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Changes in accounting methods -- recent tax developments

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—recent tax developments

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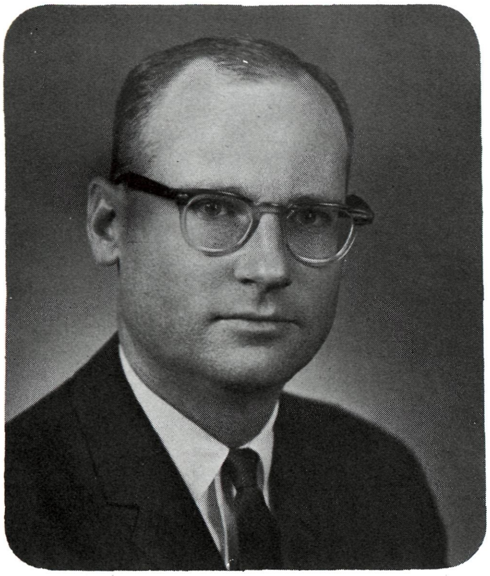
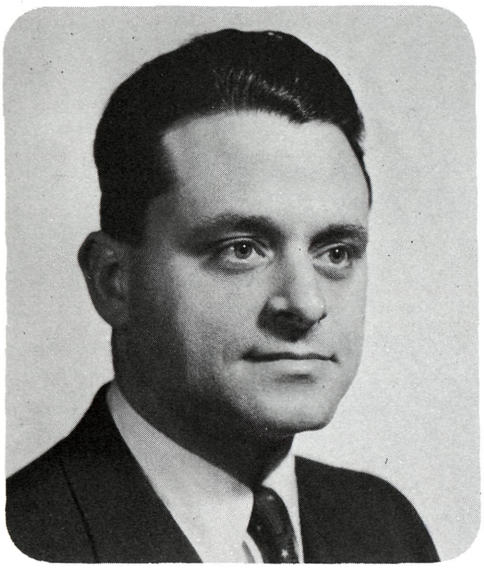


Carleton H. Griffin, partner in our Denver office, has been challenging accounting methods in speeches for a number of years, and included among his most recent published articles on the subject is an article in the Journal of Accountancy.

A native of St. Louis, Missouri, he joined our Detroit office after graduating from the University of Michigan with a B.B.A., M.B.A., and J.D. He transferred to Denver in 1959.

He is a member of the American Institute of CPAs and a member of the Board of Directors of the Colorado Society, where he was formerly chairman of the Federal Tax Committee.

ACCOUNTING IS A DYNAMIC ART. Changes in techniques and philosophy, as well as the ever growing complexity and sophistication of our modern economic system, frequently require a review of the suitability of the accounting methods used by business entities. Woe betide the professional accountant who recommends a change in the financial accounting methods of a client without also considering the possible tax consequences, since taxpayers and practitioners continue to be harassed by a myriad of federal income tax problems involved when a method of accounting is changed. Although many unanswered questions remain, developments in recent years have removed some of the areas of doubt which previously existed. The answers which have materialized may not be satisfactory to the practitioner in all respects, but at least they are answers.



Eli Gerver, partner in our San Francisco office, was director of taxation with the American Institute of Certified Public Accountants before joining TRB&S in 1960. Until last year, when he moved to San Francisco, he served as director of tax research in the Executive Office.

His lectures and articles on various phases of taxation are too numerous to list . . . one of his most recent articles, "Living with the Guidelines," was distributed in booklet form by the Tax Executives Institute in Washington after it appeared in The Tax Executive.

Mr. Gerver is a graduate of City College of New York, and has lectured there in both accounting and taxes. He is a member of the American Institute of CPAs, the California and New York State CPAs, and the National Tax Association.

