

## THE TAX TREATMENT OF THE RESERVE FOR BAD DEBTS ON INCORPORATION: THE SUPREME COURT RESOLUTION IN NASH

LEO J. RASKIND\*

The recent Supreme Court opinion in *Nash v. United States* illustrates the close tolerances to which federal income tax issues are honed.<sup>1</sup> For more than half a dozen years a spate of cases was litigated by taxpayers contesting the position of the Commissioner of Internal Revenue that income was generated by the reserve for bad debts on the transfer of proprietorship or partnership accounts receivable and other property to a controlled corporation.<sup>2</sup> Ultimately a conflict was generated among the circuit courts on this issue which the Supreme Court has now resolved by rejecting the Commissioner's analysis.<sup>3</sup>

Viewed in historical perspective, this controversy serves as a reminder of the high costs of defective analysis to both the Internal Revenue Service and taxpayers. Prior to the announcement in 1962 by the Commissioner that transfers of such reserve accounts would be treated as income-generating events, it was generally supposed that the reserve account was cloaked by the deeply ingrained general principle of non-recognition of gain on incorporation.<sup>4</sup> In rejecting that position in a cursory manner, the Commissioner contributed the first misstep.

Revenue Ruling 62-128 was brief and not to the point.<sup>5</sup> Grounded on inaccurate characterization of the role of the reserve account and on inapposite application of the tax benefit rule, this Ruling invited litigation as a means of clarifying its application. From the easier vantage of hindsight, it seems clear that a departure from the basic doctrines of non-recognition of gain, if necessary at all, ought to have been made with the detail of analysis and specificity of instance required to identify the narrow circumstances of its application.

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\* Professor of Law; Adjunct Professor of Economics, The Ohio State University.

<sup>1</sup> *Nash v. United States*, 90 S. Ct. 1550, 25 Am. Fed. Tax R.2d 70-1177 (1970).

<sup>2</sup> *Scofield v. United States*, 23 Am. Fed. Tax R.2d 69-1447 (C.D. Cal. 1969); *Rowe v. United States*, 23 Am. Fed. Tax R.2d 69-443 (W.D. Ky. 1968), appeal authorized, P-H 1969 Fed. Taxes Citator 12,107; *Robert P. Hutton*, P-H Tax Ct. Rep. & Mem. Dec. par. 53.6 (Oct. 13, 1969); *Schuster v. Commissioner*, 50 T.C. 98 (1968), appeal filed, P-H 1969 Fed. Taxes Citator 10,192; *Birmingham Trust Nat'l Bank v. United States*, 22 Am. Fed. Tax R.2d 5202 (N.D. Ala. 1969); *Estate of Heinz Schmidt v. Commissioner*, 42 T.C. 1130 (1964), rev'd., 355 F.2d 111 (9th Cir. 1966). See on this problem, Notes, 1969 DUKE L.J. 1298; 53 MINN. L. REV. 1354 (1969); 66 COLUM. L. REV. 1186 (1966).

<sup>3</sup> *Nash v. United States*, 24 Am. Fed. Tax R.2d 69-5271 (5th Cir. 1969).

<sup>4</sup> See, Darrell, *Corporate Organizations and Reorganizations Under the Internal Revenue Code of 1954*, 32 TAXES 1007 (1954); Costoloe, *Incorporation of the Unincorporated Enterprise*, 13 N.Y.U. INST. ON FED. TAX 685 (1955); Paul and Kalish, *Transition From a Partnership To A Corporation*, 18th N.Y.U. INST. ON FED. TAX 639 (1960); Blanc, *The Tax Treatment of Reserves Upon A Change In The Form of Doing Business*, U. SO. CAL. 1967 TAX INST. 433.

<sup>5</sup> Rev. Rul. 62-128, 1962-2 Cum. Bull. 139.

To have singled out the reserve for bad debts for special treatment without explanation seems curious, anyway. The reserve method of valuing bad debts is not a fruitful vehicle for tax avoidance. Moreover, in accepting this method of valuing accounts receivable, the commissioner provided adequate restrictions to circumscribe abuse.<sup>6</sup>

On balance, the controversy which ultimately was moved to the Supreme Court for resolution was generated by the failure of the basic Ruling to recognize the dual function of the reserve account. In seeking to provide a flat statement in the original Ruling—an entirely appropriate goal, the Service failed to identify in adequate functional and analytical terms the instances in which recognition of gain was required. In assessing the utility of the Supreme Court's resolution of this problem, it is appropriate to review the problem in the context of its origin.<sup>7</sup>

