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Income-tax Department

EDITED BY STEPHEN G. RUSK

Increasing familiarity with the federal income-tax laws enhances one's interest in a subject that to most people seems dry as dust. The more one comes in contact with the law and those entrusted with its administration the greater is the interest in it, and that which at one time seemed hopelessly complex and intricate takes definite form. Constant contact with this subject opens vistas of human nature, economics and that wide field of activity known as "business."

Take, for example, the reaction on some congressmen that was caused by the proposal of Secretary Mellon for tax reduction. What interesting phases of the working of their minds is unfolded by their comments upon the measure, in which it appears that some would reënact an excess-profits tax so that the taxpayer having a small income would be relieved of taxation and the burden would be shifted to those better able to bear it. Others, while deprecating the fact that those with large incomes are prone to invest in tax-free securities, still insist that there shall be no reduction of the higher surtax rates, but vote down a bill to amend the constitution so that income from federal, state, county and city bonds will become taxable.

Without familiarity with this subject one would be without the entertainment these views of the people's representatives furnish, and it would be difficult to sort out from this mass of ideas that which is nearest the truth.

Not alone in studying the attitudes taken by our congressmen will one find entertainment and food for thought, for there are open to him the treasury decisions that continually flow from the treasury department. Read treasury decision 3521, wherein is set forth the plight of a taxpayer who gave a cheque in payment of his tax March 10, 1921, and about a week later the bank upon which his cheque was drawn was closed by the bank examiner. As the cheque had arrived at the taxpayer's bank before the bank was closed and had been marked paid by the said bank the taxpayer probably sustained a shock when he was asked to pay his tax again. His cheque had traveled around the taxpayer's section of the country the better part of a week before it arrived at the taxpayer's depository, and a delay of twenty-four hours somewhere in its travels probably caused all the trouble, for if it had arrived home one day earlier the bank draft issued instead of the taxpayer's cheque would have been properly cleared and all would have been well. "It's an ill wind that blows no one some good," however, and this subject engaged the attention of several attorneys at law and that of District Judge Cushman of the United States district court for the western district of Washington, southern division. What, do you ask, is the moral of this sad tale? It is this: if you were not interested in income-tax matters you would not have known that Judge Cushman ruled that the several banks through which this cheque passed in its journey were not agents of the United States but of the drawer of the cheque, and therefore until the money was safely deposited in the collector's account

the tax bill was not paid. It is possible that you might have surmised what the judge's ruling would be, but the taxpayer and his lawyer did not.

(T. D. 3537—December 11, 1923)
Income tax.

Deductions: Losses—Voluntary removal of buildings.

Article 142, regulations 62, is amended to read as follows:

Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped, less salvage, and the amount of depreciation sustained with respect to the property prior to its demolition or scrapping, and allowable as a deduction in computing net income. However, if such property was acquired prior to March 1, 1913, and its fair market value as of that date was less than its cost, the deductible loss is the difference between such fair market value, less salvage, and the amount of depreciation sustained prior to the demolition or scrapping and allowable as a deduction in computing net income. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

(T. D. 3538—December 11, 1923)
Income tax.

Deductions: Losses—Voluntary removal of buildings.

Article 142, regulations 45 (1920 edition) is amended to read as follows:

Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped or the March 1, 1913, value thereof if acquired prior to that date, whichever is lower, and the amount of a reasonable allowance for the depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost or the March 1, 1913, value, if acquired prior to that date, whichever is lower, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

(T. D. 3539—December 11, 1923)
Income tax.

Deductions: Losses—Voluntary removal of buildings.

Article 155, regulations 33 (revised), is amended to read as follows:

Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income, in an amount representing the difference between the cost of such property demolished or scrapped or the value thereof as of March 1, 1913, if acquired prior to

that date, whichever is lower, and an amount measuring a reasonable allowance for depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost, or March 1, 1913, value, if acquired prior to that date, whichever is lower, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction.

(T. D. 3541—December 19, 1923)

1. INCOME TAXES—PAYMENT—LIABILITY UNDER SECTION 1314.

A check tendered in payment of federal taxes does not, under the provisions of section 1314 of the revenue act of 1918, discharge the liability of the taxpayer until the check is actually paid in money.

