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Income-tax Department

Edited by Stephen G. Rusk

Treasury decision 3029, set forth below, must relate to taxation under the revenue act of October 3, 1913, only.

The law which permits the government to tax income from isolated transactions of a taxpayer entered into for profit but does not permit deductions for losses sustained in such transactions has caused much adverse criticism.

Judge Grubb makes the observation in rendering his decision in the case of *Eugene W. Mente vs. Mark Eisner, Collector of Internal Revenue,* that "tax laws are not required to be perfect or even consistent." That the revenue act of 1913 was not perfect nor consistent in its provisions is a fact that has generally been accepted, but because of the comparatively low rates of taxation in effect at that time no great amount of protest was made against its unjust provisions.

When it is remembered that one particular imperfection in the law of 1913 was recognized at once by all whose taxes were affected by the defective language, and when it is remembered also that the revenue acts of 1916-17 and of 1918 rectified this imperfection, by allowing taxpayers to deduct losses sustained in "transactions entered into for profit but not connected with the business or trade," it is difficult for the laity to understand why a court decision made as lately as May 3, 1920, should adhere so closely to a treasury decision of October 14, 1914.

It is obvious that those responsible for the 1914 treasury decision confined themselves strictly within the most limited interpretation of the language of the act under consideration without regard for its imperfections. That the department was inspired by the highest motives is acknowledged without argument, but it would seem that administrative discretion should have been considerably extended, to the end that grave injustice might not be wrought by an interpretation so narrow.

We have no intimate knowledge of the facts in the *Mente vs. Eisner* case, and our observations are not made with specific reference to it. We are thinking only of the principle involved.

That this decision of Judge Grubb relates only to the revenue act of 1913 is shown by the following excerpts from the regulations (No. 33) appertaining to the 1916-17 revenue act and section 214, paragraph 5, of the revenue act of 1918.

Article 8, fifth paragraph of regulations No. 33, of the 1916-17 law, setting forth that which is properly deductible from gross income, reads as follows:

"Losses actually sustained during the year in transactions entered into

for profit but not connected with his business or trade to the extent of but not exceeding the profits arising from such transactions."

Section 214 (a), paragraph 6, of the revenue act of 1918, under the heading "deductions allowed," reads as follows:

"Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in case of a non-resident alien individual only as to such transactions within the United States."

From the above it is evident that Judge Grubb's decision has no effect upon tax returns made for any taxable year beginning with or since January 1, 1916, and it is also evident that, in the passage of the later law, congress recognized the inconsistency in the former law.

Treasury decision 3029 follows:

(T. D. 3029)

Income tax

Section 214 (a), 4, 5, 6, Article 141: Losses

Income Tax: Act of October 3, 1913, Section II—Deductions

1. A member of a firm engaged in the business of manufacturing is not entitled to deduct from his gross income a loss sustained by him upon the sale of shares of stock.

2. The language "losses incurred in trade" must be construed as meaning losses incurred in the actual business of the taxpayer as distinguished from isolated transactions.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND DISTRICT

Eugene W. Mente, Plaintiff in Error, vs. Mark Eisner, Collector of Internal Revenue, Defendant in Error.

[May 3, 1920]

Ward, circuit judge: Section II, subdivision 2 (b), of the act of October 3, 1913, provides that in computing net income for purposes of normal tax there shall be allowed as a deduction:

* * * Fourth: losses actually sustained during the year incurred in trade, or arising from fires, storms or shipwreck and not compensated for by insurance or otherwise.

Mente, a member of the firm of Mente & Co., engaged in the business of manufacturing jute bags and bagging, cotton bags, and materials for covering cotton bales, filed his income returns for the year March 1 to December 31, 1913, and for the whole year of 1914. He had for some three years been buying and selling cotton on the cotton exchange for his individual account, in no way connected with the business of Mente & Co., and he deducted from his gross income in each year losses sustained in the year resulting from these transactions as "losses incurred in trade."

