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Income-tax Department

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The United States circuit court of appeals, in reviewing a case previously tried by the board of tax appeals, rendered a decision which seems to be of major importance, in the case of *The Kendrick Coal Company* v. *Commissioner*.

In the language of the laity, and excluding any technical points, the court held that while the circuit court of appeals could not enlarge or piece out the findings of fact of a fact-finding body (such as the United States board of tax appeals) it could look to the facts upon which the decision was made to inform itself as to whether or not the facts justified the adjudication.

In the case of the Kendrick Coal Company, the court held that:

> "The order of the board of tax appeals is not sustained by its findings of facts, there being no findings as to (a) the cost of assets transferred by the corporation, and (b) the value of such stocks received in exchange . . ."

The court thereupon reversed order of the board of tax appeals and remanded the case with instructions to the board for such "further proceedings as may be deemed advisable not inconsistent with the views of the court."

The views of the court, as set forth above, seem especially appropriate, for in reading decisions of the board we have frequently observed appeals wherein the findings of fact seemed to bear no relation to the decision made—in fact, the decision seemed to be exactly contrary to that which might be expected from the findings of fact.

Other tax practitioners must have noted this wide divergence between facts and opinions, and have been puzzled by the apparent anomaly.

Another decision of more than passing interest is that of the *Broadway Savings & Trust Company* v. *United States*. In this case the United States court of claims held that even though it was stipulated that a certificate representing a bond of a corporation going through receivership was charged off by a bank upon the recommendation of the Clearing House Association, supplemented by an independent investigation by the taxpayer, it was not established that such debt was ascertained to be worthless. The aforementioned debt was charged off in 1919, and the deduction was therefore made under the provisions of the act of 1918. Bearing upon this subject is section 214 (a) (7), of the act of 1918, which reads, in part, as follows:

> "That in computing net income there shall be allowed as deductions: debts ascertained to be worthless and charged off within the taxable year; . . . ."

It is difficult for a layman to understand just what procedure should be used to ascertain that a debt is uncollectable, and this decision befogs the taxpayer to a greater extent.

It appears that the representative of the Clearing House Association considered the bond of no value, for if he did not so consider it he could have recommended that some portion of the book value be charged off. Further-

more, it appears that the taxpayer satisfied himself by a personal investigation as to the accuracy of this opinion, and, therefore, "ascertained the debt to be worthless" to quite a satisfactory degree.

There is nothing in the language of the act to indicate that the commissioner or any court should determine the worthlessness of a debt. The entire responsibility seems to be upon the taxpayer, and it appears doubtful that the commissioner is authorized to interpose his opinion. It will be argued, of course, that the language was not intended to leave to the taxpayer's discretion, entirely, the ascertainment of the worthless character of the debt; but, one may ask, whose duty is it to charge off the bad debt in the books?

One of the prime necessities required by the 1918 act was that a bad debt should be "charged off" within the taxable year. It is assumed that the rather ambiguous phrase "charged off" refers to the bookkeeping process of charging to profit and loss and crediting an asset account. We have not yet heard of any outsider with authority to make entries in books of account without the consent of the one who owns the records. It would follow, therefore, if a taxpayer authorized an entry in which an asset was "charged off", that the taxpayer must have ascertained that the asset was worthless.

If, upon examination, the commissioner ascertained that the taxpayer's judgment was defective, he might properly be authorized to require that the "charge off" entry be reversed, after presenting some proof that the taxpayer's conclusion was erroneous. If an asset is of such character that a Clearing House Association's examiner deems it worthless, and the taxpayer himself, upon due investigation, arrives at the same opinion, it would seem that the contra opinion of a governmental officer should be scrutinized and should not be given as much evidential weight as that of those who differ with him.

If any injustice is done the federal government by an erroneous "charge off" of a bad debt, a remedy is prescribed in provisions of the act that debts previously charged off and subsequently collected shall be included in gross income of a taxpayer.

SUMMARY OF RECENT RULINGS

Section 274 (a), act of 1926, permitting injunction pending an inquiry before the board of tax appeals extends not only to the collection of a deficiency asserted by the commissioner which was appealed to the board, but also extends to any unpaid portion of the original assessment. (U. S. circuit court of appeals, fifth circuit, *Peerless Woolen Mills* v. *J. T. Ross, collector.*)

The decedent's gross estate should not include the corpus of a trust created in 1916 providing for the distribution of the income thereof, and, at his death, of the corpus to the settlor's issue, where the trust deed provided that the settlor, but only with the written consent of the trustee, might modify or revoke the trust, in whole or in part, and the settlor, by written deed with the consent of the trustee in 1919, rearranged the shares in the corpus within the group originally fixed, such power of revocation conditional on the consent of the trustee, not being a "general power of appointment exercised by the decedent" within the meaning of sec. 402 (a), act of 1918. (U. S. Circuit court of appeals, second circuit, *The Farmers Loan & Trust Co., trustee,* v. *Frank K. Bowers, collector.*)

Amount entered in 1920 on his books as income by a member of a partnership under an arrangement with another member, to which the other partners had never consented, which arrangement was disclaimed in 1921 and readjusting entries were thereupon made in that year on the taxpayer's books, should not be included in his gross income for 1920, such income in fact belonging

to the partnership. (U. S. circuit court of appeals, fifth circuit, *J. L. Reinschmidt* v. *Commissioner.*)