The basic problem

The basic federal income tax rules concerning accounting method changes are clear. If a taxpayer intends to modify his tax reporting to the extent that a "change in accounting method" is involved, Section 446 of the Internal Revenue Code and related Regulations[1] require that he first obtain the consent of the Commissioner of Internal Revenue. To obtain such consent the taxpayer must file an application on Form 3115 with the Commissioner within 90 days after the beginning of the taxable year for which the change is to be effective. If the Commissioner's consent to the change and conditions of change is not so obtained the change cannot properly be made no matter how erroneous the taxpayer may consider the old method to be. Of course, it is possible that an unpermitted changed may occasionally be accepted, knowingly or unknowingly, by the Internal Revenue Service but the Service has the authority to reject changes in the absence of formal consent.[2]

In addition, Section 481 of the Code spells out rules with respect to adjustments to taxable income which may be required incident to a change in accounting method. Although rather complex, these rules are easily understandable when related to a simple example. Assume that Z Company is a calendar-year retailer which began business in 1946. Although Regulations required it to compute taxable income by accounting for inventories and using the accrual method for purchases and sales,[3] Z Company from its inception maintained its accounts and reported taxable income on a strict cash basis. Effective for the calendar year 1964 Z Company computed taxable income and book income on an accrual basis, clearly a change in accounting method. The following account balances existed on the dates specified:

	12/31/53 (not booked)	1/1/64 (booked 1/1/64)
Accounts receivable . .	$ 25,000	$ 35,000
Inventory	45,000	65,000
Accounts payable . . .	(30,000)	(40,000)
Net positive accruals .	$ 40,000	$ 60,000

If Z Company were allowed to report its taxable income for 1964 and later years on a strict accrual basis, net taxable income in the amount of $60,000 would escape tax. The $35,000 of receivables was not included in cash basis income prior to 1964 and would not be included in accrual basis income after 1963. Similarly, the $65,000 of inventories was deducted in the year of purchase prior to 1964 and on the accrual basis would be added to cost of sales as opening inventory in 1964. This $100,000 total of omitted income and duplicated deductions would be offset by the $40,000 of payables which was not deducted under the cash basis in prior years and could not be taken as accrual basis deductions.

The adjustments to prevent these duplications or omissions vary depending upon who initiated the change in method — i.e., Z Company or the Internal Revenue Service. If the change were initiated by the Service the pre-1954 positive accrual of $40,000 would be excluded completely from taxable income for all years.[4] In addition, the post-1953 positive accrual of $20,000 would be included in taxable income of 1964, subject to limitation of tax by theoretically spreading the adjustment to 1964 and two or more earlier taxable years.[5]

If the change were initiated by the taxpayer the result would be considerably different. Specifically, the Code provides in that case that the entire $60,000 positive accrual at January 1, 1964, would be included in taxable income of 1964 subject to the spread-back limitations on tax liability.[6] (If the change had been made in a taxable year beginning before January 1, 1964, only 10% of the pre-1954 accrual of $40,000 would be included in taxable income of the year of change, with the remaining $36,000 adjustment allocated equally to the succeeding nine taxable years.[7] However, it seems likely that if the taxpayer wished to initiate the change in years beginning after December 31, 1963, he could obtain a prior agreement with the Commissioner to apply a similar spread-forward rule as a condition to the change.)

Who initiates the change?

It is thus clear that in cases to which Section 481 applies it is most important to identify which of the two parties initiated the change in method. Moving now to a discussion of current developments, we will consider first the cases which have a bearing on this particular question.

Taxpayers have for some time contended that a change effected by the taxpayer to conform tax reporting to clearly established rules would not be a change initiated by the taxpayer, but would be a change initiated by the government to which the taxpayer merely acceded. Regulations state an opposite position, as follows:

> "... a taxpayer who, on his own initiative, changes his method of accounting to conform to the requirements of any Federal income tax regulation or ruling shall not, merely because of such fact, be considered to have made an involuntary change."[8]

In *Pursell v. Comm.*[9] this question was raised and the Regulations were upheld. The taxpayer was a wholesaler who maintained his books on an accrual basis but reported for tax purposes on a cash basis. Commencing with his tax return for the calendar year 1954 he began reporting for tax purposes on the accrual basis and contended that he did not initiate the change but merely complied with the statutory rule that taxable income must be computed on the same basis as book income.[10] The Tax Court disagreed with the taxpayer, stating that the question is who acted to make the change and is not concerned with why the change was made. This decision presumably would govern in any situation in which the taxpayer acted to correct a clearly improper accounting method, holding that the taxpayer would have initiated the change and pre-1954 accruals would not escape tax.

