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Income-tax Department

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It seems to be well within the limits of conservatism to assert that one of the most difficult allowable deductions to determine was the amount of amortization sustained upon wartime facilities purchased during the period from April 6, 1917, to December 31, 1918.

One remembers with some pleasure the mental stimulation of calculating the amortization and the gymnastics to which the arithmetical calculations were subjected in order to make them conform to the commissioner's requirements of evidence as to the authenticity of the deductions.

It seemed for a long time as if it would be an impossibility to satisfy the commissioner that (1) the facilities were of the kind upon which amortization was allowable; (2) that the taxpayer had actually acquired such facilities, and (3) that the post-bellum values were correctly stated. One would prove the first two items listed above, only to come into violent contact with abstruse methods of proving after-war values. Every possible technical obstacle was raised before the claimant and it appeared for a time at least that the amortization sections of the several acts were not adopted in good faith by congress.

However, the tax practitioners were not daunted, and perseverance was rewarded in meritorious cases. All the foregoing is apropos a case that was recently decided in the United States district court, district of Connecticut, *The Briggs Manufacturing Co.* v. *United States*, in which it was held by the court:

> (1) Buildings, machinery and various items of equipment were held to have been constructed or acquired by a manufacturer of cloth and tent duck during the period beginning April 6, 1917, and before the termination of the war and to be facilities for the production of articles contributing to the prosecution of the war within the meaning of the statute.
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> (2) Residual value of war facilities for determining reasonable amortization deductible under the 1918 act was held to be (a) in case of detachable facilities capable of being returned to the field of commerce, the market value at the end of the post-war period, as evidenced by the sale price, if sold, plus depreciation from date of acquisition, and (b) in case of non-detachable facilities incapable of being returned to the field of commerce, prima facie, nothing, rejecting the government's method of labor-hour or production-quantum ratios.

The foregoing opinion of the court is interesting enough, but the manner of reasoning out the method of determining amortization sustained is refreshingly lucid, as compared with the reasoning underlying the method prescribed by the regulations, which reads in part as follows:

> (2) In case of property not included in (1) above [(1) above comprises property which has been sold or permanently discarded.—*Ed.*], the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business, such value to be not less than the sale or salvage value of the property and not greater than the estimated cost of replacement under normal post-war conditions, less depreciation and depletion.

The court brushed aside the usual elaborate schedules prepared by the bureau of internal revenue showing the average number of working hours during

the war period and of those during the after-war period, on the basis of which the proportion thus established determines the value of the facility to the taxpayer, and the statistics as to quantum of production during the war period as compared with the following period, by holding that "I am constrained to regard these methods as fallacious." The court continues the argument by saying "The values of no other plant, machinery or equipment are thus determined or determinable. The methods of evaluating depletion, depreciation or obsolescence, all of which should furnish analogies, employ no such formula. I regard the method as out of relation to the practical facts."

After thus thoroughly disposing of the clumsy machinery for determining amortization by comparison of labor hours and quantum production, the court attacks the problem in the following manner:

> "Our first inquiry is: How does the concept of residual value stand in relation to that of amortization? The statute makes no mention of residual value. It speaks of a 'reasonable deduction' for the amortization of the cost. But it is also to be observed that it does not speak unqualifiedly of amortization. Obviously it is not the whole cost that is to be observed. The amount of the amortization must be reasonable."

Then the court examines and elucidates amortization in an admirable statement which, however, is too voluminous for the limits allowed this department. The conclusion has already been quoted, and is based on the value at which the facilities can be returned to the "field of commerce" during the post-bellum period. While the method of determining this value the court says is dubious, it is, nevertheless, a great improvement over the labor-hour and quantum-of-production method.

We commend to our readers a study of this decision. It puts into simple phraseology that which many of us have known but were too timid to express, viz., that the language of the statute relating to amortization indicated a concept of what is allowable as a deduction much broader than the interpretation of the language contained in the regulations and the methods adopted by the commissioner for determining it. That these methods were not in conformity with the theory animating congress in enacting the amortization provisions has been proven in a number of instances, some of which are cited by the court in its analysis.

