Income-tax Department

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Income-tax Department

Edited by Stephen G. Rusk

From the voluminous mass of income-tax rulings and decisions that are published each month an attempt has been made to sort out those that seemed of greatest importance to the greatest number. The commenting upon all of them or the publication of all these rulings in their entirety has never been contemplated because of the obvious impossibility of so doing. Even those that have seemed to contain matter of outstanding importance have at times piled up because of lack of space for their publication and have, therefore, appeared at later dates than they otherwise would have been printed. The Journal of Accountancy goes to press about the fifteenth of the month and is mailed the first of the following month. These conditions render it necessary to review and publish decisions and rulings that seem old when they are read by the subscribers, and this fact has been commented on by some of our readers. There have been times when the comments and opinions expressed in these columns have been misleading to our readers, because subsequent to their expression a later ruling has been made diametrically opposed to the one upon which comment was made.

An example of this is furnished by comments and opinion appearing in the February issue of this periodical on treasury decision 3521, containing a court decision upon the subject of "return of income for period of less than 12 months—section 226 (c)—returns of income of decedent and of his estate for year in which he dies." The ruling contained in treasury decision 3521 was reversed by the United States circuit court of appeals, second circuit, on December 10, 1923; this later ruling was embodied in treasury decision 3547, issued by the treasury department February 7, 1924, and appears in the government's publication, Treasury Decisions, dated February 14th, a copy of which was received about February 20th, and is published herein.

Realizing that comments upon and publication of a treasury decision that has been reversed by the time this publication is delivered to its readers is likely to be misleading and is not good service, an endeavor will be made, henceforth, to correct this defect. Beginning, therefore, with this issue the columns appertaining to income tax will contain brief summaries of the latest decisions available, as well as the important decisions that are derived in the usual manner from the government publications.

An opinion was recently expressed that engagements coming to accountants for federal income-tax matters will decrease materially within the next three or four years and that the subject will become less important to accountants because of the decreasing engagements. There is probably some truth in this opinion, but when one remembers that at the present time there are some forty thousand of the more important tax returns for the year 1918 to be examined by the bureau of internal revenue, five years after these returns were made; that there is a greater number to be examined for each year since; that there seems to be no decrease in

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decisions upon the several revenue acts under which these returns were made, it would seem that accountants will find plenty to do for years to come in handling federal income-tax matters, and it will undoubtedly be found desirable to keep informed upon this subject.

SUMMARY OF RECENT RULINGS

DEPARTMENT CIRCULAR No. 230 prohibits former employees of the treasury department from appearing before it as counsel, attorney or agent for prosecuting any claim against the United States, or in any manner, or by any means to aid in such prosecution, within two years after they have ceased to be such employees.

TREASURY DECISION No. 3451 extends the time to June 15, 1924, for filing information returns as to dividends paid in 1923.

COURT DECISION in case of Cadwalader, et al., v. Edward L. Sturgess, collector, denies injunction against collection of tax after expiration of period of statute of limitations where assessment was made prior to close of such period.

COURT DECISION in case of United States v. Bresin and Schaefer, bankrupts, rules that one year limitation for filing claims against a bankrupt does not apply to a claim of the United States and that such claims against the individual partners can be satisfied out of partnership assets where individual's assets are insufficient but where partnership assets and salaries left in the business are sufficient.

COURT DECISION in case of New Creek Company v. Lederer, collector, rules that entire proceeds, including royalties to a lessor, derived from the mining of coal, constitutes gross income;

That a mining corporation which in consideration of certain royalties, grants the right to extract ore from its land is not entitled as an inherent right to any deduction from gross income for depletion, and the right to such deduction depends upon the statutory provisions of the taxing act.

The revenue act of 1916 as amended provides a reasonable allowance for depletion and delegates to the secretary of the treasury the power to prescribe the amount by appropriate regulations. The allowance for depletion provided by articles 171 and 172 of regulations No. 33 is reasonable.

The subjects comprehended in the foregoing summary of recent rulings will be treated at length when the treasury decisions are received.

In these days when the government is seriously considering making tax returns subject to inspection by certain congressional committees as well as duly constituted officers of the several state governments, it is interesting to learn through treasury decision 3546, that:

"The government has the right to require the employees or agents of a bank who know facts as to deposits or investments or any dealings of parties who owe income taxes, to testify to the entries made on the books of the bank relating to such transactions."