One ingredient of the erroneous position of the basic Ruling is its restrictive conception of the function of the reserve for bad debts account. In accounting practice, the reserve method arises as a means of valuing accounts receivable. Since an unknown probability of uncollectibility clouds the accuracy of any stated dollar value of an account receivable generated by credit sales, various methods have been devised to narrow the overstatement in the dollar value of the receivable account. This element of correction or adjustment is provided by the reserve account whereby the account receivable is stated in gross terms and the estimated uncollectible segment thereof is shown by the reserve. Thus the reserve allowance is an aggregate estimate of the total amount of anticipated bad debts without reference to any single ledger account of any individual customer. The reserve account serves in this way to adjust the value and tax basis of receivables in a balance sheet sense.

In tax consequences, the reserve method of accounting for bad debts also generates a deduction from gross income.<sup>8</sup> By use of the reserve, a taxpayer is permitted to deduct his anticipated bad debts in the year of their anticipation, even though the actual loss has not yet been sustained in any individual customer's account receivable. In recognizing this practice, the Commissioner's Regulations contain the expected caveat that a taxpayer using the reserve method will be required to justify the reasonableness of any additions to the reserve in light of the facts existing at the close of the taxable year.<sup>9</sup>

In this function, the reserve serves to adjust the gross income of the

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<sup>6</sup> Treas. Reg. 1.166-1(d) (1969); Treas. Reg. 1.166-4 (1964); Broader doctrines such as anticipatory assignment of income as well as provisions like § 482, would also be available to bar abuses of the reserve method of account for bad debts.

<sup>7</sup> For critical comment on the Ruling when it was issued, see Arent, *Reallocation of Income and Expenses In Connection With Formation and Liquidation of Corporations*, 40 TAXES 995 (1962); Hickman, *Incorporation and Capitalization*, 40 TAXES 974, 977 (1962).

<sup>8</sup> INT. REV. CODE OF 1954, § 166(c); Treas. Reg. § 1.166-4 (1964).

<sup>9</sup> Treas. Reg. § 1.166-4(b) (1964).

business. The deduction from gross income permitted by the use of the reserve method adjusts gross income downward; the gross value of the recorded receivables which will not contribute to ultimate cash receipts are thus withdrawn from gross income. In this fashion, the reserve account serves an income statement function.

Recognition of this dual function of the reserve is a fixture of the accounting literature; a leading authority notes of the reserve for bad debts that it ". . . must be considered from the standpoint of both the income statement and the balance sheet."<sup>10</sup> However, in his basic Ruling which generated this series of cases seeking the appropriate characterization of the reserve in the context of incorporating a partnership or sole proprietorship, the Commissioner took a narrower view of the function of the reserve.<sup>11</sup>

Couched in conclusory terms, Revenue Ruling 62-128 announced as its holding that the reserve for bad debts in this context,

. . . is not transferable to any other entity. Accordingly, the reserve for bad debts represents ordinary income to the taxpayer for the taxable year during which the transfer of the accounts receivable was made since, during such time, his need for the reserve ceased.<sup>12</sup>

A basic tax issue is raised by this brief reference to the non-transferability of the reserve for bad debts. Unlike depreciation reserves, Congress has provided no detailed statutory machinery governing the transfer of bad-debt reserves.<sup>13</sup> The transfer of the latter on the occasion of formal changes of business units has traditionally been controlled by case law, Rulings, and Regulations. In this network of authority, the occasions of income recognition were restricted to events of complete corporate liquidation, either under general provisions or under § 337.<sup>14</sup> A carry-over of the reserve balance along with the accounts receivable where the

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<sup>10</sup> ACCOUNTANTS' HANDBOOK § 11.25 (4th ed. R. Wixon 1964).

<sup>11</sup> Rev. Rul. 62-128, 1962-2, Cum. Bull. 139.

<sup>12</sup> *Id.*

<sup>13</sup> Unlike the reserve for depreciation, the bad debt reserve is not mentioned in Int. Rev. Code § 381, which governs the carryover of the net operating loss and certain other accounts and attributes in a corporate acquisition; the depreciation reserve is also subject to express statutory adjustment requiring gain from depreciable property to be restored to ordinary income on disposition of the asset, Int. Rev. Code §§ 1245 and 1250. The 1954 revision of the Code contained a provision, § 462, which permitted accrual method taxpayers the election of using the reserve method for certain estimated trade of business expenses; this provision was repealed retroactively in 1955 by P. L. 74; 69 Stat. 134 (1955); 1955-2 Cum. Bull. 852, 858. See also, Blanc, *The Tax Treatment of Reserves Upon a Change in the Form of Doing Business*, U. SO. CAL. 1967 TAX INST. 443.