Another interesting problem as to who initiates the change arises when a taxpayer is forced to change a method of accounting to conform to Regulations governing tax-free corporate acquisitions or consolidated returns. For example, assume that Corporations A and B are both calendar-year taxpayers and both have been engaged in a personal service business for many years. A has always filed its income tax return on an accrual basis while B has reported on a cash basis. Assume further that on January 1, 1964, B merged into A in a tax-free reorganization and the two businesses were integrated into one operation. Under the provisions of Section 381 and related Regulations[11] either the cash or accrual method must be used (in absence of consent to the contrary) for the integrated business[12] and we shall assume that A's accrual method continues in use. There would be a change in accounting method with respect to the share of the business formerly owned by B and adjustments would be required to prevent duplication or omission of income. The Regulations further specify that the change in method would be considered as initiated by the taxpayer[13] with the result that B's pre-1954 accruals would not escape taxation. Of course, the reason for this position is that A and B voluntarily entered into the merger which in turn caused the change in method.

A similar situation would arise if A and B were a parent and wholly-owned subsidiary and they elected to file a consolidated return for the first time for the calendar year 1964. Under the facts assumed it is likely that the consolidated return for A and B would have to reflect consolidated taxable income on either the cash or accrual method,[14] with a resulting change in accounting method for A or B, respectively. Although the consolidated return Regulations do not clearly state the rule,[15] it would appear that the change would be considered as initiated by the taxpayers since the first filing of the consolidated return would be a voluntary act by A and B.[16]

A question can arise as to who initiates a change when an examining agent enters the scene. Certainly, if the agent effects the change in a report ultimately approved by his superiors and issued to the taxpayer, the following Regulation would apply:

> "A change in the taxpayer's method of accounting required as a result of an examination of the taxpayer's income tax return will not be considered as initiated by the taxpayer."[17]

However, the answer is not so clear if an agent only verbally states to the taxpayer, with varying degrees of force, that the taxpayer should make the change and the taxpayer obliges when filing his next return. In *Lindner*[18] the agent was examining a taxpayer's returns which had been incorrectly filed on the cash basis. The agent instructed the taxpayer to file its forthcoming 1955 return on the accrual basis and suspended his investigation of the earlier years' returns until the 1955 return was properly filed. The government argued that an agent cannot by himself initiate a change but the District Court (Utah) determined that the agent asserted his position so strongly that the taxpayer made the change as a direct result of his statements and representations. The opposite result was reached in *Falk*[19] and *Welch*[20] in which the Tax Court found that the agents had only suggested that the changes be made and with sufficient restraint that the initiative was not taken from the taxpayer. It is interesting to note that in *Welch* the agent even gave certain schedules to the taxpayer which would be required in making the suggested change.

It is of course impossible to assess the precise differences in facts in these cases. However, no taxpayer should feel secure in effecting a change based upon any kind of verbal direction from an examining agent.

An interesting problem has developed with respect to situations in which the government has admittedly initiated a change but pre-1954 accruals do not escape tax since the taxpayer's legal status has changed. For example, in *Ezo Products*,[21] a manufacturing partnership commenced operations in 1944 and began filing its income tax returns on the cash basis with no adjustments for inventories. On January 1, 1956, the partnership assets were transferred to a corporation in a tax-free transaction and the corporation filed its returns on the cash basis. As a result of examining the corporation's returns for the calendar years 1956 and 1957 the Service changed the taxpayer's method of accounting to the accrual method and required that inventories be recognized. The Service reasoned:

(1) The partnership had not recognized accounts receivable or inventory in computing taxable income, and its basis in these assets was accordingly zero.

(2) Since these assets were transferred to the corporation in a tax-free transaction the same zero-basis carried over to the corporation.[22]

(3) Collection of the zero-basis receivables by the corporation generated taxable income in the year of collection; consumption of the zero-basis inventory existing on January 1, 1956 would not be allowable as a cost of sales deduction.

Thus, as a result of the change to the accrual method, there would be a substantial bunching of income in 1956.

The taxpayer contended that since the government forced the change the provisions of Section 481 were applicable (with the result, presumably, that pre-1954 accruals would escape tax completely). The Tax Court noted that Section 481 applies only where the taxpayer for the year of change and for the years in which the adjustments built up are identical and rejected the taxpayer's position by holding that the partnership and corporation were different taxpayers.