In the February issue of The Journal of Accountancy treasury decision No. 3521 was published. This decision embodied a court decision by Judge Goddard of the United States district court, southern district of New York, in which it was held by the court that

"when a taxpayer dies during his taxable year, the return of his income and the return of the income of his estate for the said year are returns for a period of less than 12 months within the meaning of section 226 (c) of the revenue act of 1921, and the respective incomes must be placed upon an annual basis, as required thereby."

This decision has been overruled by the United States court of appeals, second district, and the later decision is embodied in treasury decision 3547, published herein.

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The latter court rules that:

"the tax upon the income of a decedent to the date of death and the tax upon the income of an estate during the period of settlement should be computed under the general provisions relating to returns for a period of twelve months and not under section 226 (c), revenue act of 1921, which applies to returns for a period of less than one year."

Judge Goddard in reading section 226 concluded that paragraph (c) thereof applied to cases independent of those referred to in paragraphs (a) and (b), whereas Judge Manton held that section 226 was interdependent and that paragraph (c) thereof amplifies and explains the previous paragraphs of the said section, and does not apply to returns of income of a decedent and of his estate.

TREASURY RULINGS
(T. D. 3545—February 7, 1924)

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

1. Gross Estate—Trust to take effect at death.

Where the creator of a trust reserves the income for life, the value of property passing under the instrument is part of the gross estate of the creator within the wording of section 402 (c), revenue act of 1918.

2. Same—Consideration.

A release of dower incidental to the creation of a trust under the terms of which the wife is to get one-sixth of the corpus and undistributed income does not constitute a bona fide sale for a fair consideration in money or money's worth within the meaning of section 402 (c), revenue act of 1918.

The following decision of the United States district court for the eastern district of Missouri, in the case of Mercantile Trust Co., guardian of the estate of Tevis Reyburn and Florence K. Schill v. Arnold J. Hellmich, is published for the information of internal revenue officers and others concerned.

DISTRICT COURT OF THE UNITED STATES, EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI. No. 6451.


MEMORANDUM OPINION OF THE COURT.

Faris, judge: This case was submitted to the court a few days since on a demurrer to the petition. The petition itself does not fully set forth the trust agreement which forms the bone of contention. If the petition stood absolutely alone, without the briefs of counsel in the case, it is highly probable, as a strictly technical matter, that the demurrer ought to be overruled merely because the facts upon which the demurrer is bottomed do not appear in the petition. Both sides, however, in their briefs have referred to the terms of the trust agreement. Both sides, both in their arguments and their briefs, have seen fit to bottom the field of contention absolutely upon the terms of that trust agreement. I think, then, that I am warranted in considering the terms of that agreement, which were set out fully in the brief of the defendant, and which is referred to in the brief of the plaintiffs; in short, both sides consider the matter as turning upon the terms of the trust agreement, and seem to concede the power of this court regardless of the precise language of the petition itself, to determine the matter upon a full consideration of the question of ultimate liability.

On the 24th of June, 1912, one Amedee V. Reyburn, Jr., joined with his wife, Florence, and who now seems to be Florence K. Schill, in a certain trust agreement by which the settler of that trust, the said Reyburn, conveyed
to the plaintiff, Mercantile Trust Co., in trust, all of his property. Under the terms of that trust agreement, which took largely, if not wholly, the form of the instrument commonly called a "spendthrift trust," Reyburn was to be paid the sum of $750 per month out of the net income for the term of his natural life. If there were income over $750 per month such income could, in the discretion of the trustee, Mercantile Trust Co., be paid to the settler, or to any other person whom he might select. At the death of the settler Reyburn the trust created in the Mercantile Trust Co. ceased, or it was so provided in the trust agreement, and thereupon one-sixth of the corpus and undistributed income of the trust estate, it was provided, should go to and vest in Florence Kelley Reyburn, now, as stated, Florence Kelley Schill.

There was a proviso to this provision, however, to the effect—

That if, after the date of this instrument and during the life of said Amedee V. Reyburn, Jr., there shall not have been paid by the said trustee, to or for the use of said Florence Kelley Reyburn, annually, a sum equal to at least one-sixth of the annual net income distributed by the trustee each year, then and in that event, instead of only the foregoing one-sixth of the corpus and undistributed income, one-fourth of the corpus and undistributed income of said trust estate shall go to and vest in and be paid and delivered to Florence Kelley Reyburn, absolutely and in fee simple, if she be then living.

