Journal of Accountancy

Volume 27 | Issue 5 Article 6

5-1919

Income Tax Department

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Herewith are published treasury decisions 2810-2, inclusive, and 2815-6, inclusive; also a welcome extension of the filing date to June 15th for all corporations (but only corporations) which filed tentative returns (1031-T) on or before March 15th. Observe particularly that this extension does not apply to individuals or to corporations whose fiscal years end later than December 31, 1918. To those classes of taxpayers extensions will be granted only on request.

Returns of non-resident aliens are dealt with in T. D. 2811 and 2815. The first gives a partial list of those countries, so far as known to the treasury department, whose citizens may claim the specific personal exemption of income earned by them from American sources, under section 216 (e), because of reciprocal privileges granted by their countries to American citizens. T. D. 2815 deals with the adaptation of the forms for resident individuals to use for non-resident aliens. It should not be overlooked that the latter are not entitled to the 6% rate on the first $4,000.00 of income bearing the tax, but must pay the 12% rate on the entire income.

In T. D. 2816 is contained a decision of the supreme court that reverses a decision of the circuit court of appeals embodied in T. D. 2720 (see THE JOURNAL OF ACCOUNTANCY, July, 1918, pp. 43-4, 48-55). The decision arose under the 1913 act, but would apply to the present law as well. It decrees that trusts vested with power of discretion, usually possessed by a board of directors, over the distribution of trust income in their control are not to be regarded as "associations," but as fiduciaries, because the power of the trustees to defer payment or divert the income to improvement of the capital is not enough to convert the trust into a joint-stock company. Consequently the beneficiaries and not the trust must pay the tax.

TREASURY RULINGS

(T. D. 2810, March 21, 1919)

Income tax.

Extension of time in which taxpayers living or temporarily residing in the territory of Alaska may, pursuant to the requirements of the revenue act of 1918, file returns of income for the year 1918 with the collector of internal revenue for their respective districts.

Because of the fact that it will be impossible to put into the hands of taxpayers residing or located in the territory of Alaska the blank forms and instructions prescribed by this department for the use of taxpayers in making returns pursuant to the new revenue act in time for such returns to be filed on or before the due date (March 15, 1919) an extension of time to June 15, 1919, is hereby granted to all taxpayers living or residing temporarily in the territory of Alaska. This extension shall not be construed as extending the payment of the second instalment due June 15, 1919, and subsequent instalments, therefore two instalments will be due June 15, 1919.

(T. D. 2811, March 22, 1919)

The preliminary edition of regulations 45, amended (1) by the addition of a new article numbered 307, concerning the allowance of credit for a personal exemption and for dependents to a nonresident alien individual, and (2) by the addition of a new article numbered 316, concerning the allowance of credits to a non-resident alien employee.

The preliminary edition of regulations 45 is hereby amended by the addition of two new articles, numbered 307 and 316, respectively, and reading as follows:

ART. 307. *Credit for a personal exemption and for dependents in case of nonresident alien individual.*—(a) The following is an incomplete list of countries which either impose no income tax or in imposing an income tax allow the similar credit required by the statute: Argentina, Brazil, Canada, Cuba, France, Italy, Mexico, Union of South Africa.

(b) The following is an incomplete list of countries which in imposing an income tax do not allow the similar credit, required by the statute: Australia, Great Britain and Ireland, Japan, New Zealand.

A nonresident alien individual who is a citizen or subject of any country on the first list is entitled for the purpose of the normal tax to such credit for a personal exemption and for dependents as his family status may warrant. (See arts. 302-305.) If he is a citizen or subject of any country on the second list he is not entitled to any such credit. If he is a citizen or subject of a country which is on neither list, then, to secure credit for a personal exemption or for dependents, or both, he must prove to the satisfaction of the commissioner that his country does not impose an income tax on that, in imposing an income tax, it grants the similar credit required by the statute. (See art. 306.)