Accordingly, any taxpayer incorrectly reporting on the cash basis must recognize that a change in his legal status renders him vulnerable to a government-initiated change to the accrual method without the protection of Section 481 with respect to the pre-1954 accruals or the tax limiting rules. Any voluntary transfer of a business to a corporation or trust should be made with this consequence understood. Likewise, a sole proprietor whose business will pass to an estate or heir should recognize that his death will call into being a new taxpayer who will face a similar problem.[23] In these circumstances a taxpayer foreseeing a change in status should consider initiating a change to the accrual method before the change in status occurs, provided he can agree with the Service on a satisfactory method of spreading the impact of the bunching of income over several years.

Changes vs. corrections

For income tax purposes, there is not necessarily a change in accounting method merely because the accounting treatment of an item is different in one year from that of the previous year. It is necessary to distinguish situations where the difference in treatment is a correction of an error from those where the difference in treatment is a change in accounting method.

The correction v. change problem is more than semantics. As previously stated, Section 446(e) requires that a taxpayer who changes the method of accounting regularly used in his books must obtain permission of the Internal Revenue Service before he may use such new method in computing taxable income. However, if the change is only the correction of an error, prior permission would not be needed.

In *Beacon Publishing Company*[24] the taxpayer was an accrual basis newspaper publisher who included subscriptions in income when received. In 1943 the taxpayer began to report subscription income as earned rather than when received. The Tenth Circuit held the switch in treatment was not a change in accounting method but rather a correction of accounting for a particular item in order to conform its treatment to the overall method of accounting. Hence, permission for the change was not required.

If the *Beacon* case were to arise today, it is quite possible there would be a different result. The concept of a method of accounting and what constitutes a change is presently far more sophisticated. The Regulations now make it clear that a change in method of accounting for which advance permission is needed includes a change in the treatment of a material item.[25] Moreover, permission is required even where the change is from a method considered erroneous. The Regulations provide no clue as to what would be a material item but in several recent cases involving changes in the treatment of vacation pay, the Tax Court has held that changes of an item which resulted in an adjustment to income of $25,000[26] or of $19,000[27] were material in an absolute sense irrespective of their possible minor effect on income in a relative sense.

In cases involving years under the 1939 Code, the Tax Court has indicated a willingness to accept the principle of *Beacon,* i.e., the change in treatment of an item will be only a correction if the change conforms the treatment of that item to an overall method. However, recent decisions of the Tax Court taking this position have been reversed.

In *American Can* an accrual basis taxpayer changed the treatment of vacation pay and property taxes from the cash to the accrual basis. Although there was no doubling of deductions (the taxpayer stipulated that it would not take the cash basis deduction for that year) there was a substantial reduction in taxable income resulting from the accrual basis deduction. The Tax Court reasoned that the 1939 Code did not allow a hybrid method of accounting and that the change was only a correction of erroneous accounting for which permission was not needed. On appeal, the Second Circuit reversed, calling attention to the need of the government to retain control over accounting changes in order to minimize distortion of income between years.[28]

In *O Liquidating Corp.* the taxpayer for many years had accrued insurance dividends as a reduction of expense but omitted from its 1953 return the accrual of the dividend received in 1954. The Tax Court held permission was not required since there was no basis for the accrual under any method of accounting. The Third Circuit reversed[29] and based its decision on the need for consistency.

With respect to years covered by the 1954 Code the Tax Court does not recognize the right of a taxpayer to effect a conforming change to an overall method. In *Dorr-Oliver,*[30] the Court explained its change in view by noting that under the 1954 Code a hybrid method of accounting is permitted,[31] whereas this was not so under the 1939 Code. Under the hybrid method there is no need for the correction of accounting for an expense (vacation pay in this case) to conform to an overall accrual method.

While this view of the hybrid method may seem reasonable in an abstract sense it does not seem to be the real explanation. It is submitted that the hybrid method as described in the Regulations[32] contemplates a system where gross income is determined on an accrual basis and all expenses are on a cash basis rather than just one or two isolated cash basis expense items. It may be more accurate to take the position that the courts do not follow *Beacon* but instead have adopted the view of a former Chief Counsel who defined a method of accounting as:

> "The accounting treatment of any significant item according to a defined and regular plan, system or

practice which has been consistently applied to that item, *whether or not such item is correct under the taxpayer's overall method of accounting.*"[33] (Emphasis supplied.)