It was provided further that all the balance and residue of the estate, save and except that just referred to, should, upon the death of Amedee V. Reyburn, Jr., vest in the legal heirs of said settler, and that each stirpes should share equally.

The settler died about the year 1920 leaving, it seems, only one grand-daughter surviving him, who seems to be Tevis Reyburn, for whom the Mercantile Trust Co. is guardian, and for whom the Mercantile Trust Co. sues here.

I think there can be no question that, so far as regards the property held by the Mercantile Trust Co. for Tevis Reyburn, that the tax paid, a recovery of which is here sought, was correctly paid, and can not be recovered. But little contention seems to be made touching that proposition. Clearly, the property which came to Tevis Reyburn came to her only upon the death of the settler. If this be true, then there can be no question that the Mercantile Trust Co. was entitled to pay to the defendant here the inheritance tax sought here to be recovered back, so far as concerns such part of that payment as was due from Tevis Reyburn.

The statute in which the tax in this case was imposed and paid first provides for the levying of a certain percentage of tax in favor of the United States, upon the net estate of every deceased dying after the passage of the act. This provision is found in section 401 of the act of 1918 (40 Stat. 1057).

Section 402, subdivision (c), provides for the levy of this tax—

To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of, or intended to take effect in possession or enjoyment at or after his death, whether such transfer or trust is made or created before or after the passage of this act, except in case of a bona fide sale for a fair consideration in money or money's worth.

As stated, upon the facts presented in this controversy, there is absolutely no question that so much of this estate as has come to Tevis Reyburn, and which was taxed, was liable to this tax, for, clearly, the estate came to her only after the death of the settler. So much seems to be conceded, but the contention is made in behalf of Florence Kelley Schill that she ought to recover back the amount paid to defendant by her because there was a bona fide sale for a fair consideration, in money or money's worth,
to her. This proposition is bottomed upon the theory that when Florence Kelley Schill, as the wife of the settler, joined in the trust agreement she inevitably conveyed away from herself all dower rights in the property, and in effect she took, by the provisions of that trust agreement, upon the death of her husband, the settler, other property, namely, a one-sixth interest in the estate, which was less than the statutory one-third, and that therefore the conveyance of her dower was in fact a bona fide sale to the trustee in trust for a fair consideration, in money or money's worth, and that therefore she falls within the exception of the statute named.

I think, however, that a fair reading of the trust agreement shows conclusively that Florence Kelley Schill benefited by the trust agreement; that she was helped and not hurt by the making of it. In short, that she took more, perforce its terms, than she would have taken had she not made it and relied upon the provisions made for her by the Missouri statutes touching dower. That, however, will not necessarily settle the case. A further consideration comes in, and that is whether such a sale, such a conveyance of dower (which, it will be noted, happened only incidentally in this case), falls within the purview of that bona fide sale for a fair consideration in money mentioned in the exception contained in the statute. I am of the opinion that it does not. Florence Kelley Schill, while joining in the trust agreement with the settler, necessarily conveyed her dower interest, but such a conveyance, in my view, does not constitute a bona fide sale for a fair consideration in money. The language "fair consideration in money" has been construed by various courts of the United States. The definition of the term, in my opinion, does not include a situation similar to that here presented.

I think the demurrer ought to be sustained, and so it will be ordered.

(T. D. 3546—February 7, 1924)

General administrative provisions—Revenue act of 1921—Decision of court.

1. Examination of Books and Records.

The government has the right to require the employees or agents of a bank who know facts as to deposits or investments or any dealings of parties who owe income taxes to testify to the entries made on the books of the bank relating to such transactions.

2. Same—Constitutional Rights—Searches and Seizures.

The fourth amendment to the constitution, which prohibits unreasonable searches and seizures, does not authorize a third person who has books and papers which may be relevant to federal tax liability to refuse to produce such books or papers and testify as to the facts.

The following decision of the United States district court for the southern district of Alabama in the case of United States v. First National Bank of Mobile is published for the information of internal-revenue officers and others concerned.

United States District Court for the Southern District of Alabama.

United States v. First National Bank of Mobile.

Ervin, district judge: This is a petition filed under section 1310 of the revenue act of 1921, volume 48, part 1, of the public laws of 1921-23, page 312, asking the assistance of the court to require the First National Bank to furnish information as to the transactions had by William J. Hanlon and his wife, Annie E. Hanlon, with the bank involving deposits of money and investments by said Hanlon and his wife.