The taxpayers were of the opinion that the amortization deduction was to cover an allowance of a major portion, if not all, of the excess cost of facilities during the war period, acquired during that period for the purpose of production of articles needed in the prosecution of the war. Everyone knows that excessively high prices were paid for such facilities as compared with before-the-war prices, and everyone knew that these facilities at the high cost of acquisition would prove a handicap to their owners in a competitive market.

But that which was not foreseen was that the general scale of prices established during the war was to recede in 1919 and rise to new heights in 1920 and 1921. Nor did anyone foresee that due to higher labor efficiency as well as to other causes, the general scale of wealth was to reach such astounding levels.

The amortization sections of the several acts were abstruse as a vehicle for conveying to the taxpayer a concept of what was intended. The regulations, while clearer, left much to be desired in defining that which was intended, and the methods adopted by the commissioner to determine amortization

seemed not designed in conformity with the act nor with the regulations. It is not surprising, therefore, that there were cases where the amortization allowed was excessive and that others were denied any amortization although entitled to it.

SUMMARY OF RECENT RULINGS

A distributee may not deduct from income derived from securities transferred and delivered to such distributee in 1918 by the executor of an estate in process of administration that portion of the federal estate tax paid by the executor in 1919 but contributed by the distributee pursuant to an agreement between the executor and the distributee at the time of the transfer to meet promptly estate liabilities, such tax being imposed upon the estate and the executor, and not against the distributee. (Court of claims of the U. S., *Eda Matthiessen* v. *U. S.*)

Two corporations were held affiliated during 1919 where one owned all the preferred and 80% of the common stock of the other, the remaining 20% being owned by an officer-employee under a contract requiring resale to the taxpayer on termination of the employment, both corporations being controlled by the same interests and operating practically as a single unit. (U. S. court of claims, *Ullman Manufacturing Co., a corporation*, v. *U. S.*)

Closing inventory for finished goods for 1920, taken at market, should not be reduced by selling commissions or trade discounts which the taxpayer would have had to pay or allow, since the regulations as prescribed by the commissioner pursuant to the authority conferred on him by sec. 203, act of 1918, define "market" as the "current bid price" without reference to such discounts and commissions. (U. S. court of claims, *Riverside M'f'g. Co., a corporation*, v. *U. S.*)

The commissioner's action in consolidating the returns of two corporations for 1917 was approved, where the taxpayer, engaged in manufacturing candy, owned 94.33% of the stock of a corn-refining company from which it obtained its corn syrup. Articles 77 and 78 of the regulations issued pursuant to sec. 201 of the 1917 act, providing for consolidated returns for affiliated corporations are not in violation of the constitution.

Where the claim for refund was not based upon (a) failure to include organization expenses in invested capital, or (b) failure properly to allocate excess-profits taxes between corporations contended by the commissioner to be affiliated, such contentions can not prevail in a suit to recover the taxes paid. (U. S. court of claims, *National Candy Co.* v. *U. S.*)

A corporation organized for the purpose of purchasing, holding, leasing and selling real estate was held to be "carrying on and doing business" and subject to the capital-stock tax imposed by the 1921 and 1924 acts, where it acquired coal land in exchange for its stock and bonds, leasing it to a corporation owned by its sole stockholder, had no separate office, or employees, its officers being the same as those of the other corporation owned by its sole stockholder, paid current expenses and with its income paid off its bonds and made investments. (U. S. court of claims, *Morrisdale Land Co.* v. *U. S.*)

A corporation in existence in the preceding taxable year only one month ended June 30, 1925, in arriving at the fair average value of its stock for the year ended June 30, 1925, for purposes of the capital-stock tax imposed by section 700, act of 1924, is permitted to average the fair value of its capital stock only over the period of its existence, and not over a period of twelve months. (U. S. court of claims, *Alaska Consolidated Canneries, Inc.*, v. *U. S.*)

A trust created in 1911, reserving to the creator the income for life with remainder over in certain contingencies, and the power of revocation, was held to have been created to take effect in possession and enjoyment at or after death, the value of which should be included in the decedent's gross estate under sec. 402 (c), act of 1918. (U. S. district court, southern district of New York, *Home Trust Co., as executor of Andrew Carnegie, deceased*, v. *William H. Edwards, collector of internal revenue; Home Trust Co., as executor of Andrew Carnegie, deceased*, v. *Frank K. Bowers, collector of internal revenue.*)

