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Income-tax Department

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During the coming winter much will be said with reference to modification, simplification and changes generally in the federal income-tax laws. The report of the Couzens committee is being awaited with intense interest. The incidents associated with the inception of this committee and the newspaper stories of the outgivings of its chairman have centered attention upon it. What has been found and what it will report and recommend is not as yet known with any degree of definiteness. However, it has been reported that Senator Couzens favors the exemption of all incomes up to five thousand and a reduction of surtaxes as much as or more than is now being contemplated by the secretary of the treasury.

Senator Couzens estimates that if incomes up to $5,000 were exempt from taxation, ninety-one per cent of the tax returns now made would be eliminated. As he states, this would lift a burden of giant proportions from the personnel of the bureau of internal revenue. It would be interesting to know whether or not the cost of handling these returns, their examination, collection and filing is so large a part of the revenue derived from them as to render the net revenue insufficient to justify the expenditure of effort.

There is a theory that the obligation to pay a tax causes the taxpayer to take a greater interest in his government than do those not taxpayers. This theory seems to be too general to be accurate.

It is reported that Senator Smoot is in favor of the abolition of the estate taxes and the gift taxes but that this will be opposed to a certain extent by Senator Couzens and the bloc of which he is a representative.

Much attention is being given by those in authority in our government and those not of that body to proposals for a more scientific basis of levying and collecting the income taxes. One of the major problems of the treasury department in its work of assessing and collecting federal taxes is that of obtaining competent employees at the salaries that are prescribed. The vast majority of its employees are competent but the personnel is constantly changing for the very obvious reason that the salaries paid are below the scale of the business and professional world. No claim is made that this discovery is original with the writer. Everyone in contact with the taxing departments is aware of it. It would seem to be a duty of everyone having this in mind to make his influence felt in having this condition remedied, for with greater incentive and the ability to get high grade employees, satisfied to remain in the employ of the government indefinitely, there would be a great saving to the taxpayers. It costs money to employ men and instruct them in the work they are to perform.

SUMMARY OF RECENT RULINGS

Under the 1918 act, an action at law may not be maintained by the United States for an extra estate tax where the executor's return is incorrect, without a return by the collector and the assessment of a tax thereon by the commissioner, as prescribed by the statute. (*U. S.* v. *James C. Ayer, et al.*, in U. S. district court of Massachusetts.)

A partnership which carried on business solely with borrowed money had no invested capital under the 1917 act and was subject to tax under section 209 thereof and not to any excess-profits tax. (*King* v. *Hopkins, Collector*, U. S. district court, N. D. of Texas.)

When conservative valuations are placed upon lands by administrators in their estate-tax returns, such valuations will not be later held excessive on their motions although the market value of such land was greater at time of decedent's death than it was before or after that date.

When the year's taxes on real estate became a lien on May 1st of that year, the value of the estate of a person dying after that time should have deducted therefrom all of such taxes, notwithstanding article 40 of regulations in effect when the taxes were paid, October 18, 1920.

When taxes were voluntarily paid but a claim for refund was made, the question reopened by the government and a partial reduction allowed because of certain taxes paid, the courts may allow a further reduction on account of said taxes if considered proper. (*Thompson et al. Administrators* v. *U. S.*, U. S. district court of Minnesota, third division.)

Goodwill is not "property used in trade or business" under the act of 1918, and an allowance for the obsolescence thereof may not be allowed because of prohibition legislation in the case of a manufacturer of malt. (*Red Wing Malting Co.* v. *Willcutt, Collector*, U. S. district court of Minnesota, third division.)

Where the value of corporate stock has been increased or decreased during the preceding year, the capital-stock tax must be based upon its fair average value during that year which is not the same as its fair value on June 30th. (*One Liberty Street Realty and Securities Corporation* v. *Bowers, Collector*, U. S. district court, S. D. of New York.)