Section 1306 provides:

That the commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, ** to examine any books, papers, records, or memoranda bearing upon the matters required to
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be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons. (Italics mine.)

Section 1310 (a) provides:

That if any person is summoned under this act to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

Section 1300 provides:

And every person liable to any tax imposed by this act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the commissioner, with the approval of the secretary, may from time to time prescribe.

The petition sets out that the said Hanlon and his wife have not made full, true, and correct statements of their respective incomes of the years 1918, 1919, 1920, 1921, and 1922, and that the ledgers and other books of the bank containing the accounts of the said Hanlons will be of material assistance to the United States in arriving at the true and correct incomes of said individuals of the respective years. That summons to appear and testify and produce the books had been served on D. P. Bester, Jr., as president of the bank and that the said bank and its officers had failed to appear at the time and place designated in the summons and they now refuse to appear and permit the duly authorized agents of the internal revenue of the United States to have access in any manner to the records and accounts of said bank and prays for the assistance of the court to require the bank officers and employees to testify and the bank to produce its books and accounts.

Said bank refuses to testify and produce the books and contends that they are protected by the fourth amendment to the constitution from doing so. As I understand the fourth amendment, it protects the parties to criminal prosecution against unreasonable searches and seizures of their papers, and I do not understand this to authorize a third party who has books and papers which may be relevant to the inquiry, to refuse to produce such books and papers because of this amendment.

This is not a question of a search and seizure of a party's books and papers but of whether a witness who has information as to a party's dealings may be required to testify to those facts and produce book entries as to such entries in connection with and supporting such testimony.

The bank further contends that there is no specific showing of any deposits or investments by the Hanlons or to the materiality of the books and entries in the bank accounts against said Hanlon. It is true that such entries as may be found in the bank's books without more are inadmissible against Hanlon and wife as showing any income received by them, but the bank not only refuses to produce the books but refuses to have its president testify as to the facts.

Many cases have been read to me where evidence had been sought under subpoena duces tecum and objection has been made that no showing of the materiality and relevancy of this evidence had been made. In the present matter, however, it appears clear to me that if Hanlon and wife are shown by the testimony of the agents and employees of the bank to have deposited funds in the bank at various dates and to have made investments in securities that the entries in the books in connection with the testimony of the officers and agents of the bank as to transactions will be both material and relevant against Hanlon and his wife to show moneys or income which

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they had received. It is not necessary to say that many accounts in the
bank are accounts of parties who handle money for other parties and don't
show any individual receipt of income in such cases of fiduciary funds.
These transactions, of course, like those of use of funds coming in fiduciary
relation can be explained, but until explained they tend to show income
received. Nor is it any excuse for refusing to testify and give the facts
to say that moneys which pass through a man's bank account are not
always income received by him. This may be conceded, and yet it is
evidence from which income can be inferred and does tend to show income.
Like other transactions, however, it may be explained by Hanlon and wife.

It is monstrous, it seems to me, to say that because sometimes money
which is deposited in banks doesn't show income and because the bank
desires to protect the dealings of its customers from unauthorized inves-
tigation by third parties that the government could not inquire as to the
moneys of its citizens who owe income taxes and trace these moneys
through its various agencies, such as national banks, in order to ascertain
the correct income tax that is owing by the citizens.

For these reasons I am of the opinion that the government has the
right to require any of the employees or agents of a bank who know facts
as to deposits or investments or any dealings of parties who owe income
taxes to testify to the entries made on the books of the bank as to such
transactions so the government may be correctly informed as far as possible
of the income which has been received by its citizens.

An order will therefore be issued ordering the bank to furnish the
information desired.

(T. D. 3547—February 7, 1924)

Income tax—Revenue act of 1921—Decision of court.

In the case of Bankers Trust Co. et al., executors
of Glackner v. Bowers, collector, is published for the information of
internal-revenue officers and others concerned.

United States Circuit Court of Appeals, Second Circuit. No. 173.
October Term, 1923.

(Argued November 12, 1923. Decided December 10, 1923.)

Bankers Trust Co. and Frederick H. Pearce, as executors of the last will
and testament of John Glackner, deceased, complainants-appellants, v.
Frank K. Bowers, as collector of internal revenue for the second district
of New York, defendant-appellee.