The taxpayer is not alone in taking the position that a change is only a correction of an error. When to its advantage the Internal Revenue Service has argued that a change forced upon the taxpayer was only a correction of an error, so that there would be no pre-1954 cut-off under Section 481.

In *Fruehauf Trailer Company*[34] the taxpayer generally used the lower-of-cost-or-market method for valuing inventories but had for many years inventoried at $1.00 per unit used trailers acquired by repossession or as trade-ins. At the time this method first was adopted no one could place any meaningful value on a used trailer but for some time prior to 1954 (the earliest year involved in the decision) the trailers could be valued and at December 31, 1954 the difference between the fair market value of the inventory and the $1.00 per unit was more than $5,000,000. The Internal Revenue Service was aware at all times of the method used and for 1942 actually tried to place the inventory on a lower-of-cost-or-market basis but finally required the continued use of the $1.00 per unit method.[35] However, the Internal Revenue Service finally did force a change in accounting for the used trailer inventory to a lower-of-cost-or-market basis on the 1954 return under its authority to prescribe a change where the method used does not clearly reflect income. In addition, the Service argued that it was correcting errors in pricing and not changing a method of accounting. As did the taxpayers in the vacation pay cases, the Service contended that the change involved was outside the scope of Section 481. The Tax Court approved the change but agreed with the taxpayer: (1) that the change was a change of method; (2) that the change was initiated by the government; and (3) that under Section 481 the cost of used trailers sold during 1954 (the year of change) should be computed by valuing the opening inventory of used trailers on the lower-of-cost-or-market basis ($2,512,058) rather than on the $1.00 per unit basis reflected in the closing inventory on the 1953 return ($2,411).

The government lost the *Fruehauf* case insofar as Section 481 is concerned. However, on the question of defining an accounting method the opinion is consistent with those of other cases in which the question has been whether the taxpayer required permission for the change he sought to make. Thus, the opinion would seem to establish firmly Internal Revenue Service control over a change in accounting method.

The problem of correction v. change still has not been resolved completely. For example, what kind of a change in inventory valuation is a correction and what is a change in accounting method? It seems logical that there is a change of method if burden is added to inventory where the taxpayer never has included any burden. How should an increase in the burden rate be handled? Should any increase be a correction regardless of its relationship to the old burden rate? If a $19,000 item is a material item requiring permission for change, how about $1,900? There are presently no authoritative answers to these questions.[36]

Perhaps what is needed is a regulatory definition such as suggested by the Committee on Federal Taxation of the American Institute of CPAs.[37] The Committee has suggested that a method of accounting includes (1) the overall method of accounting (cash, accrual, etc.); (2) the treatment of items specifically authorized under the Code (depreciation, bad debts, inventory, etc.); and (3) the accounting treatment of any material item which has been consistently treated for at least five years. For this purpose a "material item" would not include any item where under Section 481 the adjustment would be less than 10% of average taxable income for the five years preceding the year of change but not more than $250,000. In addition, a change would not be a change of a material item if it would cause a Section 481 adjustment of less than $3,000.

Simplifying a complex problem

The Internal Revenue Service seems to have complete control of changes in accounting. It appears quite difficult to change the accounting treatment of any item of income or expense without advance permission. In view of the narrow restrictions on the time when such permission may be requested[38] accounting methods may stagnate and continue to be used for tax purposes long after they have any meaning. Further, the disinclination of many taxpayers to have differences between book and tax accounting probably causes many taxpayers to perpetuate outmoded accounting in the books as well as the tax return.

A welcome innovation in Internal Revenue Service rules which should go far in eliminating this problem is the method for changing an "accounting practice"[39] recently ruled upon in Revenue Procedure 64-16. Under this ruling the question of whether a change in practice is a change in method of accounting will not be raised, considered or conceded by either the taxpayer or the

Internal Revenue Service. Until the Service has adopted guidelines as to what is a change in accounting method a taxpayer will be permitted to change the accounting for particular items of income or expense to an acceptable method provided the taxpayer agrees to spread over a 10-year period the adjustments arising out of the change. Although the ruling ordinarily will apply to the first year for which a return has not been filed, experience indicates that the Service is reluctant to consider any request to change unless it is received at a date sufficiently in advance of the due date of the return (including extensions) for the first year of the change for the Service to rule on the request. If such a request involving a negative adjustment is approved, the adjustment for the year of change will be minor and the difference between the normal adjustment and the one made will be taken into account during the second and third years of the ten year changeover period.