Goodwill value for purposes of invested capital cannot be established by oral testimony or by proof of stock being issued therefor. (U. S. B. T. A. decision 666, docket 84, *Pacific Baking Company.*)

Earnings subsequent to the acquisitions of intangibles purchased for stock have evidentiary value in determining the worth of such intangibles.

The commissioner has the burden of proving the facts if an affirmative defense is alleged in his answer. (B. T. A. decision 667, docket 1858, *General Lead Batteries Company.*)

Where a taxpayer owes no obligation to declare a bonus, those declared after the close of a taxable year are not deductible from the income of such prior year. (B. T. A. decision 671, docket 1776, *Delaware Electric and Supply Company.*)

A deficiency for 1918 taxes based upon a waiver, pursuant to section 250 (d), act of 1921, which was signed after the statutory period had elapsed was disallowed. (B. T. A. decision 672, docket 2420, *Estate of Samuel Heinrich.*)

Any formula for determining the value of intangible property acquired must be based upon knowledge of the cost value of tangible property. (B. T. A. decision 673, docket 2506, *International Consolidated Chemical Company.*)

Reasonable salaries agreed to by all the directors and stockholders of a close corporation without formal action are deductible, though due to the bookkeeper's failure to follow instructions, no book entries were made until the following year.

Unpaid salaries forgiven to a corporation may be included in invested capital only from the date of forgiveness. (B. T. A. decision 676, docket 583, *The Parisian.*)

Where a corporation holding seventy-five per cent of the stock of another has no control over the remaining shares, the two are not affiliated under the act of 1918. (B. T. A. 697, docket 1856, *Ditter Bros., Inc.*)

Amounts paid to stockholders who rendered no services are not allowable deductions. (B. T. A. decision 681, docket 1940, *Alexander Reid and Company*).

A loss sustained by the cancellation of government contracts is deductible in computing taxable income from such contracts.

A return, incorrect by reason of an error made by an inexperienced bookkeeper, is not a fraudulently false one made with intent to evade the income tax. (B. T. A. decision 687, docket 234, *Gutherman Strauss Company.*)

The value of an interest at the time of a decedent's death cannot be established by a statement showing an estimated deficit at a date several years subsequent thereto.

Balance-sheets, net earnings, dividends, existing surplus and capital stock tax valuation over a five-year period are more competent to show stock value than an isolated sale made six months prior to the valuation date. (B. T. A. decision 692, docket 1782, *Walter et al., Executors.*)

Taxpayer's failure to claim a deduction for depreciation of patents in his original return does not preclude the claiming of such deduction later. (B. T. A. decision 693, docket 1839, *S. Marsh Young.*)

A debt may not be deducted as worthless as long as the assets of the debtor will permit a recovery in part. (B. T. A. decision 698, docket 3021, *Equinox Company.*)

An objection to testimony of purely hearsay character as to the average rate of tax paid by representative corporations was sustained by the board. (B. T. A. decision 702, docket 2856, *Walker Creamery Products Company.*)

TREASURY RULINGS

(T. D. 3743, August 17, 1925)

ARTICLE 1008: Collection of tax by suit.

INTERNAL REVENUE TAXES—RECEIVERSHIP—DECISION OF COURT

An order of a state court requiring the filing of all claims in receivership on or before a certain date does not apply to the filing of a claim by the United States for unpaid taxes, as such a claim can be filed at any time while the receivership is pending and assets of the estate remain undistributed.

The following decision of the appellate court of the first district of Illinois in the case of *Reinecke, Collector,* v. *General Combustion Co., Insolvent,* is published for the information of internal-revenue officers and others concerned.

APPELLATE COURT OF ILLINOIS, FIRST DISTRICT

Reinecke, Collector, v. *General Combustion Co., Insolvent*

[June 9, 1925]

FITCH, presiding justice: This is an appeal from an order of the superior court directing the receiver in charge of the property of the General Combustion Co., an insolvent corporation, "to reject, disallow and disregard" the claim of appellant as collector of internal revenue for taxes alleged to be due to the United States.