Appeal from the District Court of the United States for the Southern
District of New York.

Before Rogers, Manton, and Mayer, Circuit Judges.

Writ of error to the United States district court for the southern district
of New York. Action by Bankers Trust Co. and Frederick H. Pearce,
as executors of the last will and testament of John Glackner, deceased,
complainants, v. Frank K. Bowers, as collector of internal revenue for
the second district of New York, defendant. Judgment for defendant.
Plaintiffs appeal. Reversed.

Joseph M. Hatfield, Esq., counsel for appellants.

Victor House, Esq., Assistant United States Attorney, counsel for
appellee.

William R. Conklin, Esq., as counsel for parties similarly situated.
MANTON, circuit judge: We shall refer to the parties as below, plaintiffs and defendant.

The plaintiffs have appealed from a judgment at law. Their remedy on appeal is by writ of error, and we shall treat their appeal as a writ of error pursuant to the act of September 6, 1916 (chap. 448, sec. 4, 39 Stat. 727), ignoring the mistake and regarding the action taken as appropriate so as to bring the cause here for review.

John Glackner died April 4, 1921, leaving a will which was duly admitted to probate and the plaintiffs qualified as his executors. On March 15, 1922, they filed two income-tax returns. One reported the net income of decedent during the calendar year of 1921 and the other the net income received by the plaintiffs as executors during the same calendar year. The first cause of action set forth in the complaint is for a tax paid upon the basis of the return filed for the decedent. It alleges that the correct tax liability of the decedent for the calendar year 1921 was $260.44 and that the defendant demanded and was paid on account of this tax $1,560.04; that $1,290.60 of said tax was paid under protest and duress and a claim for the refund thereof was subsequently rejected by the commissioner of internal revenue. The second cause of action sets forth a tax paid upon a basis of the return reporting the net income received by the executors in 1921. The correct tax is alleged as $2,050.27, whereas there was demanded and paid $2,635.85; of this amount $583.58 was paid under protest and a claim for refund was denied by the commissioner of internal revenue. The tax collected and paid was computed by the internal revenue commissioner under a construction of section 226 (c) of the revenue act of 1921. On motion made by the defendant that the complaint did not state a cause of action, the complaint was dismissed, the court delivering an opinion which supported the claim of the government as to the amount of the taxes. The question raised on this review is whether the taxes in question should have been determined in the manner described in section 226 (c) of the revenue act of 1921 or by other provisions of the act referred to herein. Section 226 reads as follows:

(a) That if a taxpayer, with the approval of the commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(b) In all cases where a separate return is made for a part of a taxable year the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included.

(c) In the case of a return for a period of less than 1 year the net income shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months included in such period; and the tax shall be such part of a tax computed on such annual basis as the number of months in such period is of 12 months.

Subdivision (c) of section 226 applied only to computing tax in case of a return for a period of less than 1 year, and the district court has held that returns necessary to be filed by the plaintiffs were returns for a period of less than a year and that the tax liability was properly determined applying the statutory formula of (1) multiplying the net income by 12;
(2) dividing the product so obtained by the number of months and fraction thereof in the period covered by the return; (3) computing the normal and surtax on the quotient; and (4) dividing the total tax so computed by 12 and multiplying the quotient by the number of months and fraction thereof in the period covered by the return.

The statute and regulations of the department, apart from section 226 (c), contain a complete scheme for the filing of income-tax returns of decedents and their estates. We must accept the fact that income-tax statutes are designed and intended to reach actual income received by the taxpayer. Section 213 (a) defining gross income points this out in providing:

Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

Section 212 defines net income as meaning the gross income as defined in section 213 less the deductions allowed by section 214 and subdivision (b) thereof provides that 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. Actual income was to be taxed—not constructive or hypothetical. The plaintiffs argue that the return was not a return for a period of less than one year within section 226 (a) and that the tax should be computed by the ordinary method prescribed for the computation of income tax. The plaintiffs base this writ of error upon the nonapplicability of section 226 and urge that if it applies it is unconstitutional for the reason that in operation it would tax as income that does not constitute income within the sixteenth amendment of the constitution and therefore violates the provisions of article 1, section 2, clause 3, and article 1, section 9, clause 4, of the constitution; also if so construed, it would violate the fifth amendment of the constitution. In the view we take, it will be unnecessary to consider the constitutional questions presented. This, for the reason that section 2, subdivision (c) provides solely for the placing of income on an annual basis and for computation of the tax thereon in the case of a return for a period of less than one year where the change is made voluntarily by the taxpayer or pursuant to an order of the commissioner. The fundamental scheme of title 2 of the revenue act is for a tax upon the net income of the taxpayer during an accounting period of 12 successive months. This general accounting period seems to be a predetermined measure to be applied to a taxpayer as income and is not affected by his death or change of status within the period. The tax is imposed upon the entire net income for such period and the return of such income constitutes his return for the period of 12 full months, even though he may have lived only a portion thereof. The exception to this is where a voluntary change is made in the accounting period by the
taxpayer or where it becomes involuntary in so far as the taxpayer is concerned by the commissioner's declaring the taxable period terminated under section 250 (g). Sections 210 and 211 impose a normal tax and surtax for each taxable year upon net income of the individual. A taxable year, a term applied to the general accounting period, is by section 200 defined as follows:

(1) The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1921, shall be the calendar year 1921 or any fiscal year ending during the calendar year 1921.

The basis for computing the net income of individuals is found in section 212 and provides:

(b) 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; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the commissioner does clearly reflect the income. 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.

(c) 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.

Thus it will be observed that except where a voluntary change is made, the accounting period is 12 months which becomes the taxable year. And, so that the commissioner of internal revenue may have the necessary information for determining the tax liability upon this basis, returns are to be filed under section 223 (1) by individuals having a net income for the taxable year equal to or in excess of specific sums; (2) by partnerships for each taxable year; and (3) by fiduciaries for individuals, estates, or trusts having income equal to or in excess of specified sums for the taxable year. The time of filing is given by section 227 as:

(a) That returns (except in the case of nonresident aliens) shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the 15th day of March. In the case of a nonresident alien, individual returns shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the 15th day of June.

No time other than the close of the calendar or fiscal year is fixed. By section 225 "any fiduciary required to make a return under this act shall be subject to all the provisions of the act which apply to individuals." Section 219 entitled "Estates and Trusts," does not require filing returns for less than one year and subdivision (a) thereof provides that taxes imposed by section 210 and section 211 apply to income of estates and trusts. It reads:

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;
(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;
(3) Income held for future distribution under the terms of the will or trust; and
(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

By subdivision (b) "The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212."

The executors here have made a return of income received and paid taxes for the estate "during the period of administration or settlement" and by subdivision (c), "the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216."

We therefore observe that section 219 (b) expressly required that the net income shall be computed in the same manner and on the same basis as provided in section 212 and that section 212 provides for an accounting of twelve full months. The only exception being in the case alone where "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."

The plaintiffs allege their accounts as executors were kept on the calendar-year basis, and upon this basis they are taxable pursuant to section 219. We find nothing in the act making returns filed for decedents or estates exceptions to the general rule. The plaintiffs in their returns for the decedent and his estate did not elect to change the accounting period nor is there any attempt to defeat the collection of the tax which might invoke either of the sections above referred to. Therefore, not falling within either of the exceptions above, they would be improperly considered if returned for less than a year. The time of receipt of income or the ability to receive income has no bearing upon the accounting period. A taxpayer may receive his income for the year on the first day of the year. He may become a nonresident alien during the year without property in or income from any source in the United States. As an alien, he may have come to this country during the first taxable year and he may have attained his majority or become incompetent during the year. When during the year his status changes and he becomes a taxpayer, or ceases to be one, is immaterial. If he received taxable income during any part of that year and kept his books on a calendar-year basis, a return is required of all such income derived from or received within the twelve months of such calendar year and the return is for a period of twelve months. Here the plaintiffs reported all the taxable income received by the decedent during the calendar year 1921. And in their return, they reported all the taxable income received by the estate of the decedent during the same calendar year 1921. The estate and deceased were separate entities, each having a separate accounting. Because their books were kept for the calendar year 1921, it required them to return for that year. It was possible for the estate to have kept its books on a fiscal-year basis. A different period might then have been called for. The return filed for the decedent was one of the returns required to be filed by the fiduciaries and for "an individual" having a net income for the taxable year of "$1,000 or over" under section 225, and the estate return was required for "every estate or trust the net income of which for the taxable year is $1,000 or over" under the same section.
The decedent and his estate have long been regarded as separate taxable entities. In Mandell v. Pierce (16 Fed. Cas. 516, case No. 99008), arising under the act of June 30, 1864 (13 Stat. L. ch. 173), an executor sought to recover a tax collected on the income received by the decedent from January 1, 1865, to July 2, 1865, the date of his death. The plaintiff argued that the income tax was imposed on an annual income and the act required no return to be filed by an executor where the deceased died before the time appointed for the filing of the return. In sustaining the tax, the court said it was imposed upon the income received within the income-year and that the income received by the decedent within the income-year constituted "annual gains, profits, and income" within the meaning of the act, holding that "gains, profits, and income received within the income-year are "amounts, profits, and income within the meaning of those laws, although the whole amount of the same in a given case may be received within the first month or the last month of the year." And further "When ascertained as required by law, the intention of congress was that gains, profits and income received within the income year, from the sources therein defined, should be subject to the prescribed taxation, whether such gains, profits, or income were derived from any kind of property, rents, interest, dividends, salaries, or from any trade, profession, employment, vocation, owned, collected, pursued, or followed for the whole or any part of the income-year."