2. SAME.

The stamping of a check tendered in payment of federal taxes as "paid" by the drawee bank and the return of the canceled check to the drawer does not constitute payment where due to insolvency of the drawee bank the amount of the check is not received in money by the collector.

The following decision of the United States district court for the western district of Washington, southern division, in the case of *United States v. H. E. McKenney,* is published for the information of internal-revenue officers and others concerned.

UNITED STATES COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION. NO. 3799. DECISION ON THE MERITS.

United States, plaintiff, v. H. E. McKenney, defendant.

Thos. P. Revelle, United States attorney (*W. W. Mount,* assistant United States attorney), attorney for plaintiff.

T. P. Fisk, attorney for defendant.

CUSHMAN, district judge: This cause has been submitted upon the following statement of facts:

It is hereby agreed and stipulated by and between Thos. P. Revelle, United States attorney for the western district of Washington and attorney for the above-named plaintiff, and T. P. Fisk, attorney for the above-named defendant, that the following statement of facts may be submitted to the court as the evidence in the above entitled cause:

On March 10, 1921, Mr. H. E. McKenney, above-named defendant and a resident of the city of Kelso, Washington, was indebted to the United States government in the amount of four hundred thirty-two and 08/100 ($432.08) on account of income tax for the year 1920. On the day above mentioned Mr. McKenney drew his personal check on the Kelso State Bank payable to David J. Williams, then the collector of internal revenue for the district of Washington, for the sum of $432.08. His check was immediately transmitted to the collector of internal revenue at Tacoma, Washington. Upon receipt of this check in the office of the collector of internal revenue at Tacoma, there was stamped across the face of the check the following words: "This check is in payment of an obligation of the United States and must be paid at par. No protest. David J. Williams, collector internal revenue." The following indorsement was made on the back of the check: "Pay to the order of Seattle branch, Federal Reserve Bank of San Francisco, California. Income and profits-tax account. David J. Williams, collector of internal revenue." The check was received at the office of the collector of internal revenue at Tacoma, Washington, on the 11th day of March, 1921. On the same day it was transmitted to the Seattle branch of the Federal Reserve Bank of San Francisco, California, and deposited on March 12th to the credit of the collector of internal revenue. The Kelso State Bank, upon which institution the check was drawn, is located within the business zone covered by the Portland branch

of the Federal Reserve Bank of San Francisco, and following the usual custom in such cases the aforementioned check was forwarded by the Seattle branch to the Portland branch of the Federal Reserve Bank of San Francisco. By the Portland branch this check was forwarded direct to the Kelso State Bank. Upon receipt of the check this latter institution drew a draft on the United States National Bank of Portland, Oregon, and sent the draft to the Portland branch of the Federal Reserve Bank of San Francisco. The check drawn by H. E. McKenney was canceled "paid" and returned to the drawer, and his account was debited in the amount of $432.08. At the time this transaction occurred the First National Bank of Kelso, a member of the Federal Reserve System and a national bank, was transacting a banking business in the city of Kelso, Washington.

Subsequent to the time that the Kelso State Bank forwarded the draft on the United States National Bank of Portland to the Portland branch of the Federal Reserve Bank of San Francisco and prior to the receipt of the draft by such branch of the federal reserve bank, the supervisor of banking of the state of Washington, on the 17th day of March, 1921, closed the Kelso State Bank. The draft was duly presented to the United States National Bank of Portland, Oregon, for payment, but was refused on account of the failure of the Kelso State Bank. The Portland branch of the Federal Reserve Bank of San Francisco thereupon returned to the Seattle branch a copy of the original check, which copy has been protested for nonpayment. The Seattle branch in turn returned the copy of the original check to the collector of internal revenue and charged the account of the collector of internal revenue with the amount of the McKenney check, to wit, four hundred thirty-two and 08/100 ($432.08).

Section 1314 (internal revenue act), 40 Statutes at Large, page 1057 (vol. 1, Supplemental U. S. Compiled Statutes, sec. 6371½ O), provides:

> SEC. 1314. That collectors may receive, at par with an adjustment for accrued interest, certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits, and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the commissioner, with the approval of the secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

Whatever want of uniformity there may be in the reported cases upon the general question of when a check will be treated as payment, in view of the language of the foregoing section it is clear that congress intended the person tendering a check in payment to the collector to remain liable for the payment of the tax until it was actually paid in money. The fact that the Kelso State Bank marked the check when presented "paid" and issued its draft on the Portland bank in payment did not amount to payment or in any way lessen defendant's liability to the United States. Former acts show the same intention, a change in which intention is not to be lightly presumed.—Act of March 2, 1911 (36 Stat. L. 965); section 1010 of the act of October 5 [3], 1917 (40 Stat. L. 327).