Eisner, as collector of internal revenue for the third district of the state of New York, assessed an additional tax upon these deductions, which Mente paid under protest, taking an appeal to the commissioner of internal revenue under sections 3220 and 3228, *United States Revised Statutes,* and the regulations of the secretary of the treasury in pursuance thereof, who rejected his claim. Thereupon Mente began this action against Eisner as collector to recover the amounts so paid, with interest and costs.

Treasury decision 2090, dated October 14, 1914, reads:

Loss, to be deductible, must be an absolute loss, not a speculative or fluctuating valuation of continuing investment, but must be an actual loss, actually sustained and ascertained, during the tax year for which the deduction is sought to be made; it must be incurred in trade and be determined and ascertained upon an actual, a completed, a closed transaction. The term "in trade," as used in the law, is held to mean the trade or trades in which the person making the return is engaged; that is, in which he has invested money otherwise than for the purpose of being employed in isolated transactions, and to which he devotes at least a part of his time and attention. A person may engage in more than one trade and may deduct losses incurred in all of them; provided that in each trade the above requirements are met. As to losses on stocks, grain, cotton, etc., if these are incurred by a person engaged in trade to which the buying and selling of stocks, etc., are incident as a part of the business, as by a member of a stock, grain or cotton exchange, such losses may be deducted. A person can be engaged in more than one business, but it must be clearly shown in such cases that he is actually a dealer, or trader, or manufacturer, or whatever the occupation may be, and is actually engaged in one or more lines of recognized business, before losses can be claimed with respect to either or more than one line of business, and his status as such dealer must be clearly established.

Both parties having moved for the direction of a verdict, Judge Grubb directed a verdict in favor of the defendant.

We think that the language "losses incurred in trade" are correctly construed by the treasury department as meaning in the actual business of the taxpayer as distinguished from isolated transactions. If it had been intended to permit all losses to be deducted it would have been easy to say so. Some effect must be given to the words "in trade."

There is an inconsistency in making profits derived from such transactions a part of the taxpayer's gross income and on the other hand allowing him no deduction for losses. But tax laws are not required to be perfect or even consistent. It must be determined from the facts in each case whether or not the losses claimed to be deducted have been incurred in a business.

In this case the court must be taken to have found as matter of fact that these transactions in 1913 and 1914 did not constitute a business. Such a finding is binding upon us.

Judgment affirmed.

Treasury decisions 3030 and 3031 amend and amplify the regulations concerning withholding taxes at the source, and comment upon them perhaps is superfluous.

Section 256, article 1078 (a): Foreign items presented for collection unaccompanied by ownership certificates. T. D. 3030

The final edition of regulations 45 is amended by inserting immediately after article 1078 an article which will be known as article 1078 (a), as follows:

ART. 1078 (a). *Foreign items presented for collection unaccompanied by ownership certificates.*—If the foreign item is an interest coupon detached from bonds containing a tax-free covenant clause, issued by a foreign country or corporation having a paying agent in the United States, an affidavit and ownership certificate, form 1000, revised, shall be furnished as provided in article 368.

In the case of other foreign items which are received unaccompanied by an ownership certificate and the owner is unknown, an affidavit shall be required of the payee, showing the name and address of the payee, the name

and address of the debtor organization, the date of the dividend cheque or the maturity of the interest coupon, the name and address of the person from whom the dividend cheque or interest coupon was received, and a statement that the owner of the securities is unknown to the payee. The first bank receiving such foreign item shall prepare a certificate of ownership, form 1001A, revised, crossing out the word "owner" and substituting therefor the word "payee." The first bank shall stamp or write across the face of the certificate "affidavit furnished," adding the name of the bank. Thereupon the affidavit and certificate shall be forwarded to the commissioner as provided in article 1079.