The taxpayer who seeks to make a change in accounting practice should write to the National Office of the Internal Revenue Service. The letter should state the over-all method of accounting used; the accounting practice used for the item or items to be changed; the practice to be used in the future; the amount and nature of the adjustments; whether or not the taxpayer's accounting procedures presently are involved in a return under examination; that the taxpayer will take the adjustment into account over a 10-year period and will enter into a written collateral agreement to that effect.

The amount of the adjustment would be that required to prevent duplication or omission of the item. Assume that an accrual basis taxpayer has been deducting vacation pay on a cash basis and wishes to change this practice beginning with the calendar year 1965. At January 1, 1965, the accruable vacation pay amounted to $45,000. If the change is made, a deduction would be allowable for the amount accruable at December 31, 1965. The $45,000 beginning-of-year liability (presumably paid during the year) would be spread over a 10-year period beginning with 1965.

Where the accounting practice is a question in the audit of the taxpayer's return, the change can be made effective with the return most recently filed. In this case, the letter should be submitted through the District Director and while awaiting action of the National Office, the local audit procedure on this particular issue will be suspended.

In a collateral agreement which the Service asked one taxpayer to sign, the latter agreed to make the change for the year of transition (i.e., the first year to be affected by the change); that there was no issue involving the item pending with the Internal Revenue Service or any federal court; that after the change was effected the taxpayer would not attempt to obtain a refund for any prior year based on the item involved; that one-tenth of the adjustment would be picked up each year; that any balance of adjustment remaining when the taxpayer ceased to engage in a trade or business would be taken into account in a final return unless the cessation of business was because of a transaction subject to Section 381, in which case presumably the balance of the adjustment would be taken into account by the successor.

There are a few situations in which the change of accounting practice ruling may not be used: a change in the over-all method; a change from charge-off of specific accounts to the reserve method of treating bad debts; a change from LIFO to FIFO inventory valuation; a change from farm price and from unit-livestock; a change in the method of depreciation. Any of these changes would have to be requested as a change in accounting method (i.e., by filing Form 3115 within 90 days after the beginning of the year of change). However, it is important to note that the ruling can be used to effect a correction of understated inventories, one of the more prevalent accounting method problems.

Conclusion

In conclusion, it can be said that two important developments in the area of accounting method changes have occurred within recent years which greatly overshadow all others. First, a series of judicial decisions have come down which have clearly established the authority of the Internal Revenue Service to thwart changes in particular items of accounting even where the accounting profession would clearly regard the effect of change as immaterial. Second, in the exercise of that authority, the Service has issued Revenue Procedure 64-16, under terms of which rather liberal provision is made for effecting many changes to the benefit of either the Treasury or the taxpayer. The Revenue Procedure offers both a means of correcting long-term understatements of inventory and of effecting minor corrective changes to an overall accrual method.

[1] Regs. Sec. 1.446-1(e).

[2] *The Geometric Stamping Company v. Comm.*, 26 T. C. 301 (1956); *Klein Chocolate Company v. Comm.*, 36 T. C. 142 (1961).

[3] Regs. 111, Sec. 29.41-2 and -3(1); Regs. Sec. 1.446-1(a)(4)(i) and (c)(2)(i).

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Henry E. Bodman Named "Detroit's Outstanding Young Man of 1964"

Henry E. Bodman, partner in our Detroit office, last month was named "Detroit's Outstanding Young Man of 1964" by the Detroit Junior Chamber of Commerce.

The award, presented annually since 1940, goes to men between the ages of 21 and 35 who have demonstrated a high level of personal achievement and dedication to the welfare of the community. The large, framed citation cites Mr. Bodman for "loyal and unselfish efforts" which have been a great contribution to Detroit, and his "evidence of leadership ability, personal and business progress and his interest in the general community welfare."

Mr. Bodman has twice been elected to the City of Grosse Pointe Farms Council and is serving his sixth term on the Wayne County Board of Supervisors. He is chairman of the Taxation and Apportionment Committee of the Board of Supervisors and formerly served as chairman of the Wayne County Building Authority. Appointed Director of the Michigan USO in 1964, he is treasurer of the Gabriel Richard School PTA, a trustee of the Liggett School for Girls and the Franklin Settlement as well as a member of the Economic Club of Detroit, the Greater Detroit Board of Commerce and the Country Club of Detroit.