In the course adopted in the transmitting of the check for collection no departure is shown from well-established banking custom in such cases, unless it be that the check was sent by the Portland branch of the Federal Reserve Bank of San Francisco for collection to the drawee, the Kelso State Bank. The want of uniformity in the discussion upon the question whether this constituted negligence is sufficiently indicated by the following: 5 Cyc. (D), page 506-7; *Kershaw v. Ladd* (34 Ore. 375; 56 Pac. 402); *Morris Miller Co. v. Von Pressentin* (63 Wash. 74, at 78 and 79); *First National Bank, Trinidad, v. First National Bank, Denver* (Fed. Cas. 4810); *Farwell et al. v. Curtis* (Fed. Cas. 4690).

If it be conceded to be negligence on the part of the Portland bank to so send the check to the Kelso State Bank, yet under the language of the act (sec. 1314 before quoted) such negligence is not to be attributed to the United States. If agency then be in the matter the collectors and banks are agents of the taxpayers and not of the United States, until such time as the tax is paid in money.

Judgment will be for the plaintiff.

(T. D. 3542—January 2, 1924)

Income tax—Revenue act of 1918—Decision of court.

1. MANDAMUS—AMENDED RETURNS.

Mandamus will not lie to compel the exercise by the commissioner of internal revenue of the power vested in him by section 212 of the revenue act of 1918 to approve a change in a taxpayer's accounting period from a fiscal year to a calendar year, or to accept amended returns.

2. ACCOUNTING PERIOD—CHANGE FROM FISCAL TO CALENDAR YEAR.

When a taxpayer voluntarily changed its accounting period from a calendar to a fiscal year basis and filed returns on this basis, mandamus will not lie to compel the commissioner to accept amended returns on a calendar-year basis.

3. JUDGMENT AFFIRMED.

Judgment of the supreme court of the District of Columbia denying appellant's petition for a writ of mandamus (T. D. 3500) affirmed.

The following decision of the court of appeals of the District of Columbia in the case of the *Greylock Mills, a corporation, v. David H. Blair, commissioner of internal revenue,* is published for the information of internal-revenue officers and others concerned.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA. NO. 4015.

United States ex rel. the Greylock Mills, a corporation appellant, v. D. H. Blair, commissioner of internal revenue, appellee.

(December 3, 1923.)

Before SMYTH, Chief Justice; ROBB, Justice, and BAILEY, a Justice of the Supreme Court of the District of Columbia.

ROBB, justice, delivered the opinion of the court:

Appeal from a judgment in the supreme court of the District denying appellant's petition for a writ of mandamus to compel the appellee, as commissioner of internal revenue, to accept appellant's amended income and profits-tax returns for the calendar years 1918 to 1922, inclusive, and to accept returns in future upon the calendar-year basis.

An answer was interposed to appellant's petition, to which answer appellant filed certain pleas. Appellee demurred to these pleas and the demurrer was sustained.

The income-tax law of February 24, 1919 (40 Stat. 1057), in part provided:

> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * * If the taxpayer's annual accounting period is other than a fiscal year, as defined in section 200, or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.
>
> If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226.

Since there was not sufficient time between the date of the passage of this act and March 15, 1919, the date on which a return was required, appellant filed on March 14, 1919, a tentative and cursory return, containing the averment that it was not possible to file a complete return within the time allowed for the following reasons: "No blanks available; and auditors can not complete work." A request therefore was made for an extension of time, which was granted.

In the tentative return the tax was estimated on the calendar year ending December 31, 1918. The real or complete return was filed on June 14, 1919, for the fiscal year ending June 30, 1918. Annually thereafter and down to and including the year 1922, as already noted, returns were made upon the fiscal-year basis.