The rule that an appellate court will not look to the opinion of a fact-finding court or body to eke out the findings of fact made by such court or body applies to the board of tax appeals. This court held that the order of the board of tax appeals in decision 2409 is not sustained by its findings of fact, there being no findings as to (a) the cost of assets transferred to a corporation, and (b) the value of such stock received in exchange, and the case was reversed and remanded with instructions for such further proceedings as may be deemed advisable not inconsistent with the views of the court. (U. S. circuit court of appeals, eighth circuit, *Kendrick Coal & Dock Co.* v. *Commissioner.*)

Annual payments for life which a widow elected to accept under the will of her deceased husband in lieu of her statutory interest in his estate under the Nebraska law, are not taxable income to her under the 1918, 1921 and 1924 acts until she shall have recovered the value of her interest in the estate, since by her election to take under a will she became a purchaser for value of the yearly payments. (U. S. circuit court of appeals, eighth circuit, *Arthur B. Allen, collector,* v. *Mrs. Arthur D. Brandeis.*)

The evidence as to the grounds for an addition to a bad-debt reserve deducted in 1921 by a taxpayer (which had set up a reserve in 1919) in addition to bad debts ascertained to be worthless and charged off, was held to be highly persuasive if not entirely conclusive. The order of the board of tax appeals in decision 2897, in which the board denied a deduction for an addition to a bad-debt reserve claimed in addition to debts ascertained to be worthless and charged off, and allowed a deduction for bad debts, was vacated and remanded with instructions to consider, legally and reasonably, claimed deductions of items consisting of a debt disallowed and the addition to the reserve claimed, as additions to the reserve allowable in whole or in part, in the sound discretion of the taxing authorities. (U. S. circuit court of appeals, first circuit, *Rhode Island Hospital Trust Co.* v. *Commissioner.*)

The court was unable to hold that there was no substantial evidence to sustain the finding of the board of tax appeals that the purchase of a residence was not a "transaction entered into for profit" resulting in no deductible loss upon sale thereof in 1921 where the taxpayer resided in the property up to the time of sale except for several short periods when he was absent from the country. (U. S. circuit court of appeals, first circuit, *Henry DeFord* v. *Commissioner.*)

A stipulation that a trust certificate representing a bond of a corporation going through a receivership was charged off by a bank in 1919 upon recommendation of an examiner of the Clearing House Association supplemented by independent investigation by the taxpayer, was held not to have established that such debt was ascertained to be worthless in that year. (U. S. court of claims, *The Broadway Savings Trust Co.* v. *United States.*)

An overpayment of taxes may not be refunded where no claim therefor was filed within the statutory period, and a claim for refund based upon the right to special assessment filed after the expiration of the statutory period under the applicable act, does not relate back to a claim for a refund for the same year, filed within the statutory period, which was not based on the grounds given in the later claim. (U. S. court of claims, *Jonesboro Grocer Co.* v. *United States.*)

A waiver on assessment of taxes for the fiscal year 1919 executed after the expiration of the statutory period on assessment is not valid to extend the period of assessment, the provisions of section 276 (c), act of 1924, relating only to an agreement entered into prior to the expiration of the statutory period. (Court of appeals of the District of Columbia, *Joy Floral Co.* v. *Commissioner.*)

A mutual life-insurance company's invested capital for 1917 includes the amount of the reserve funds maintained by it, as required by law, made up of premium payments paid in for insurance policies. (U. S. court of claims, *The Minnesota Life Insurance Co.* v. *United States.*)

A mutual life-insurance company's gross income for income and capital-stock purposes should not be reduced by the amount of the net additions to

its deferred-dividend reserves which it was required to maintain by state statutes under the provisions of section 12 (a) (2), act of 1916, and section 234 (a) (10), act of 1918. (U. S. court of claims, *The Minnesota Mutual Life Insurance Co.* v. *United States.*)

The taxpayer has the burden of proving error in the commissioner's findings. The fact that the commissioner's answer to a petition before the board of tax appeals was not under oath did not result in a default or a shifting of the burden, the rules of the board governing practice and procedure, which it had the authority to prescribe, not requiring such verification. (U. S. circuit court of appeals, seventh circuit, *Sam Greengard* v. *Commissioner.*)

The board of tax appeals erred in holding that the evidence was insufficient for the determination to a newspaper of building up a circulation structure which admittedly should be restored to invested capital, such cost originally having been charged to expense. (Court of appeals of the District of Columbia, *News Publishing Co.* v. *Commissioner.*)

Waiver of collection of additional tax for 1917, assessed in 1920, executed in 1925, after statute of limitations had expired, was void for want of consideration running to the taxpayer. The waiver provided for extension of the six-year period for collection after assessment under sec. 278 (d), act of 1924, although collection was barred when such tax was passed. (U. S. district court, E. D. New York, *James A. Walsh* v. *Warren G. Price, collector.*)

The amount received by an inventor in 1920 as compensation for the transfer to his employer in 1911 of all of his interest in a certain patent application, did not constitute income to him for 1920, but was the "purchase price of capital sold in 1911" where at the time of the transfer, the inventor knew of a rule of his employer that a "sum of money" would be paid, the amount depending upon the circumstance, the patent not being finally issued until 1918 after litigation conducted by the employer. B. T. A. reversed. (U. S. circuit court of appeals, third circuit, *Augustus M. Saunders* v. *Commissioner.*)