Subdivision (f) of section 216 provides:

The credits allowed by subdivisions (c), (d) and (e) of this section shall be determined by the status of the taxpayer on the last day of the period for which the return of income is made; but in the case of an individual who dies during the taxable year, such credits shall be determined by his status at the time of his death, and in such case full credits shall be allowed to the surviving spouse, if any, according to his or her status at the close of the period for which such survivor makes return of income.

This section indicates it was not the intention of congress that the date of death be the last day of the period for which the decedent's return is filed. If congress wanted to include within section 226 (c) decedent's and other estates, it might have done so in appropriate language.

Reading section 226 as a whole, it is clear that the purpose was to present a single unified plan for computing tax liability of a taxpayer who voluntarily changed his accounting period. Subdivision (a) provides for making of separate returns covering a period of less than 12 months in case of a taxpayer who, with the consent of the commissioner, changes his accounting period, and this is the only provision providing for a change of accounting period except section 250 (g). Subdivision (b) merely provides that in all cases where separate returns are made for part of the taxable year, the return shall include the taxpayer's income during the period covered by the separate return and that the tax rate of the calendar year in which the period falls is applicable. The use of the phrase "all cases" undoubtedly applies to cases where separate returns are required under subdivision (a). Having provided the periods to be covered by returns in the case of a change in voluntary periods and in income to be accounted for in returns and the tax rate applicable thereto, subdivision (c) provides for the computation of the tax on an annual basis. The returns required under subdivision (a) are returns for a period of less than one year, and it is clear from the context that subdivision (c) was intended to apply to such returns alone. There was nothing in subdivision (c) which would indicate a purpose to create a new and extensive class of returns such as those in the instant case, for a period of less than one year. We regard subdivision (b) and (c) as interrelated. Subdivision (b) assumes that the period covered by the return will fall within a single calendar year, for it provides that tax shall be paid at the rate for the calendar year in which such period is included.
In case of a voluntary change of the accounting period, the period of less than one year will necessarily fall within a single calendar year in the case of a taxpayer who renders returns on a fiscal-year basis. However, the period from the beginning of the fiscal year to the date of his death may very well fall within two calendar years. So it is with executors who may keep their books on a fiscal-year basis, in which case the period from the date of the decedent's death to the end of the fiscal year may fall within two calendar years. If Congress had considered returns for decedents and for their estates to constitute "a separate return * * * for a part of a taxable year," subdivision (b) would have made provision for the application of the rates of taxes for the calendar year in which the periods covered by the returns were included. The revenue act nowhere contains a provision or computation of a tax in the case of a return for a period commencing in one calendar year and terminating the following calendar year other than at the close of a fiscal year. It is only in section 205 in which provision is made for a tax where a tax shall be computed in case of fiscal years beginning in 1920 and ending in 1921 or beginning in 1921 and ending in 1922, but there fiscal years only are covered. Therefore, subdivision (c), which provides for the method of computing the tax applying the rates provided in subdivision (b), could not apply to returns for decedents or their estates. Again, subdivision (c) in providing for the placing of a net income on an annual basis refers solely to the number of months included in such period. This language is entirely inappropriate where death occurs on any date during the month and no provision is made for computation which would include a period covering a fraction of a month. The language used is entirely appropriate in cases of returns filed under subdivision (a) for a month, for such returns would not include a fraction of a month.