<sup>14</sup> In complete liquidations, the dissolving corporation will ordinarily be required to restore to its final period income, the unused portion of its bad debt reserve; see, *C. Standlee Martin, Inc. v. Riddell*, 51 Am. Fed. Tax R. 1376 (S.D. Cal. 1956); *M & E Corp. v. Commissioner*, 7 T.C. 1276 (1946). The same result would apply also to special statutory liquidations, see INT. REV. CODE OF 1954, §§ 333(e), (f), 334(c); INT. REV. CODE OF 1954, § 337 has also been so interpreted, see, *West Seattle National Bank v. Commissioner*, 288 F.2d 47 (9th Cir. 1961), aff'g 33 T.C. 341 (1959).

transfer was occasioned only by a change of form was not, prior to the Ruling, considered to require the restoration of the reserve balance to income.<sup>15</sup> Given the clear break with the established and accepted doctrines on this point, the brief announcement in the Ruling that the § 351 context henceforth required restoration of the reserve balance was troublesome.

No less difficult to accept without explanation was the correlative conclusion in the Ruling that the "need" for the reserve had ceased in the context of incorporation. On this point, the Ruling again widened the gap between the settled interpretation of reserve accounting and its announced position. In general terms, the reference to the cessation of the "need" for the reserve is misleading in the context of a transfer, because as a valuation account, the reserve is not usefully considered as a separate item independent of the receivables account for which it was created.<sup>16</sup> Functionally the two accounts operate together, with the reserve serving to reduce the stated amount of the receivables by the estimated amount of uncollectible items. In traditional accounting theory, the reserve is to be restored to income if the stated receivables were collected at full stated value, not because the "need" for the reserve had ceased, but because the estimated amount of non-collectibles had not materialized in income terms. It is not entirely inappropriate to refer to the "cessation of need" in these circumstances, but such a broad reference does not serve when narrow analysis is required.

What the Ruling might have provided was a statement of those instances in which the transfer of the reserve was to be examined on the occasion of incorporation to determine whether an over-estimate of loss on collection of receivables had been made. In those instances, the prior over-estimate would appropriately have been cured by a restoration to income of the amount of over-estimate. To depart from the narrow issue of rectifying an over-deduction by the broad language of "cessation of need" was inarticulate.

Apparently the concept of "cessation of need" was injected into this controversy by the Commissioner's misplaced reliance in the Ruling on the *Geyer, Cornell & Newell* case which he cites for this proposition.<sup>17</sup> That case does not identify the income issues raised by the transfer of the reserve in a § 351 context for several reasons. First, it essentially involved a complete liquidation. Second, it is an instance in which the receivables were collected in full. There the corporate taxpayer using the

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<sup>15</sup> See note 4, *supra*.

<sup>16</sup> "A reserve consists of entries upon books of account. It is neither an asset nor a liability. It has no existence except upon the books, and, unlike an asset or a liability, it cannot be transferred to any other entity." *Geyer, Cornell & Newell, Inc., v. Commissioner*, 6 T.C. 96, 100 (1946).

<sup>17</sup> *Geyer, Cornell & Newell, Inc., v. Commissioner*, 6 T.C. 96 (1946).

reserve method sold for cash all its assets, with the exception of some liquid assets and its receivables, in one year. The corporation ceased its business operations but continued to hold and collect the retained receivables, virtually all of which were collected by the end of the year of sale. Five years later (the receivables having been fully collected in interim) the corporate taxpayer transferred the remaining assets to the same purchaser, and was dissolved. The litigated issue was whether the bad debt reserve was to be restored to income in the prior year when the receivables were collected or in the subsequent year of final transfer and liquidation. In holding that the restoration was to take place in the prior year of substantial collection, the Tax Court accepted the Commissioner's position that the "need for the reserve ceased" in the earlier year.<sup>18</sup>