Property bequeathed by a prior decedent to his son who died intestate in 1918 while in army service without having received actual distribution from his father's estate and which passed to the decedent should not be excluded from the decedent's estate as prior taxed property, even though the father died within five years of the death of the decedent, the son being the "prior decedent" within the meaning of the 1921 act. The claim of an estate against a joint mortgagor for reimbursement for indebtedness upon which the decedent was jointly and severally liable is property, the value of which should be included in the decedent's gross estate. (U. S. circuit court of appeals, ninth circuit, *John Parrott, Jr., and Mary Emilie Parrott Williams, as executor and executrix respectively of the estate of Mary Emilie Parrott, deceased,* v. *Commissioner.*)

Blow-out patches for repair of worn-out or bursted pneumatic tires are not automobile parts or accessories within the meaning of section 900, act of 1921, and section 600, act of 1924. (U. S. court of claims, *Auburn Rubber Co.* v. *U. S.*)

Exemption as a personal-service corporation for the years 1919 to 1921, was denied a corporation engaged in buying and selling advertising space in theaters on curtains, programmes, slides and films, the evidence not establishing the proportion of income derived from trading as a principal. (U. S. circuit court of appeals, ninth circuit, *Green's Advertising Agency* v. *D. H. Blair, commissioner.*)

The fair market value on March 1, 1913, of land subject on that date to adverse claims of title which in a suit for ejectment were declared in 1916 unfounded was fixed at the value of such land in the hands of an owner able to convey a complete title with exclusive right of possession on March 1, 1913, as stipulated without regard to the adverse claims. (U. S. circuit court of appeals, third circuit, *D. B. Heiner, collector,* v. *Charles P. Hewes.*)

Invested capital should not be reduced on account of a tentative tax computed upon the income of the taxable year in determining the amount of current earnings available for the payment of dividends. (U. S. circuit court of appeals, fifth circuit, *David H. Blair, commissioner* v. *W. G. Ragley Lumber Co.*)

Distraint proceedings for collection of taxes assessed for the fiscal year 1919 were held barred by the statute of limitations where on March 15, 1919, a tentative return and on June 16, 1919, a complete return were filed and the warrant of distraint was issued on March 17, 1925. Where an amount was offered in compromise of all liability on account of additional assessments and paid to the collector, which compromise offer was rejected, and was applied on an additional assessment for the fiscal year 1919, alleged to have been done "by direction of the plaintiff", such act was tantamount to a waiver of the protest of the taxpayer of and a consent to the retention of the amount paid, and the taxpayer is not entitled to a refund of the amount so paid. District court decision affirmed except on this point. (U. S. circuit court of appeals, ninth circuit, *C. A. Rassmussen, collector,* v. *Brownfield Canty Carpet Co.*)

Profits from the sale of timber lands were held taxable in 1916, where the price was agreed upon on December 27, 1916, the purchaser was satisfied as to title, but was granted a ten-day option to arrange for a loan, and telegraphed on December 30th that it was prepared to complete the purchase, and the deed was delivered on January 5, 1917, since, as between the parties, the transaction was complete and their rights vested on December 30, 1916. (U. S. circuit court of appeals, fifth circuit, *North Texas Lumber Co.* v. *Commissioner.*)

Cost of property acquired for stock was fixed at the price disclosed by the deed, rejecting the value entered in the books at the par value of the stock issued therefor.

Evidence held insufficient to overcome the presumption in favor of the commissioner's valuation of bonds received as part payment of the price of property sold and as a distribution in liquidation of the corporation. (U. S. circuit court of appeals, fifth circuit, *Robert L. Crook and Daniel H. Christman* v. *U. S.*)

Income derived from personal services rendered by the husband and reported by the wife in her separate return as her income under the community-property laws of Texas may be treated as earned income. (U. S. circuit court of appeals, fifth circuit, *Mrs. Ethel Hopkins McLarry* v. *Commissioner.*)