The order recites that the matter came on to be heard in the superior court upon the petition of the receiver for instructions as to the disposition of the collector's claim, which was filed on July 14, 1923; that on June 24, 1922, an order was entered requiring all persons having claims against said corporation to file the same on or before August 1, 1922, which order also provided that "all persons, firms, or corporations" who shall fail to file their claims on or before August 1, 1922, should be forever barred from sharing in the property or assets of the corporation then in the possession of said court, and directed that a notice thereof be published for three weeks in some newspaper of general circulation published in Chicago, Ill.; that the receiver had published such a notice and had complied in all respects with such order; that the court being advised that the claim so made, if allowed and paid by the receiver, "would exhaust the assets" in the hands of the receiver, a request was made upon the collector "to show under the law the amount of tax due, or to submit an equitable basis of compromise authorized by the secretary of the treasury of the United States of America," and the disposition of the petition of the receiver for instructions was continued to afford time to the collector "to secure instructions and authority from the secretary of the treasury"; that more than 60 days had elapsed, and that said claimant "has failed to submit any proposition for the settlement of her claim."

From the terms of this order, it would appear that the chancellor deemed the claim of appellant to be of such a doubtful character that he had suggested to the collector that she either "show under the law the amount of tax due" or submit an authorized equitable basis of compromise. But the record shows that the parties stipulated "that the only question at issue before the court in this cause and for appeal is an issue of law, to wit, whether or not in this, a receivership proceeding in the state court where the cause is still pending and the assets undistributed, the order . . . requiring all persons having claims against the General Combustion Co., insolvent, to file such claims on or before August 1, 1922, or else be forever barred from filing such claims, applies to the United States of America or the collector of internal revenue in case of a claim for federal taxes."

Such being the stipulation of the parties, the appellant has filed in this court only a praecipe record, containing certain orders and stipulations. This record shows that two claims were filed by appellant. The first was filed on June 13, 1923, and is a claim of the collector against the General Combustion Co., "bankrupt," for an alleged capital-stock tax assessed for the year 1922, under section 1000 of the revenue act of 1918, for $100.80 and interest. As to this claim, the order appealed from makes no mention of it, and there is no stipulation concerning it except that such a claim was filed. The second claim was filed on July 14, 1923, and is a claim of the collector against said "bankrupt" for income taxes for the year 1918, levied under the revenue act of 1917, amounting to $12,521.41 and interest; and it was stipulated that the tax appears in "the original income-tax assessment list for the month of June, 1923." This is the only claim mentioned in the order appealed from. It was further stipulated that no actual personal notice of the limitation order of June 24, 1922, was ever given to or served upon the collector, and that there has been no distribution of the assets of the insolvent corporation, but that the receiver has on hand the "sum of $14,000 cash money," subject to distribution.

Under the stipulation, the question of the validity or amount of appellant's claim is not before us. The only question is whether the federal government is barred from asserting its claim against the assets in the hands of the receiver because its claim was not presented on or before August 1, 1922, as required by the previous order of the superior court. To this question there can be but one answer, and that in the negative.

"The principle that the United States are not bound by any statute of limitations nor barred by any laches of their officers, however gross, in a suit brought by them as a sovereign government to enforce a public right or to assert a public interest, is established past all controversy or doubt." (*U. S.* v. *Beebe*, 127 U. S., 338, 344.) "It is settled beyond doubt or controversy—upon the foundation of the great principle of public policy applicable to all governments alike, which forbids that the public interest should be prejudiced by the negligence of the officers or agents to whose care they are confided—that the United States, asserting rights vested in them as a sovereign government, are not bound by any statute of limitations, unless congress has clearly manifested its intention that they should be so bound. (*Lindsey* v. *Miller*, 6 Pet., 666; *U. S.* v. *Knight*, 14 Pet., 301, 315; *Gibson* v. *Chouteau*, 13 Wall., 92; *U. S.* v. *Thompson*, 92 U. S., 486; *Fink* v. *O'Neil*, 106 U. S., 272, 281 (4 Am. Fed. Tax Rep., 4600); *United States* v. *Nashville, Chattanooga & St. Louis Ry. Co.*, 118 U. S., 120.) No act of congress has been cited, and we know of none, in which a contrary intention is manifested.