In a descriptive sense, the need for the reserve had ceased in the *Geyer* case when the receivables were collected in full. However, the narrower and more accurate ground for requiring the restoration to income of the amount of the reserve is the tax benefit principle. The case is more appropriately cited for that operative proposition. Thus the collection in the prior year of the receivables constituted a recovery of debts previously deducted as worthless. Had the Ruling in 1962 been rested exclusively on the tax benefit rule instead of on the cessation of need concept with a qualification of the tax benefit rule, the subsequent controversy might have been avoided.<sup>19</sup> Perhaps the most unfortunate part of the Ruling's reliance on the *Geyer* and *Martin* cases, is the implication that the § 351 transaction is for this purpose to be treated like a complete liquidation.<sup>20</sup>

The subsequent widening of the controversy can be traced to the Ruling. The weight afforded the Commissioner's Ruling by the Tax Court was apparent in *Schmidt*, the first case to be litigated under it.<sup>21</sup> There the sole issue was the proper accounting treatment of the reserve for bad debts on the occasion of the transfer of all proprietorship assets, including receivables, to a controlled corporation under § 351.<sup>22</sup> The problem was presented to the Tax Court in terms of doric simplicity, the Commissioner having conceded that the amount of the reserve was reasonable and that the transfer otherwise qualified under § 351. In holding that the taxpayer was required to restore the balance of the reserve to

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<sup>18</sup> See note 16, *supra*.

<sup>19</sup> A strict interpretation of the tax benefit principle would have barred the issuance of the Ruling in the first instance; for such a recent interpretation of the tax benefit rule in his context see *Nash v. United States*, 90 S. Ct. 1550; 25 Am. Fed. Tax R.2d 1177 (1970) and text, *infra*, at notes 36, 37.

<sup>20</sup> See notes, 14 and 17, *supra*.

<sup>21</sup> *Estate of Heinz Schmidt v. Commissioner*, 42 T.C. 1130 (1964) rev'd., 17 Am. Fed. Tax. R.2d 242 (9th Cir. 1966).

<sup>22</sup> INT. REV. CODE OF 1954, § 351.

income, the Tax Court stated its agreement with the position of the Government in Revenue Ruling 62-128 by noting that

[W]hen the proprietorship terminated, the need for maintaining the reserve for bad debts ceased and therefore the balance in the account at the time of termination should be restored to income.<sup>23</sup>

Following the Ruling further in treating the transfer, on incorporation like the transactions of complete liquidation, the Tax Court drew an analogy between the litigated transaction and a § 337 liquidation.<sup>24</sup> Having removed any independent significance from the § 351 nature of the transaction, the court concluded by pointing out the absence of any statutory authority for carrying over the reserve for bad debts.<sup>25</sup> In *Schmidt* the broad theory of the Ruling had come into its own.

The ninth circuit, however, was not persuaded; in reversing the Tax Court, it undertook to return the resolution of the controversy to basic principles.<sup>26</sup> The ninth circuit opinion laid the groundwork for the ultimate conflict between the circuits by rejecting the Commissioner's reliance on the concept of cessation of the need for the reserve. The appeals court first pointed out the reliance on this concept in the Ruling, but noted that the case law, notwithstanding some language in the opinions, did not support the Commissioner's conclusion.<sup>27</sup> More narrowly, the ninth circuit opinion required that the issue of restoring the reserve to income be decided on the precise ground of recovery. Thus the opinion states,

It is quite true that the taxpayer no longer 'needed' the reserve, but it is certainly not true, in any economic sense, that he has recovered its value. . . .

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<sup>23</sup> *Estate of Heinz Schmidt v. Commissioner*, 42 T.C. 1130, 1134 (1964) rev'd., 17 Am. Fed. Tax R.2d 242 (9th Cir. 1966).

<sup>24</sup> The Tax Court opinion states:

The Government's position follows Rev. Rul. 62-128 . . . and is in accord with our position in *West Seattle National Bank*. . . . The Court . . . ruled . . . [there] that the nonrecognition provisions of Section 337 did not apply . . . . A like result is called for in the present case.

*Estate of Heinz Schmidt*, at 1135.

<sup>25</sup> The Court notes,

It is true, as petitions point out, that in *Citizens Federal S. & L. Ass'n of Cleveland v. United States*, 290 F.2d 932 (Ct. Cl.), . . . there is a dictum which distinguishes a sale . . . from a nonrecognizable transaction where the same interests continue to operate the same business in a different form and where the need for the reserve continues. The difficulty with the dictum, however, is that it does not appear to be based upon any statutory provision, nor have the parties called our attention to any statutory language providing for the carryover of the bad debt reserve to the transferee. (Italics added)

*Id.* at 1135-6.