It is alleged and admitted, by the demurrer, that the fiscal-year basis was first adopted by appellant upon advice of accountants, based upon their interpretation of the act of February 24, 1919. It was further alleged by appellant that the annual accounting period upon a calendar-year basis clearly reflected its income for that period, and that prior to 1919 it had filed its return on a calendar-year basis; that it never requested or received permission of the commissioner of internal revenue to change its annual accounting period from a calendar to a fiscal-year basis. It further appears that for many years appellant regularly has closed its books on the last days of March, June, September, and December; has computed its income accurately for each of the quarters indicated; has taken a physical inventory on the last day of each quarter; has ruled down its books on June 30 of each year, and has held its annual stockholders' meeting during the month of July.

No protest or application for leave to change to the calendar-year basis was filed by appellant until February, 1922. It is averred that the request then made was based upon a recent ruling of the committee on appeals in the internal revenue bureau in another case, in which a corporation had elected to file its return on a calendar-year basis. It appearing there that the books of the corporation were ruled down on August 31, although also closed on December 31, the income-tax unit had sought to require the corporation to file its return upon a fiscal-year basis. The ruling was that, under the facts, the corporation was justified in filing its returns on the basis of a calendar year and that "should not now be permitted or required to change the basis of filing its returns."

Appellant's application finally was denied and this suit filed.

The purpose of the income-tax law was the raising of revenue to meet pressing needs of the government. The provisions of this law, at least so far as they relate to the question here in issue, were reasonably free from ambiguity. Whatever may have been the view of the accountants employed by appellant as to the proper interpretation of those provisions, it was the duty of appellant, within a reasonable time, to invoke the discretion of the commissioner of internal revenue, if a change to a calendar-year basis was desired. Instead of doing this, however, appellant thereafter filed several returns upon a fiscal-year basis and paid its taxes accordingly. It will be apparent at once that if taxpayers were to be permitted, several years after voluntarily filing a return upon one basis, to compel the commissioner to accept returns for the same period upon a different basis, endless and needless confusion would result and the real purpose of the law measurably defeated.

As the supreme court has said, the writ of mandamus is awarded not as a matter of right but in the exercise of sound judicial discretion and upon equitable principles. It is not within general statutes of limitation, but is subject to the equitable doctrine of laches.—*United States, ex rel. Arant v. Lane* (249 U. S. 367).

Believing that appellant's delay in the present case was so long and unexcusable as to amount to laches, we affirm the judgment, without considering other questions involved.

Affirmed.

(T. D. 3544—January 18, 1924)

Estate tax—Revenue act of 1918—Decision of court.

1. GROSS ESTATE—TENANCIES BY THE ENTIRETIES.

A tenancy by the entireties is not created by a deed which conveys property in trust to pay the income from a part to the husband for life and from another part to the wife for life with remainders over to the survivor for life.

2. SAME—TRANSFERS INTENDED TO TAKE EFFECT AT DEATH.

A conveyance of property to a trustee reserving the income for life with joint power of revocation in the husband and wife is a trust intended to take effect at or after death within the meaning of section 402 (c) of the revenue act of 1918.

3. SAME—GIFTS INTENDED TO TAKE EFFECT AT DEATH—CONSIDERATION.

Where a husband conveys property to a trustee in trust to pay the income therefrom to him for his life, then to his wife for her life, and then to distribute the corpus, and the wife conveys other property of a less value to the same trustee in trust to pay the income therefrom to her for her life, then to her husband for his life, then to distribute the corpus, the transaction is not "a bona fide sale for a fair consideration" within the meaning of section 402 (c) of the revenue act of 1918.

4. CONSTITUTIONALITY.

Section 402 (c) of the revenue act of 1918 is not unconstitutional, although it includes transfers or trusts made either before or after the passage of the act.

The following decision of the United States district court for the district of Maryland in the case of *Safe Deposit & Trust Co., executor of Talbot J. Albert, deceased, v. Galen L. Tait,* collector of internal revenue for the district of Maryland, is published for the information of internal-revenue officers and others concerned.

DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.
Safe Deposit & Trust Co., executor of Talbot J. Albert, deceased, v. Galen L. Tait, collector of internal revenue for the district of Maryland.

MEMORANDUM OF DECISION.

SOPER, district judge: This case arises on the demurrer of the United States to the suit of the executor to recover back the sum of $3,095.26 paid by it under protest to the United States as a tax on the estate of Talbot J. Albert under the revenue act of 1918, which became effective February, 1919. Mr. Albert died March 18, 1919. The commissioner of internal revenue included in the net estate, upon which the tax was computed, property covered by a deed of trust executed in 1911 and by certain additions thereto in 1917 and 1918.