ART. 316. *Allowance of credit to nonresident alien employee.*—A nonresident alien employee, provided he is entitled under section 216 of the statute to credit for a personal exemption or for dependents, or both (see arts. 301-307, particularly the lists of countries in art. 307), may claim the benefit of such credit by filing with his employer form 1115 duly filled out and executed under oath. On the filing of such a claim the employer shall examine it. If, on such examination, it appears that the claim is in due form, that it contains no statement which, to the knowledge of the employer, is untrue, and that such employee, on the face of the claim, is entitled to credit, and that such credit has not yet been exhausted, such employer need not, until such credit be in fact exhausted, withhold any tax from payment of salary or wages made to such employee. Every employer with whom affidavits of claim on form 1115 are filed by employees shall preserve such affidavits until the following calendar year, and shall then file them, attached to his annual withholding return (see art. 367) on form 1042, revised, with the collector on or before March 1. In case, however, when the following calendar year arrives, such employer has no withholding to return, he shall forward all such affidavits of claim, so filed with him by employees, directly to the commissioner (sorting division), with a letter of transmittal, on or before March 1. In all other cases benefit of the credits allowed against net income for the purpose of the normal tax may not be received by a nonresident alien by filing a claim with the withholding agent, but only by claiming them upon filing a return of income as prescribed in article 403.

(T. D. 2812, March 22, 1919)

Correction in form 1120, corporation income-profits tax return form.

Attention is directed to an error in the title of schedule K, form 1120, "Corporation income-profits tax return." The title of this schedule reads "Changes in invested capital from end of pre-war period to beginning of

taxable year not shown in schedule E." It should read "Changes in invested capital from end of pre-war period to beginning of taxable year not shown in schedule D."

(T. D. 2815, April 2, 1919)

Returns of income by or for nonresident alien individuals.

Nonresident alien individuals or their authorized agents should use form 1040, revised, or form 1040A, revised, in making returns of income derived from sources within the United States, regardless of amount, unless the tax on such income has been fully paid at the source. If a nonresident alien individual is not liable for any tax which has been withheld at the source, no refund of such tax will be permitted unless such a return is filed and a statement is attached thereto indicating the amounts of tax withheld and the names and post-office addresses of all withholding agents. Unless a nonresident alien individual shall render a return of income, the tax will be collected on the basis of his gross income (not his net income) from sources within the United States.

In filling out form 1040, revised, or form 1040A, revised, the income reported in each case should be the income from sources within the United States, as defined in article 91 of regulations 45, and the deductions taken should be those allowed under article 271 of the regulations. In items 28 and 33 of form 1040, revised, and in items O and P of form 1040A, revised, *the tax must be computed at* 12 *per cent instead of* 6 *per cent.* No credit may be taken for item 40 in form 1040, revised.

A nonresident alien individual, similarly to a citizen or resident, is entitled for the purpose of the normal tax to credit dividends from domestic or resident foreign corporations, interest on obligations of the United States, a personal exemption, and $200 for each dependent, except that if he is a citizen or subject of a country which imposes an income tax a personal exemption or credit for dependents is allowed him "only if such country allows a similar credit to citizens of the United States not residing in such country." "If such country allows a similar credit" means if such country in imposing its income tax allows a personal exemption or a credit for dependents, as the case may be, and allows it without discrimination to citizens of the United States not residing in such country. To satisfy the requirement of a similar credit it is not necessary that the personal exemption or credit for dependents, as the case may be, should be the same as that allowed by the United States statute. For countries that allow and do not allow similar credits see T. D. 2811 of March 22, 1919.

See generally title II of the revenue act of 1918 and regulations 45, and particularly articles 2, 91, 92, 271, 305, 311-315, 361-372, 403, 443, 1121, 1131, and 1132.

(T. D. 2816 April 2, 1919)

Income tax—Decision of the Supreme Court.

1. JOINT-STOCK ASSOCIATION.

Where trustees hold shares of stock of a corporation and real estate subject to a lease, collecting the dividends and rents, but otherwise doing no business, and distribute the income less taxes and similar expenses to the holders of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, upon these special facts under the act of October 3, 1913, the trust is *not subject to the income tax as a joint-stock association,* and the trustees and the cestui que trust are *to be treated as fiduciaries and beneficiaries for purposes of taxation.*

2. JUDGMENT REVERSED.

The judgment of the circuit court of appeals is reversed and the judgment of the district court is affirmed. (See T. D. 2720 of June 4, 1918.)

The appended decision of the United States supreme court in the case of *Alvah Crocker et al., trustees, v. John F. Malley, collector of internal revenue,* is published for the information of internal-revenue officers and others concerned.