<sup>26</sup> *Estate of Heinz Schmidt v. Commissioner*, 355 F.2d 111, 17 Am. Fed. Tax R.2d 242 (1966).

<sup>27</sup> The opinion states,

In Revenue Ruling 62-128 . . . , the Commissioner relies upon certain language in the cases that he cites to the effect that the taxpayers did not any longer "need" the reserve. . . . The cases, however, do not go so far.

17 Am. Fed. Tax R.2d 242, 244.

And there is no gain merely because the reserve is no longer 'needed'; rather the correctness of the reserve as an estimate of those is . . . [dispositive].<sup>28</sup>

The ninth circuit also pointed out the necessity of identifying the function of the reserve account in each case. In the record before it, there was a finding that the taxpayer had received stock certificates reflecting the net rather than the gross value of the receivables.

The controversy widened and deepened. Although two district courts followed the reasoning of the ninth circuit in doctrinally identical cases, the Tax Court in *Schuster*, with three judges dissenting, adhered to the theory of the Ruling as interpreted below in *Schmidt*.<sup>29</sup> By its opinion in *Nash*, the fifth circuit ripened the controversy for Supreme Court resolution.<sup>30</sup> The fifth circuit's opinion invites invidious comparison with the more structured discussion of the ninth circuit in *Schmidt*.<sup>31</sup> Overall, the opinion is essentially a recitation of the competing contentions of the Commissioner and the taxpayer, devoid of any sorting out of the key elements in the transaction at issue. Thus obeisance is made to the reigning principle of cessation of the need for the reserve, but its operative significance is withdrawn by the qualification that income is to be restored under this principle, "generally . . . only upon final liquidation or upon sale of the assets in a manner that demonstrates that they are worth face value."<sup>32</sup>

This qualification would seem to withdraw the utility of the principle of cessation of need in much of the § 351 area. The opinion announces its adherence to the Commissioner's position by stating in succession that the "Government's position is at least technically correct," and that the court would, "without attempting to be too precise" give its views of the scope of non-recognition under § 351.<sup>33</sup>

The basic contentions below were presented to the Supreme Court.

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<sup>28</sup> *Id.*

<sup>29</sup> *Scofield v. United States*, 23 Am. Fed. Tax. R.2d 69-1447 (C.D. Cal. 1969); *Rowe v. United States*, 23 Am. Fed. Tax R.2d 69-443 (W.D. Ky. 1968), appeal authorized P-H 1969 Fed. Taxes Citor 12,107; *Schuster v. Commissioner*, 50 T.C. 98 (1968).

<sup>30</sup> *Nash v. United States*, 414 F.2d 627; 24 Am. Fed. Tax R.2d 69-5271 (1969).

<sup>31</sup> See note 29, *supra*.

<sup>32</sup> 24 Am. Fed. Tax R.2d 69-5271, 69-5273 (1969).

<sup>33</sup> The opinion suggests that it would be inappropriate and inconsistent with the policy of § 351 to allow nonrecognition on the transfer of the reserve. The reasoning is not persuasive. The Court apparently assumed that a loss will result at the time of the transfer of the accounts receivable to the corporation by assuming further that the partnership basis in the accounts receivable was their face value and that they were transferred to the corporation at their net value. From this perspective, the bad debt reserve is apparently entirely independent of the receivables account; the better view would be that the amount of the reserve would have been restored to income when the determination was made that the partnership basis in the receivables was their face value. That determination would negate the existence of the reserve since it would state that the probability of non-collection was zero. *Id.* For a discussion of the determination of the basis of accounts receivable see *Raich v. Commissioner*, 46 T.C. 604 (1966).

The losing taxpayers in the fifth circuit attacked the validity of the Ruling and the inappropriateness of the selection of § 351 transactions as occasions for the extended application of the tax benefit rule to reserve account.<sup>34</sup> The Government, urged the Court to accept the validity of the Ruling and the need to treat the reserve account in § 351 transactions on a parity with § 337 treatment.<sup>35</sup>

The brief opinion by Mr. Justice Douglas effectively resolves this controversy on narrow functional lines. Given the history of this dispute, it was to have been anticipated that some lack of unanimity would appear even in the Supreme Court. In brief statements of dissent Mr. Justice Black and Mr. Justice Stewart indicate their preference for the result in the fifth circuit and in the majority opinion of the Tax Court in *Schuster*.<sup>36</sup>