While counsel for the government have covered a wide field in their brief, we are of the opinion that the above quotations are decisive as to the only question involved on this appeal. Counsel discuss the questions, whether state insolvency laws are suspended by the national bankruptcy act, whether the government is entitled to priority over the claims of other creditors, whether a notice by publication of such a limitation order is binding upon the government, and similar questions. None of these questions is pertinent to the stipulated question at issue on this appeal. However, as the stipulated extract from the "tax assessment list" is a meaningless jumble of figures,

when separated from its context and otherwise unexplained, and as neither the order appealed from, nor any other part of the praecipe record, shows that any evidence was heard, we deem it not wholly obiter for us to say that it is our understanding of the law that if the government has a valid claim against the insolvent corporation for unpaid taxes, its claim must be proved like any other claim, and if allowed, its claims will have priority over the claims of other creditors (*Union Trust Co.* v. *Ill. Midland Co.*, 117 U. S. 434; sec. 3466, U. S. Rev. Stat.); also, that it is the right of the federal government to present its claim for taxes at any time during the pendency of the receivership proceedings and before the assets are distributed. (*U. S.* v. *Birmingham Trust & Savings Co.*, 258 Fed. 562, 564.)

The suggestion contained in the order that the court might require the government to submit a proposition of settlement or compromise is clearly untenable. Section 3469 of the United States *Revised Statutes* authorizes the secretary of the treasury to compromise claims in favor of the United States, when recommended by the solicitor of the treasury, upon a report from a district attorney or any special attorney having charge of the claim. But we do not understand that it has ever been held that the court, by which a receiver has been appointed, may require the government, as a condition to either the filing or the allowance of its claims for taxes, to submit a proposition of settlement.

For the reasons stated, the order of the superior court is reversed and the cause remanded for further proceedings not inconsistent with the views herein expressed.

(T. D. 3744, August 17, 1925)

ARTICLE 836: Tangible property paid in: value in excess of par value of stock.

WAR PROFITS AND EXCESS PROFITS TAX—TANGIBLE PROPERTY PAID IN: VALUE IN EXCESS OF PAR VALUE OF STOCK

Article 836, regulations 45 (1920 edition), and article 836, regulations 62, amended.

Article 836, regulations 45 (1920 edition), and article 836, regulations 62, are hereby amended to read as follows:

ART. 836. *Tangible property paid in: value in excess of par value of stock.*—EVIDENCE offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (*a*) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (*b*) certification of the assessed value in the case of real estate; and (*c*) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid into the corporation. In all cases the proof of value must be clear and explicit.

(T. D. 3747, August 21, 1925)

ARTICLE 1009: Collection of tax by distraint.

TAKING SEIZED PROPERTY FROM CUSTODY OF INTERNAL REVENUE OFFICER—SECTION 71, CRIMINAL CODE—CHARGE TO JURY

1. Where property has been seized under warrant for distraint to satisfy an unpaid internal-revenue tax due by a corporate taxpayer, and a portion of the property so seized is removed by an officer of the corporation, on his own motion after the levy, his claim that the property removed belonged to him individually is inadequate as a defense when charged under section 71, *Criminal Code*, with dispossessing or receiving property taken or detained by an officer under the authority of a revenue law.

2. The words "rescue" and "dispossess" mean that where an article or person has been seized and taken into custody, the forcible or surreptitious taking of that article or that person out of the custody of the officer then a "rescue" has occurred.

3. Leaving property in the possession of an individual after levy does not justify him in taking and disposing of it for his own purposes.

