In 1954, Pursell began filing accrual-basis tax returns, consistent with his books.
For 1954, Pursell's return included an opening inventory but did not account for beginning accounts receivable or payable in income calculations.
The IRS determined deficiencies for 1954-1958, adjusting Pursell's 1954 income by adding back opening inventory and receivables and deducting payables from December 31, 1953, to prevent income omission or duplication due to the accounting change.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies for Pursell for the years 1954-1958.
Pursell petitioned the Tax Court contesting these deficiencies.
The Tax Court upheld the Commissioner's determination.

Issue(s)

1. Whether Pursell's change from cash-basis to accrual-basis tax reporting in 1954 constituted a change in accounting method under Section 481 of the 1954 Internal Revenue Code.
2. Whether Section 29 of the Technical Amendments Act of 1958, amending

Section 481, is constitutional.
3. If there was a change in accounting method, whether Pursell "initiated" the change within the meaning of Section 481(a)(2), as amended.
4. Whether the Commissioner correctly computed transitional adjustments under Section 481(a) by including inventory, accounts receivable, and accounts payable from December 31, 1953.
5. Whether the assessment and collection of income tax for 1954 is barred by the statute of limitations.

Holding

1. Yes, because Section 481 applies to changes in the method of computing taxable income, not just bookkeeping methods.
2. No, because prior cases have upheld the constitutionality of Section 29 of the Technical Amendments Act of 1958.
3. Yes, because Pursell voluntarily changed his method of tax reporting, initiating the change for purposes of Section 481, regardless of whether it was legally required.
4. Yes, because Section 481 mandates adjustments to prevent income duplication or omission, and the Commissioner's computation correctly reflected these necessary adjustments.
5. No, because Pursell executed valid waivers extending the statute of limitations for assessment, and the deficiency notice was issued within the extended period.

Court's Reasoning

The court reasoned that Section 481 of the 1954 Code was enacted to address inconsistencies and prevent income from escaping taxation or being taxed twice due to changes in accounting methods. The court stated, "We think it is clear from the express language used by Congress, particularly when viewed in the light of the confusion in the law existing at the time this legislation was being considered and its legislative history, that application of the section is not limited to those cases in which the taxpayer changes his method of keeping his books, but applies in any case wherein the method of accounting employed in computing taxpayer's taxable income for a particular year is different from the method of accounting employed in computing the taxpayer's income for the preceding taxable year…"

Regarding the taxpayer-initiated change, the court interpreted "initiate" to mean "originate" or "make a beginning with." Since Pursell voluntarily changed his tax reporting method without IRS prompting, he initiated the change. The court emphasized, "To interpret the provision in the manner requested by petitioners would give an advantage to the taxpayer who had deliberately kept his books or reported income on the wrong method and then chose the year 1954 to correct his error to conform to the law. We find nothing to support or justify such an interpretation."

The court dismissed Pursell’s argument to reduce adjustments based on prior years’ tax treatments, stating Section 481 is not for correcting past errors but for adjustments solely due to the accounting method change in 1954. The court noted, “Section 481 does not provide a means by which errors of past years may be corrected; it applies only to those adjustments made necessary by the taxpayer’s change in method.”

Finally, the court upheld the validity of the statute of limitations waivers, finding they were properly executed and extended the assessment period to cover the deficiency notice.

Practical Implications

Pursell v. Commissioner clarifies that for purposes of Section 481, a taxpayer “initiates” an accounting method change when they voluntarily alter their tax reporting method, even if their bookkeeping method remains consistent. This case underscores that taxpayers cannot avoid Section 481 adjustments by arguing they were merely conforming tax reporting to their existing books. It reinforces the IRS’s authority to make transitional adjustments, including pre-1954 items under the amended Section 481, when a taxpayer-initiated accounting change occurs. This decision is crucial for tax practitioners advising clients on accounting method changes, highlighting the potential for significant income adjustments in the year of change, particularly when transitioning from cash to accrual accounting. Later cases have consistently cited *Pursell* to support the broad application of Section 481 to taxpayer-initiated changes in tax reporting methods.