Speaking for the majority, Mr. Justice Douglas rejected the cessation of need concept of the Ruling as an appropriate occasion to invoke the tax benefit rule in connection with the reserve for bad debts. Like the ninth circuit, the majority opinion requires that a benefit or recovery be shown in order to require restoration of the reserve account to income. The Court pointed out the misplaced identity of recovery with cessation of need, as follows:

Congress could make the end of 'need' synonymous with 'recovery' in the meaning of the tax benefit rule and make the rule read: 'a bad debt reserve which has produced an income tax benefit in a prior year is to be added to income in the year in which it is recovered or when its need is ended.' The semantics would then be honored by the Commissioner's ruling. *But we do not feel free to state the tax benefit rule in those terms in this context.* (Italics added)<sup>37</sup>

The majority explicated the traditional view that application of the tax benefit rule required a recovery without any connotation of cessation of need by noting that the value of the stock received by the taxpayers was equal to the net value of the receivables. The Court thus recognized the function of the reserve account in the context of the § 351 transfer by stating,

A tax benefit was received by the partnership when the bad debt reserve was originally taken as a deduction from income. There would be a double benefit to the partnership if securities were issued covering the face amount of receivables. We do not, however, understand how there can be a 'recovery' of the benefit of the bad debt reserve when the receivables are transferred less the reserve.<sup>38</sup>

The opinion is ended on a note of acceptance of the reasoning of the

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<sup>34</sup> Brief for Petitioners at 16-17, *Nash v. United States*, see note 36, *infra*.

<sup>35</sup> Brief for United States at 9-11, *Nash v. United States*, see note 36, *infra*.

<sup>36</sup> *Nash v. United States*, 90 S. Ct. 1550, 25 Am. Fed. Tax R.2d 70-1177 (1970).

<sup>37</sup> 90 S. Ct. at 1551.

<sup>38</sup> *Id.* at 1552.

Ninth Circuit Court of Appeals in the *Schmidt* case; in the final paragraph, the Court restates with approval, the conclusion of the ninth circuit that the cessation of need for the reserve does not constitute a recovery within the meaning of the tax benefit principle.

The narrowest effect of this brief opinion by the Supreme Court is to strike down Revenue Ruling 62-128. By rejecting the concept of cessation of need as having any significance for invoking the tax benefit rule, the Court has withdrawn the single conceptual basis of the Ruling and ended its significance.

The content of the opinion warrants the conclusion that the Court has done more than return the problem of the tax treatment of the bad debt reserve in this context to the general principles that governed prior to the announcement of Revenue Ruling 62-128. To be sure, the brief opinion, appropriately limited to the narrowest ground of decision, contains no such pronouncements. Yet the existence of a Supreme Court opinion in this area, necessarily generates some shading of the pre-existing doctrines.

The principal change effected by this opinion is to underscore the role of the reserve in the valuation of the receivables transferred to the corporation. By adopting the reasoning of the ninth circuit in *Schmidt*, the Supreme Court has emphasized the importance of the determination made there of the transfer of the receivables at their net value. As a result of this opinion, the pre-incorporation planning of taxpayers will now require renewed concern with the mode of valuing receivables; the Service can be expected to assess deficiencies in those instances in which the reserve has not been absorbed in the valuation process. Such litigation as ultimately arises on this score would seem now to require a finding by a lower court on the function of the reserve in the valuation of the transferred receivables. An added reference in the opinion to the reserve for bad debts as a valuation account reinforces this conclusion.<sup>39</sup>

Otherwise, the Supreme Court opinion leaves the matter essentially where it was prior to the escalation of what might have been an inconsequential potter. Some, none, or all of the reserve for bad debts will be restored to income on a complete liquidation or termination of a business taxpayer depending on the accuracy of the reserve balance as a prediction of uncollectibles and as a measure of the final transfer value of the receivables. In this context, complete liquidation will include typical corporate liquidations as well as those of a subsidiary by a parent, and those pursuant to the terms of I.R.C. §§ 333 and 337. The transfers of reserves for bad debts upon incorporation will generally be the occasion for a carryover of the reserve balance to the corporation, without more,

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<sup>39</sup>Nash v. United States, 90 S. Ct. 1550, 1551 at n.4, quoting Geyer, Cornell & Newell; see note 16 supra. The same point is repeated by a quotation from the leading critic of Rev. Rul. 62-128; see note 7, supra.

where the occasion of the transfer conforms to the I.R.C. § 351 requirements and is merely change in the form of a business unit.

This instance of an eight year lag in the reversal of an inappropriate characterization serves as a sobering reminder of the real and money costs of error in this context.