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TAX NEWS

TENNIE C. LEONARD, C.P.A., Memphis, Tennessee

THE BUSINESS OF RAISING TAX DEDUCTIONS

Every tax practioner has at least a few clients with substantial taxable incomes who have hit upon the idea of farming with the purpose of deducting from their large incomes such expenses as are incurred during the development of the farm. Tax services have sometimes pointed out the tax saving possible, since a gain from the sale of the improved farm will be taxed at capital gain rates.

Indeed, we hear that the Bureau of Internal Revenue in Washington is concerned with the number of Bureau employees (presumably in the mink coat bracket) who are conducting farming operations in nearby Virginia and Maryland and using Form 1040F to report losses.

The law and regulations as to farming for profit have never been stated better than by Judge Learned Hand when, as a district Judge, he rendered an opinion in Archibald G. Thacher et al. Executors of the Last Will and Testament of Julien T. Davies, Deceased, v. Collector of Internal Revenue, 288 F. 994, November 22, 1922. Judge Hand said—

> "I have no doubt that a lawyer can operate a farm for profit. However unlikely it may be that he will succeed in the enterprise, the enterprise may, in fact, be intended as a business. But it is equally clear that a lawyer may run a farm merely as an adjunct to his country place, and between the two the test appears to me to be only of his actual intention. Moreover in ascertaining that intention I can see no escape from making the crux of the determination his receipts and expenditures.*****
>
> "It does seem to me that if a man does not expect to make any gain or profit out of the management of the farm, it cannot be said to be a business for profit, and while I should be the last to say that the making of a profit was not of itself a pleasure, I hope I should also be one of those who agree there were other pleasures than making a profit. ******it does make a difference whether the occupation which gives him pleasure can honestly be said to be carried on for profit. Unless you can find that element, it is not within the statute."

The decision quoted was cited by the Tax Court in its memorandum opinion of 10-31-51 in Adley Hemphill, TC Memo, denying farm losses of $1,340.33 and $1,630.92 in years when gross receipts were only $238.42 and $117.88. The Court noted that the taxpayer, although a practicing CPA, made no effort to maintain careful accounting records. The Court overlooked the fact that in failing to keep records Mr. Hemphill was acting exactly like a farmer.

NEW COMPETITION FOR THE TAX PRACTITIONER

Publications of the legal profession and of our own accounting profession have devoted acres of space to discussions as to what part of tax practice belongs exclusively to one profession or the other, and what part may be shared. Little if any thought has been given to the practice of taxes by eleemosynary organizations.

Credit must be given to one attorney, George C. Johnson, TC Memo, 1-17-52, for original, if not "effective" thinking. He organized a foundation, "The Reasoning Mind Foundation", dedicated to the announced purpose of "giving social security to reasoning minds against fear, want, and loneliness in old age." Later he organized "The Effective Thinking Foundation" which was a working organization of the first foundation.

A contribution to one of Mr. Johnson's foundations entitled the donor to the preparation of income tax returns free of charge. Since he used a mailing list compiled from the official public voting records of Los Angeles to advertise the benefits of memberships, the Foundation received $3,313.86 in "contributions" in 1946 and in 1947 $4,025.05 was received. In 1946 the founder thought "effectively" enough to file an individual tax return for himself and report as income a small fee received as trustee of the Foundation, claiming medical expenses of $325.50 paid for him by the institution. The medical expense appears to be more than reasonable in the light of his book, published in 1949, entitled, *How I Freed Myself From: Diabetes, Arthritis, Neuritis, Rheumatism, Cataract of Eyes, Obesity, Blood Pressure, Doctor Bills, Drugs, OLD AGE and DEATH — at 68: with a BLOOD CIRCULATOR.*

In 1947 Mr. Johnson's "reasoning mind" decided that he should not file an income tax return for himself but the Tax Court decided otherwise on the grounds that it was immaterial that the price paid for income tax return preparation was called a "contribution"; in reality it was compensation for services rendered, and compensation for services rendered constitutes income to the person performing the services. The Court also decided that since the petitioner was an attorney who prepared tax returns for others and who failed to file a tax return for himself, the failure must have been due to willful neglect, and assessed a 25% penalty.

The learned Tax Court can well be excused for becoming confused with such a display of Effective Thinking, but in finding that the medical expenses paid for him by Mr. Johnson's Foundation in 1946 constituted income but disallowing his deduction for such expenses, it failed to follow its decision in Andrew Jergens, 17 TC No. 94, where the Court held that a deduction could be taken for expenses paid by the taxpayer's employer and charged to his account.

A New Way to Earn Income

Much has been written on the discharge of indebtedness as constituting taxable income, but little did *Denman Tire & Rubber Company, CCA*-6, 11-13-51, realize when they compromised an excise tax liability in 1941 that the excess of the liability over the amount paid would be considered taxable income.

Both the Tax Court and the Circuit Court held that the indebtedness eliminated through the compromise was taxable income. They found that

> "The Government, neither expressly or impliedly, manifested any intention of making a gift to the petitioner, but was seeking the best settlement it could get from a corporation in an unsound financial condition, although not insolvent."

Can we be sure that some of the weird tax settlements we read of in the papers lately will result in taxable income to the taxpayers?

Man Bites Dog

Sometimes in the past this column has called attention to inconsistencies on the part of the Commissioner and his inquisitors, so it is only fair to point out that taxpayers too sometimes change their positions when it is to their advantage. There have been hundreds, or perhaps thousands, of cases where husbands have given wives and daughters a part of a business and have declared the arrangement to be a partnership entered into in good faith. Here is a different kind. The taxpayer gave his wife and daughter a ranch; the two women filed partnership returns, and now he claims no real partnership ever existed. The difference is, the ranch produced only losses, and not the anticipated profits.

A. P. Phillips, a Texan, purchased 300 acres of land in 1941 and after stocking it with Hereford cattle, gave it to his wife and daughter who thereafter filed partnership returns, showing a profit in one year and losses in all the others. The husband and wife filed separate returns and under the community property laws of Texas they divided the wife's profit or losses from the ranch. A most unusual revenue agent examined the partnership returns and changed the one profit to a loss, and where losses had previously been reported, the agent found greater losses. Thereupon Mr. Phillips took the position that no proper partnership had ever existed and filed claim for the benefit of all the losses. A Texas District Court, however, decided it had been a bona fide partnership and that Mr. Phillips could share only in his wife's part of the losses.

Fruit Jar Method of Accounting

Mr. Horace Tolbert, of Johnson County, Arkansas, owns and operates a peach orchard. When he sells peaches he deposits the proceeds in his bank account and deposits the deposit slip in a fruit jar kept by his wife for that purpose. When income tax time rolls around, the deposit slips in the fruit jar are totaled—and that's the gross income. By inadvertance a few of the deposit slips were mislaid in 1944 and not included in the reckoning of gross income. A skeptical revenue agent found that the tax should have been $9,459.20 more than reported by Mr. Tolbert and assessed a fraud penalty of $4,729.60. Mr. Tolbert paid the deficiency, interest and penalty and sued for a refund of the penalty. On the grounds that Mr. Tolbert is a farmer, not an accountant or technical tax consultant and that his method of keeping records had proved sufficient over a period of years, the jury held unanimously that Mr. Johnson could recover the penalty paid. That ought to teach the revenue men not to meddle with the privileges long enjoyed by farmers!