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LIQUIDATION AND REPLACEMENT OF CERTAIN INVENTORIES

AUGUST 16 (legislative day, JULY 20), 1950.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 3278]

The Committee on Finance, to whom was referred the bill (H. R. 3278) to amend section 22 (d) (6) (a) of the Internal Revenue Code, relating to involuntary liquidation and replacement of inventory, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

GENERAL STATEMENT

This bill amends that part of the Internal Revenue Code which deals with taxpayers who account for inventories on the so-called "LIFO"—last-in, first-out—basis, and who were compelled to liquidate all or part of their inventory during the war period. It corrects the language of the present law, relating to the method of making an election, which has resulted in an unintended hardship for some taxpayers.

REQUIREMENTS WITH RESPECT TO AN ELECTION

Section 22 (d) (6) of the Internal Revenue Code provides a special relief provision for taxpayers using the "LIFO" method of inventory accounting. If, during any taxable year beginning after December 31, 1940, and prior to January 1, 1948, an inventory on the "LIFO" basis was liquidated in whole or in part, because of "prevailing war conditions beyond the control of the taxpayer," and that part of the inventory was replaced at any time prior to January 1, 1951, an appropriate tax adjustment for the year in which the liquidation occurred is provided. If the cost of replacing the inventory was greater than the value of the liquidated inventory, as determined under the "LIFO" method, the excess cost is deductible in recom-

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puting the tax for the year of liquidation. Conversely, if the replacement cost was less than the original value, the difference is an additional item of income in recomputing the tax for the year in which the liquidation occurred.

Present law provides that, in order to have the advantage of such a tax recomputation, the taxpayer must elect to have these provisions apply "at the time of the filing of the taxpayer's income-tax return" for the year in which the inventory liquidation occurred. However, in some cases taxpayers did not know, at the time the return was filed, that it would be to their advantage to make such an election. For example, there are cases where, at the time of a subsequent investigation of the return, Government agents have segregated into two groups or classes an inventory which the taxpayer considered as consisting of only one class of items. As a result of this segregation it is now held that a liquidation of the inventory of one class of items occurred, although there was no decrease in the number of both classes combined. It is held that, not having made a timely election, the taxpayer cannot apply the excess cost of replacing these items in a subsequent year to reduce the tax for the year in which the liquidation occurred.

This bill provides that the taxpayer can make the required election "at such time and in such manner and subject to such regulations as the Commissioner with the approval of the Secretary may prescribe." Since the amendment is retroactive to taxable years beginning after December 31, 1940, the Commissioner of Internal Revenue can provide relief in any case which appears to involve hardship.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the joint resolution are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE

SECTION 22 (D) (6)

(6) INVOLUNTARY LIQUIDATION AND REPLACEMENT OF INVENTORY.—

(A) ADJUSTMENT TO NET INCOME AND RESULTING TAX.—If, for any taxable year beginning after December 31, 1940, and prior to January 1, 1948, the closing inventory of a taxpayer inventorying goods under the method provided in this subsection reflects a decrease from the opening inventory of such goods for such year, and **[if,]** *if the taxpayer elects, at such time and in such manner and subject to such regulations as the Commissioner with the approval of the Secretary may prescribe, to have the provisions of this paragraph apply, and if* **[,** at the time of such election,**]** it is established to the satisfaction of the Commissioner in accordance with such regulations, **[as the Commissioner may prescribe with the approval of the Secretary,]** that such decrease is attributable to the involuntary liquidation of such inventory as defined in subparagraph (B), and if the closing inventory of a subsequent taxable year, ending prior to January 1, 1951, reflects a replacement, in whole or in part, of the goods so previously liquidated, the net income of the taxpayer otherwise determined for the year of such involuntary liquidation shall be adjusted as follows:

(i) Increased by an amount equal to the excess, if any, of the aggregate cost of such goods reflected in the opening inventory of the year of involuntary liquidation over the aggregate replacement cost; or

(ii) Decreased by an amount equal to the excess, if any, of the aggregate replacement cost of such goods over the aggregate cost thereof reflected in the opening inventory of the year of the involuntary liquidation.

The taxes imposed by this chapter and by chapter 2 for the year of such liquidation for preceding taxable years, and for all taxable years intervening between the year of liquidation and the year of replacement shall be re-determined, giving effect to such adjustments. Any increase in such taxes resulting from such adjustments shall be assessed and collected as a deficiency but without interest, and any overpayment so resulting shall be credited or refunded to the taxpayer without interest.

