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Taxation--Cash Basis to Accrual Basis--Inventory Included

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In deference to this affirmative indecisiveness, the vast preponderance of the courts have admitted the results of such tests in evidence only to show nonpaternity, *Roberts v. Van Cleave,* 205 Okla. 319, 237 P.2d 892 (1951), although some courts admit the test as either affirmative or negative evidence of paternity. *Livermore v. Livermore,* 233 Iowa 1155, 11 N.W.2d 389 (1943). It would seem that the former view is preferable in that any consideration given by the jury to an affirmative finding would be without sufficient scientific foundation.

After the results of such test are admitted, the question arises as to whether a negative finding should be conclusive evidence of nonpaternity. Again, cases are found which impute conclusiveness to such a showing, *Jordan v. Mace,* 144 Me. 351, 69 A.2d 670 (1949), and others which hold that a negative result is only some evidence of nonpaternity. *State v. Morris,* 156 Ohio St. 333, 102 N.E.2d 450 (1951). The courts which adhere to the latter view generally maintain that such evidence is to be treated as expert opinion, in that the conclusions reached are based upon processes with which the layman is unfamiliar, and that paternity is not exclusively a subject for expert evidence. *Arais v. Kalensnikoff,* 10 Cal. 2d 457, 74 P.2d 1043 (1937).

Notwithstanding these latter arguments, it is suggested that the better view would treat a negative result as conclusive evidence of nonpaternity because of the scientific finality of such a determination. This, however, should be dependent upon a finding by the jury that the test was properly and efficiently conducted by an impartial expert. Too many people, in this age of scientific miracles, are prone to ascribe unquestioned infallibility to science and scientists, while, in fact, there was never such thing as an unerring man.

G. M. S.

TAXATION—CASH BASIS TO ACCRUAL BASIS—INVENTORY INCLUDED. —Action to recover federal income tax alleged to have been erroneously assessed. The taxpayer kept his books and reported his income, in which inventory was an income-producing factor, on a cash basis. Subsequent to 1946 the commissioner decided that the method used by the taxpayer in reporting his income did not properly reflect it; thereupon the commissioner calculated the income for that year upon an accrual basis, and assessed the taxpayer on that basis. *Held,* that the beginning inventory should also be included in determining the income of a taxpayer when he changed from a cash basis to an accrual basis. *Welp v. United States*, 201 F.2d 128 (8th Cir. 1953).

Whether to allow a taxpayer to include beginning inventory after changing from a cash basis to an accrual basis of reporting his income has been a topic of much discussion and dispute.

The system of accounting known as the "cash basis" involves simply the deduction of all expenses paid from all the money received, that is, cash receipts less cash disbursements. Under the "cash basis," because inventories are not used, the merchandise paid for and purchased for resale is an expense even though it remains unsold. Under the "accrual basis" the net income is determined from all transactions, that is, income accrued and received less expenses paid and outstanding. The merchandise which is on hand at the end of an accounting period is not deducted as an expense under the accrual basis method.

Inventories are not kept under the cash basis as this method of accounting charges only the expenses which are paid during the accounting period. Merchandise is not deducted as an expense unless the merchandise is paid for in cash. The income is determined as follows:

Cash Receipts	$100,000
Less: Cash Disbursements	$ 30,000
Net Income	$ 70,000

The effect of the beginning inventory on a businessman's income under the accrual method can best be illustrated by a "Costs of Goods Sold" statement. The purpose of such a statement is to show the cost of the merchandise sold during the accounting period. The effect of the inventory on income is as follows:

Sales		$100,000
Cost of Goods Sold:		
Beginning Inventory	$20,000	
Purchases	$30,000	
Goods Available for Sale	$50,000	
Less: Ending Inventory	$20,000	
Cost of Good Sold		$30,000
Net Income		$70,000

By being allowed to include beginning inventory when he changes from a cash basis to an accrual basis of reporting income, the taxpayer escapes taxation on this inventory as it was deducted from the income of the previous year in the form of a cash disbursement and will also be deducted from the following year's income in the form of an expense. The closing inventory for any given period is the opening inventory for the next accounting period. In the instant case, by deducting the inventory under the cash basis and by being allowed to deduct it as beginning inventory under the accrual basis, the taxpayer received credit for the inventory both at the close of 1945 and at the beginning of 1946.

In *Hardy, Inc. v. Comm'r of Internal Revenue,* 82 F.2d 249 (2d Cir. 1952), the taxpayer kept his books and reported his income on a cash basis. After observing that he changed to an accrual method of keeping his books and reporting his income, the court said that to allow deduction of the beginning inventory would result in computing the taxpayer's income at an amount much less than its actual income subject to taxation.

In *Comm'r of Internal Revenue v. Schuyler,* 196 F.2d 85 (2d Cir. 1952), which allowed the taxpayer to include the beginning inventory, the court said that "the commissioner cannot treat a deduction erroneously taken in prior years as income in a later year on the theory that it will otherwise escape taxation." This case is distinguished from the *Hardy* case in that, here, the taxpayer properly kept his books on an accrual basis, while the taxpayer in the *Hardy* case changed his method of accounting from a cash basis to an accrual basis.

INT. REV. CODE § 41 provides that "the net income shall be computed upon the basis of the taxpayer's annual accounting period . . . in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income . . . ." In the instant case the cash basis method of accounting does not clearly reflect the taxpayer's income, and thus the taxpayer has been reporting his income erroneously in view of INT. REV. CODE § 22 (c) which provides that whenever in the opinion of the commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken upon such basis as the commissioner may prescribe as conforming as nearly as may be to the best accounting practice in the business, and which most clearly reflects income. The commissioner's interpretation of this section is found in U. S. Treas. Reg. 111, § 29.41-2 (1943) which reads in part as follows: ". . . in any case in which it is necessary to use an inventory, [as in the *Welp* case] no method of accounting in regard to purchases and sales will correctly reflect income except an accrual method. . . ."

The courts must choose between two alternatives: (1) allow the taxpayer to escape taxation when he changes from a cash basis to an accrual basis of reporting his income, or (2) deny the taxpayer the right to report properly his income for the first year of the change from a cash basis to an accrual basis. U.S. Treas. Reg. 111, § 29.22(c)-1 (1943), provides that "In order to reflect the income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. . . ."

The *Welp* case refuses to draw the fine distinction found in the *Hardy* and *Schuyler* cases. If the courts are going to allow the taxpayer to benefit from the change then they should not distinguish between how the books were kept, denying relief to those whose books were kept on a cash basis and aiding those who kept their books on an accrual basis. Although an accrual basis more accurately reflects income when inventories are maintained, such method of accounting does not properly reflect the taxable income, which is the government's prime interest, when reported on a cash basis.

J. M. H.

VENDOR-PURCHASER—RIGHTS OF DEFAULTING PURCHASER.—Oral contract between *P* and *D* under which *D* agreed to sell land to *P*, the latter making part payment. Subsequently, the parties were unable to agree upon the balance due; whereupon *D* refused to give a deed unless *P* paid an amount in excess of what *P* claimed was due. *P* refused to pay and made motion for judgment for money had and received by *D* who counterclaimed for balance due. The lower court entered judment for *D*. On appeal, *held*, that the judgment should be reversed since the contract was unenforceable under the statute of frauds, and both parties were in default in performance thereof. The purchaser should be allowed to recover the part payment. *Ballangee v. Whitlock*, 74 S.E.2d 780 (W. Va. 1953).

It is not the purpose of this comment to deal with the question which was before the court in the principal case but rather with the converse thereof. That is, can a defaulting purchaser recover his part payment, when because of his default the vendor terminates the contract or brings an action for damages?