

Department
of the
Treasury

Internal
Revenue
Service

Office of
Chief Counsel

Notice

CC-2001-010

February 9, 2001

Subject: Change in Litigating Position Upon Incorporation
Cancel Date: into the CCDM

The purpose of this Notice is to announce a change in the Service's litigating position regarding the requirement that certain taxpayers must use inventory accounts and an accrual method of accounting.

Several court decisions have recently upheld the use of the cash method of accounting by certain contractors. In these cases, the courts have rejected the Service's argument that the taxpayers were in the business of providing merchandise and therefore required to use inventory accounts and an accrual method of accounting. In Smith v. Commissioner, T.C. Memo. 2000-353, the Tax Court held that a taxpayer who installed flooring materials for customers was inherently a service provider eligible to use the cash method of accounting. The court rejected the Service's argument that the taxpayer's purchase and warehousing of flooring materials prior to installation constituted the production, purchase, or sale of merchandise within the meaning of section 1.471-1 of the regulations.

Similarly, in Jim Turin & Sons, Inc. v. Commissioner, 219 F.3d 1103 (9th Cir. 2000), the Ninth Circuit held that a taxpayer that purchased asphalt and used the emulsified asphalt to provide paving services was not required to use inventory accounts and an accrual method of accounting. The court concluded that because the asphalt could not be stored, it was not susceptible of being inventoried and was not merchandise within the scope of section 1.471-1 of the regulations. In RACMP Enterprises, Inc. v. Commissioner, 114 T.C. No. 16 (March 30, 2000), in a court reviewed opinion, the Tax Court held that a construction contractor that constructed, placed, and finished concrete foundation, driveways, and walkways was permitted to use the cash method of accounting. See also, Galedrige Construction v. Commissioner, T.C. Memo. 1997-240, involving a contractor using emulsified asphalt where the court permitted the taxpayer to use the cash method of accounting.

The Office of Chief Counsel is studying the issue addressed by the courts in the cases discussed above. Until further guidance is issued, the Office of Chief Counsel will not assert that taxpayers in businesses similar to those considered by the courts in these cases are required to use inventory accounts and an accrual method of accounting. In particular, this notice covers

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