Mr. Bodman was named a partner in Touche, Ross, Bailey & Smart in 1964. He is a graduate of Princeton University and also holds a MBA degree from the University of Michigan, School of Business Administration. He joined the firm in 1957.

(Continued from page 8)

[4] 1954 Code Sec. 481(a)(2).

[5] 1954 Code Sec. 481(b)(1) and (2).

[6] 1954 Code Sec. 481(b)(4) and (6).

[7] Ibid.

[8] Regs. Sec. 1.481-1(c)(5).

[9] 38 T. C. 263 (1962); affirmed, 315 F. 2d 629 (C. A. 3, 1963).

[10] 1954 Code Sec. 446(a).

[11] Regs. Sec. 1.381(c)(4)-1.

[12] Regs. Sec. 1.381(c)(4)-1(b)(3).

[13] Regs. Sec. 1.381(c)(4)-1(c)(1).

[14] Regs. Sec. 1.1502-44(a).

[15] Regs. Sec. 1.1502-44(c).

[16] Cf. *Transamerica Corporation v. U. S.*, 64-1 USTC Para. 9275 (D. C., Calif., 1964), wherein taxpayers were held not to have initiated change with respect to new members of affiliated group entering group under the new 80% stock ownership test of the 1954 Code.

[17] Note 8, supra.

[18] *M. A. Lindner, et al., v. U. S.*, 61-1 USTC Para. 9381 (1961) (D. C., Utah, 1961); affirmed, 307 F. 2d 262 (C. A. 10, 1962).

[19] *Irving Falk, et al., v. Comm.*, 37 T. C. 1078 (1962); affirmed, 64-2 USTC Para. 9528 (C. A. 5, 1964).

[20] *T. I. Welch, et al., v. Comm.*, 22 TCM 151, Dec. 25, 1953 (M) (1963).

[21] *Ezo Products Company v. Comm.*, 37 T. C. 385 (1961). See also *George D. Prather et al., v. Comm.*, T. C. Memo. 1961-99 (1961); affirmed, 322 F. 2d 931 (C. A. 9, 1963).

[22] 1954 Code Sec. 351 and 362 (a).

[23] See *Estate of John A. Biewer, Deceased, v. Comm.*, 41 T. C. 191 (1963).

[24] 21 T. C. 610 (1954); reversed, 218 F. 2d 697 (C. A. 10, 1955).

[25] Regs. Sec. 1.446-1(e)(2)(i).

[26] *Dorr-Oliver, Inc.*, 40 T. C. 50 (1963).

[27] *I. Lewis Corporation v. Comm.*, 22 T. C. M. 35 (1963).

[28] *American Can Company v. Comm.*, 37 T. C. 198 (1961); reversed, 317 F. 2d 604 (C. A. 2, 1963).

[29] *The O Liquidating Corporation v. Comm.*, 19 T. C. M. 154 (1960); reversed, 292 F. 2d 225 (C. A. 3, 1961); cert. den., 368 U. S. 898.

[30] Note 26, supra.

[31] 1954 Code Sec. 446 (c).

[32] Regs. Sec. 1.446-1(c)(1)(iv)(a).

[33] Hauser, *Significance and Implications of Some Recent Cases*, 39 Taxes 965, 976 (1961).

[34] *Fruehauf Trailer Company v. Comm.*, 42 T. C. 83 (1964).

[35] This was to avoid the effect of a line of cases under the 1939 Code which would require the allowance of a tax-free opening inventory for the year of change. *Appeal of The Thomas Shoe Company*, 1 B. T. A. 124 (1924).

[36] The Tax Court recently held that a "correction" may be made in the manner of computing taxable income from the property for purposes of the limitation on percentage depletion. (*N. Carolina Granite Corp.*, 43 T. C. No. 15 (1964)).

[37] See *Journal of Accountancy*, Aug., 1962, page 76.

[38] As previously indicated, Regulations require that permission be sought within 90 days after the beginning of the taxable year. (Regs. Sec. 1.446-1(e)(3).

[39] I. R. B. 1964-9, 35.