The first deed was executed by Albert and his wife, each of whom conveyed certain properties to the trust company; the value of the property conveyed by Albert was $166,944.28 and by Mrs. Albert $137,500. Three subsequent grants of property by Albert to the trustee upon the same trust brought the total of his contributions to $215,868.15. The deed provided that the income from the property transferred by Albert should be paid to him for life and that from the property transferred by Mrs. Albert to her for life; the income from all of the property, at the death of either, to be paid to the survivor for life, with certain remainders over. The trust was irrevocable except by joint consent, and the powers of sale and reinvestment of property, vested in the trustee, could only be exercised with the approval of both grantors, during their joint lives.

The assessment is claimed to be unlawful on three grounds:

First. It is claimed that section 402 (c) of the act, which in terms applies to transfers made before or after the passage of the act, is unconconstitutional, as retroactive. This question has been passed upon by the

circuit court of appeals for the sixth circuit in the case of *Schwab v. Doyle* (269 Fed. 321). This decision refers to the act of 1916, which the court interpreted to apply to transfers made before as well as after the passage of the law. The decision was reversed by the supreme court of the United States in *Schwab v. Doyle* (258 U. S. 529), on the sole ground that the circuit court of appeals had misinterpreted the act, and that the act was not intended to apply to transfers made prior to its passage. There was no intimation that the argument of the circuit court of appeals as to the unconstitutionality of the act, if retroactive, was unsound. The decision of the circuit court of appeals justifies the conclusion in this case that section 402 (c) of the act of 1918 is not unconstitutional because it includes transfers or trusts made either before or after the passage of the act.

Second. It is contended that the deed of trust created an equitable tenancy by the entirety in Mr. and Mrs. Albert. The decision of *Schwab v. Doyle* (258 U. S. 529) is conceded by the government to be decisive if such a tenancy was created. Since section 402 (d), subjecting such an interest to the tax, has no clear statement to the effect that it applies to tenancies created before the act, it must be held to apply only to those created after the act.

A tenancy by the entireties is created by a conveyance to husband and wife, whereupon each becomes seized and possessed of the entire estate, and after the death of one the survivor continues to take the whole. No special form of words need be used. On the other hand, such a tenancy is not created if the terms of the conveyance evidence a contrary intention. The deed in this case did not convey the whole estate to husband and wife. It conveyed the husband's property in trust, to pay him the income therefrom for life, and the wife's property similarly for her benefit. Each did not become seized of the whole estate. The deed gave them certain joint powers of revocation and supervision of investments, but no other joint interest. *Masterman v. Masterman* (129 Md. 167) is cited as authority for the proposition that a joint interest in income is not an incident of a tenancy by the entireties, but the case merely decided that because of the married women's act (Maryland Code, art. 45, secs. 1 and 21), the husband is no longer entitled as at common law to the whole income of such a tenancy. The conclusion is that the deed did not create a tenancy by the entireties.

Third. It is also claimed that the tax was improperly collected under section 402 (c) because, although this section applies to transfers in respect to which a trust is created, or which are made in contemplation of death, or intended to take effect in possession at or after death, there is the following exception: "Of a bona fide sale for a fair consideration in money or money's worth." It is urged that the conveyance by Albert to the trustee of his property upon the trusts therein named, and the similar conveyance of his wife of her property, were executed each in consideration of the other in such a way as to amount to a bona fide sale for a fair consideration. It may be said from one viewpoint that the conveyances were not absolutely without consideration, as is usually the case in transfers made in contemplation of death; but even in such case it can hardly be said that the circumstances constituted a bona fide sale for a fair consideration. There was no attempt on the part of either husband or wife to exact each from the other a fair price for their respective conveyances. The property conveyed by Mr. Albert in 1917 was considerably in excess of the value of that conveyed by Mrs. Albert. In 1917 and 1918 he conveyed additional property worth $48,923.87 without pretence of consideration. The transaction was not a sale. It was a family arrangement for the disposition of the property of husband and wife, for the benefit and protection of themselves and their children, and savored far more of a testamentary distribution than of a bargain and sale. The demurrer will be sustained.