SUPREME COURT OF THE UNITED STATES. No. 649. OCTOBER TERM, 1918.

Alvah Crocker, et al., trustees, petitioners, v. John F. Malley, collector of internal revenue.

ON writ of certiorari to the United States circuit court of appeals for the first circuit.

[March 17, 1919.]

Mr. Justice HOLMES delivered the opinion of the court:

This is an action to recover taxes paid under protest to the collector of internal revenue by the petitioners, the plaintiffs. The taxes were assessed to the plaintiffs as a joint-stock association within the meaning of the income-tax act of October 3, 1913 (c. 16, sec. 2, G. (a), 38 Stat. 114, 166, 172), and were levied in respect of dividends received from a corporation that itself was taxable upon its net income. The plaintiffs say that they were not an association but simply trustees, and subject only to the duties imposed upon fiduciaries by section 2, D. The circuit court of appeals decided that the plaintiffs, together, it would seem, with those for whose benefit they held the property, were an association, and ordered judgment for the defendant, reversing the judgment of the district court. (250 Fed., 817.)

The facts are these: A Maine paper manufacturing corporation with eight shareholders had its mills on the Nashua River, in Massachusetts, and owned outlying land to protect the river from pollution. In 1912 a corporation was formed in Massachusetts. The Maine corporation conveyed to it seven mills and let to it an eighth that was in process of construction, together with the outlying lands and tenements, on a long lease, receiving the stock of the Massachusetts corporation in return. The Maine corporation then transferred to the plaintiffs as trustees the fee of the property, subject to lease, left the Massachusetts stock in their hands, and was dissolved. By the declaration of trust the plaintiffs declared that they held the real estate and all other property at any time received by them thereunder, subject to the provisions thereof, "for the benefit of the cestui que trusts (who shall be trust beneficiaries only, without partnership, associate, or other relation whatever inter sese)" upon trust to convert the same into money and distribute the net proceeds to the persons then holding the trustees' receipt certificates—the time of distribution being left to the discretion of the trustees, but not to be postponed beyond the end of 20 years after the death of specified persons then living. In the meantime the trustees were to have the powers of owners. They were to distribute what they determined to be fairly distributable net income according to the interests of the cestui que trusts but could apply any funds in their hands for the repair or development of the property held by them, or the acquisition of other property, pending conversion and distribution. The trust was explained to be because of the determination of the Maine corporation to dissolve without waiting for the final cash sale of its real estate, and was declared to be for the benefit of the eight shareholders of the Maine company who were to receive certificates subject to transfer and subdivision. Then followed a more detailed statement of the power of the trustees and provision for their compensation, not exceeding 1 per cent. of the gross income unless with the written consent of a majority in interest of the cestui que trusts. A similar consent was required for the filling of a vacancy among the trustees and for a modification of the terms of the trust. In no other matter had the beneficiaries any control. The title of the trust was fixed for convenience as the Massachusetts Realty Trust.

The declaration of trust on its face is an ordinary real estate trust of the kind familiar in Massachusetts, unless in the particular that the trustees' receipt provides that the holder has no interest in any specific property and that it purports only to declare the holder entitled to a certain fraction of the net proceeds of the property when converted into cash "and meantime to income." The only property expressly mentioned is the real estate not transferred to the Massachusetts corporation. Although the trustees in fact have held the stock of that corporation and have collected dividends upon it, their doing so is not contemplated in terms by the instrument. It does not appear very clearly that the eight Maine shareholders might not have demanded it had they been so minded. The function of the trustees is not to manage the mills but simply to collect the rents and income of such property as may be in their hands, with a large discretion in the application of it, but with a recognition that the receipt holders are entitled to it subject to the exercise of the powers confided to the trustees. In fact, the whole income, less taxes and similar expenses, has been paid over in due proportion to the holders of the receipts.