4. Where an individual has knowledge that a levy has been made, but in the face of it takes goods seized under a warrant for distraint, and on his own action, without an appeal to any court, disposes of them, he is guilty of violating the provisions of section 71, *Criminal Code.*

The following charge to the jury in the case of the *United States* v. *Frank C. Sauer*, given by the court in a trial recently had in the United States district court for the western district of Pennsylvania, is published for the information of internal-revenue officers and others concerned.

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF PENNSYLVANIA. NO. 283—CRIMINAL

United States v. *Frank C. Sauer*

[May 5, 1925]

CHARGE OF THE COURT

GIBSON, J

GENTLEMEN OF THE JURY:

The defendant named in this indictment, Frank C. Sauer, is charged with having on the 22d day of December, 1922—between that date and the 29th of December, in the same year, unlawfully, knowingly, willfully, and feloniously, in a building located at No. 1039 East Ohio street, North Side, Pittsburgh, Pa., dispossessed and rescued certain property, to wit, five piles of hides, which are alleged to be of considerable value, which had been distrained by a deputy collector of internal revenue in the collection of a tax alleged to be due on the part of the Sauer Hide Co.

The government has introduced certain testimony to the effect of the assessment of a tax against the Sauer Hide Co. and the issue of warrant of distraint to the deputy collector of internal revenue, and service of that particular warrant of distraint. I shall not undertake to detail the manner of it; you will recollect his testimony in so far as the service is concerned. He is alleged to have given a copy of the list of articles seized by him to the defendant, and also to have posted the notices on the premises. A part of the property which was distrained by him, seized under his levy, according to the testimony offered by the government, was five piles of hides which were on the premises of this Sauer Hide Co., on East Ohio street, in the city of Pittsburgh. As we understand the testimony of the defendant, there is no denial of any of the testimony to the extent to which we have detailed it. That will be for your recollection, however, gentlemen of the jury.

The defense is one which to the court seems inadequate, under the present circumstances, to the effect that the defendant was the owner of the stuff seized, that is, of this particular amount of hides, five piles of hides, and claimed individual ownership of them. Under the circumstances, as detailed, as we have stated before, the court has excluded evidence of that particular defense. You are to determine here whether the government has established beyond a reasonable doubt that on or about the particular date charged in the indictment, within the western district of Pennsylvania, the deputy collector of internal revenue had distrained upon and levied upon five piles of hides, which have been mentioned in the evidence here, and whether or not this defendant rescued or dispossessed the collector of those hides. Now, the words "rescued" and "dispossess" simply mean that where an article or a person has been seized and taken into the custody of the law, if anyone forcibly or surreptitiously takes those articles or that particular person out of the custody of the officer, then a rescue has occurred. You are to determine here whether or not this defendant has taken, without lawful authority, the five piles of hides after they had been levied upon. Now, the mere fact that they were left in possession would not in any way justify his taking those goods and disposing of them for his own purpose. If you are satisfied beyond a reasonable doubt that the levy was made and served upon him, and that he knowing the existence of that levy, in the face of it, took those hides and disposed of them, without any appeal

to any court, but upon his own motion, then your verdict in this case should be guilty as indicted. If you are not so satisfied, under the evidence, your verdict should be not guilty. You will, in passing upon that, however, determine whether or not there is any evidence which would tend to contradict any of the particular matters which have been alleged here in support of the indictment.

The defendant by his counsel has submitted a point to the court and has requested us to charge the jury in accordance with it. We have refused that point, and do not read it.

You will take the case, gentlemen.

(T. D. 3748, August 31, 1925)

Income tax—Association distinguished from trust

Article 1504 of Regulations 65 is hereby amended to read as follows:

ART. 1504. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341–347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

(T. D. 3749, August 31, 1925)

Income Tax—Association

Article 1502 of regulations 65 is hereby amended to read as follows:

ART. 1502. *Association.*—Associations and joint-stock companies include associations, common-law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to state laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 2.