In interpreting a statute, the construction placed thereon should avoid unjust consequences unless the language compels such a result and a construction should be had with reference both to the history of the legislation and to other sections of the law with which it is in pari materia—Gutschalk v. Peck (261 Fed. 212). The congressional reports and the legislative history of section 226 are of interest. Under the act of 1918, section 226, a taxpayer, with the approval of the commissioner, was permitted to change his accounting period, which adjustment necessitated a return for a period for less than one year. The filing of a return for a shorter period resulted in a subsequent saving in surtaxes and made a change in the accounting periods of decided advantage to the taxpayer. This result was unfair to the taxpayers who did not change their accounting periods or who could not show a basis therefor, as well as unfair to the government. It was remedied by the present act (sec. 226-c) as finally enacted. The purpose of the proposed amendment was stated in the report of the committee on ways and means accompanying H. R. 8245:

Section 232: Under existing law the taxpayer may improperly reduce his surtax by changing his fiscal year, thus splitting his annual income into two parts. This section proposes to prevent such evasion by providing that in the case of a return for a period of less than one year the net income shall be placed on an annual basis and the surtax properly computed thereon in accordance with the number of months in such period.

In the original house bill the subdivisions of section 226 were not separately numbered or lettered, and the insertion by the senate of the distinguishing letters (a), (b), and (c) was described in the statement attached to the conference report as "a clerical change." It is apparent that this was done solely for convenience and not with the intention of separating subdivision (c) from its context. In the house bill section 226 (d) began with the words "in all of the above cases." This was changed by the senate amendment No. 346 to read "in all cases where a separate return is made for a part of a taxable year." This amendment

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was adopted in conference and states: "Amendment No. 346: This amendment is a clerical change; and the house recedes."

In the 1918 act, the title of section 226 was "Returns when accounting period changed." This bill was changed in the original house amendment and in the title as reported by the senate finance committee by amendment proposed on the floor of the senate and adopted without debate, the title of the section was changed to "Return for a period of less than twelve months" (61 Congressional Record, 7917-18). The amended title was printed in the draft of the bill accompanying the conference report. The conference report refers to the senate amendment No. 345 (reënacting section 226 (a) with the amended title) as follows:

This amendment is a clerical change made necessary by the repeal and reënactment of the revenue act of 1918 instead of its amendment in specified particulars, as explained in connection with amendment No. 3; and the house recedes.

There is nothing of the legislative history of section 226 which indicates a contrary interpretation than that which we have given it, and the conference report argues forcibly that congress had in mind returns expressly referred to in subdivision (a) when it enacted subdivision (c) thereof. The interpretation of statutes levying taxes must not extend beyond their provisions by implication, nor must they be interpreted beyond the clear import of the language used. In case of doubt, they are interpreted strongly against the government and in favor of the taxpayer.

—United States v. Wiggleworth (2 Story, 369); American Net & Twine Co. v. Worthington (141 U. S. 468); Bensiger v. United States (192 U. S. 38); Gould v. Gould (245 U. S. 151); Smietanka v. First Trust & Savings Bank (257 U. S. 602). The taxpayer may change his accounting period under section 226 as he will and may stand the disadvantage of the tax. Inequity would flow in following the formula proposed for taxation under section 226 (a), if applied to a decedent and his estate, particularly if the practice was indulged in of using the month and a fraction of a month in calculating the income. Where a construction of a statute will occasion great inconvenience or produce inequality or injustice, that view is to be vetoed if another and more reasonable interpretation is present in the statute.—Knowlton v. Moore (178 U. S. 41); Bate Refrigerating Co. v. Sulzberger (157 U. S. 37).

We think the complaint sufficiently alleges a cause of action for the recovery of the tax in question and that it was error to grant the motion for judgment.

Judgment reversed.

Edwin J. Bishop

Edwin J. Bishop, member of the American Institute of Accountants, certified public accountant of Minnesota and member of the firm of Bishop, Brissman & Co., died at St. Luke's Hospital, St. Paul, Minnesota, February 14, 1924. Mr. Bishop had been in the accounting field for many years and was a sincere believer in the highest ideals of his profession. He was highly esteemed by those with whom he came in contact and had done much for the advancement of the profession in the Northwest.

W. T. Woodbridge

W. T. Woodbridge, member American Institute of Accountants, member of the firm of W. T. Woodbridge & Co., died at the Presbyterian Hospital, Santurces, P. R., February 7, 1924.