Section 256, article 1078: Ownership certificates for foreign items. T. D. 3031

The final edition of regulations 45 is amended by amplifying article 1078 so as to read as follows:

ART. 1078. *Ownership certificates for foreign items.*—(*a*) When bonds of foreign countries, or bonds or stocks of non-resident foreign corporations, are owned by citizens or residents of the United States, individual or fiduciary, by domestic or resident foreign corporations, or partnerships, or by personal-service corporations, ownership certificate, form 1001A, revised, shall be executed by the actual owner or by his duly authorized agent when presenting the item for collection, whether such item is a dividend or an interest payment, except in the case of a foreign country or a foreign corporation having a fiscal agent or a paying agent in this country and issuing bonds which contain a tax-free covenant clause. In such a case the fiscal agent or paying agent is required to withhold the normal tax of 2 per cent from the interest on such bonds and ownership certificate, form 1000, revised, modified to show the name and address of the fiscal agent or the paying agent, should be used, unless the owner (if so entitled) desires to claim exemption, in which case form 1001A, revised, should be filed. (*b*) When such foreign bonds or stocks are owned by non-resident alien individuals, corporations or partnerships, ownership certificate, form 1001A, revised, shall be used on behalf of such owners by any responsible bank or banker, either foreign or domestic, having knowledge of such ownership. In such a case the bank or banker need not fill in the names of the owners.

Treasury decision 3032, simply makes more definite the latest date possible for notification to the collector for transmission to commissioner of the change of a taxpayer's accounting period. The amendment to article 26 of regulations 45, consists of a change in the language of "(b)" of that article.

It formerly read as follows:

> "At least thirty days before the due date of his return on the basis of the proposed taxable year."

It is amended to read as follows:

> "At least thirty days before the due date of his separate return for the period between the close of the existing taxable year and the date designated as the close of the proposed taxable year. The due date of the separate return for such period is the fifteenth day of the third month following the close of that period."

The full text of the decision follows:

Section 212, article 26: Change in accounting period. T. D. 3032

ART. 26 of regulations 45 is hereby amended to read as follows:

ART. 26. *Change in accounting period.*—If a taxpayer changes his ac-

counting period, and not merely his taxable year to conform with his existing accounting period, he shall as soon as possible give to the collector for transmission to the commissioner written notice of such change and of his reasons therefor. The commissioner will not approve a change of the basis of computing net income unless such notice is given at a time which is both (*a*) at least thirty days before the due date of the taxpayer's return on the basis of his existing taxable year, and (*b*) at least thirty days before the due date of his separate return for the period between the close of the existing taxable year and the date designated as the close of the proposed taxable year. The due date of the separate return for such period is the fifteenth day of the third month following the close of that period. If the change in the basis of computing the net income of the taxpayer is approved by the commissioner, the taxpayer shall thereafter make his returns upon the basis of the new accounting period in accordance with the requirements of section 226 of the statute, and his net income shall be computed as therein provided. See article 431.

Treasury decision 3037 promulgates a decision of the supreme court of the United States that the salaries of the president and federal judges are not subject to income tax, on the ground that the laying of such tax upon these salaries is not in accordance with the constitution.

The decision is only interesting to accountants as a matter of information, and as the full text of the decision is too voluminous for publication in THE JOURNAL OF ACCOUNTANCY a brief summary only is presented:

(T. D. 3037)

Income tax—Decision of Supreme Court

1. Taxability of Salaries of President and Federal Judges.

   Stated in its broadest aspect, the contention involves the power to tax the compensation of federal judges in general, and also the salary of the president.

2. Constitution Prohibits Diminution of Compensation.

   The constitution provides that the judge shall have a sure and continuing right to the compensation, whereon he confidently may rely for his support during his continuance in office, so that he need have no apprehension lest his situation in this regard may be changed to his disadvantage.

3. Purpose of the Prohibition.

   The primary purpose of the prohibition against diminution was not to benefit the judges, but to attract good and competent men to the bench and to promote independence of action and judgment.

4. Prohibition Includes Taxation.

   The prohibition is general, and the reasons for its adoption make with impelling force for the conclusion that the fathers of the constitution intended to prohibit diminution by taxation as well as otherwise.

5. Other Income Not Exempt.

   Apart from his salary, a federal judge is as much within the taxing power as other men are. And, speaking generally, his duties and obligations as a citizen are not different from those of his neighbors. But his compensation as a judge is protected from diminution in any form, whether by a tax or otherwise, and is assured to him in its entirety for his support.

6. Judgment Reversed.

   The judgment of the district court (262 Fed., 550) reversed.