There can be little doubt that in Massachusetts this arrangement would be held to create a trust and nothing more. "The certificate holders * * * are in no way associated together nor is there any provision in the [instrument] for any meeting to be held by them. The only act which (under the [declaration of] trust) they can do is to consent to an alteration * * * of the trust" and to the other matters that we have mentioned. They are confined to giving or withholding assent, and the giving or withholding it "is not to be had in a meeting but is to be given by them individually." "The sole right of the cestuis que trust is to have the property administered in their interest by the trustees, who are the masters, to receive income while the trust lasts, and their share of the corpus when the trust comes to an end." *Williams v. Milton* (215 Mass., 1, 10, 11; Ib., 8). The question is whether a different view is required by the terms of the present act. As by D, above referred to, trustees and association acting in a fiduciary capacity have the exemption that individual stockholders have from taxation upon dividends of a corporation that itself pays an income tax, and as the plantiffs undeniably are trustees, if they are to be subjected to a double liability the language of the statute must make the intention clear. *Gould v. Gould* (245 U. S., 151, 153); *United States v. Isham* (17 Wall., 496, 504).

The requirement of G (a) is that the normal tax thereinbefore imposed upon individuals shall be paid upon the entire net income accruing from all sources during the preceding year "to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships." The trust that has been described would not fall under any familiar conception of a joint-stock association, whether formed under a statute or not. *Smith v. Anderson* (15 Ch. D., 247, 273, 274, 277, 282). *Eliot v. Freeman* (220 U. S., 178, 186). If we assume that the words "no matter how created or organized" apply to "association" and not only to "insurance company," still it would be a wide departure from normal usage to call the beneficiaries here a joint-stock association when they are admitted not to be partners in any sense, and when they have no joint action or interest and no control over the fund. On the other hand the trustees by themselves can not be a joint-stock association within the meaning of the act unless all trustees with discretionary powers are such, and the special provision for trustees in D is to be made meaningless. We perceive no ground for grouping the two—beneficiaries and trustees—together, in order to turn them into an association, by uniting their contrasted functions and powers, although they are in no proper sense associated. It seems to be an unnatural perversion of a well-known institution of the law.

We do not see either that the result is affected by any technical analysis of the individual receipt holder's rights in the income received by the trustees. The description most in accord with what has been the practice would be that, as the receipts declare, the holders, until distribution of the capital, were entitled to the income of the fund subject to an unexercised power in the trustees in their reasonable discretion to divert it to the improvement of the capital. But even if it were said that the receipt holders were not entitled to the income as such until they got it, we do not discern how that would turn them into a joint-stock company. Moreover the receipt holders did get it, and the question is what portion it was the duty of the trustees to withhold.

We presume that the taxation of corporations and joint-stock companies upon dividends of corporations that themselves pay the income tax was for the purpose of discouraging combinations of the kind now in disfavor, by which a corporation holds controlling interests in other corporations which in their turn may control others, and so on, and in this way concentrates a power that is disapproved. There is nothing of that sort here. Upon the whole case we are of opinion that the statute fails to show a clear intent to subject the dividends of the Massachusetts corporation's stock to the extra tax imposed by G (a).

Our view upon the main question opens a second one upon which the circuit court of appeals did not have to pass. The district court, while it found for the plaintiffs, ruled that the defendant was entitled to retain out of the sum received by him the amount of the tax that they should have paid as trustees. To this the plaintiffs took a cross writ of error to the circuit court of appeals. There can be no question that although the plaintiffs escape the larger liability, there was probable cause for the defendant's act. The commissioner of internal revenue rejected the plaintiff's claim, and the statute does not leave the matter clear. The recovery therefore will be from the United States. (Rev. Stats., sec. 989.) The plaintiffs, as they themselves alleged in their claim, were the persons taxed, whether they were called an association or trustees. They were taxed too much. If the United States retains from the amount received by it the amount that it should have received, it can not recover that sum in a subsequent suit.

Judgment of the circuit court of appeals reversed; judgment of the district court affirmed.

Extension of time for completing corporate returns and for filing certain returns not the basis for assessment of tax.

To COLLECTORS OF INTERNAL REVENUE:

In view of the short time between the date on which forms were available and the due date (March 15), of calendar year returns required under the revenue act of 1918, notice was given through the public press and otherwise that tentative returns (forms 1031-T and 1040-T), accompanied by a first instalment of one-fourth of the estimated tax due would be accepted on that date, and that in such cases forty-five days would be given in which to file complete returns, but that interest at the rate of one-half of 1% per month upon the amounts by which such instalment payments fall short of the correct amounts would be collected.

In the case of corporations which filed form 1031-T on or before March 15, *a further extension, where needed, to June* 15, 1919, in which to file complete returns on form 1120 *is hereby granted,* but all such corporations will be required to pay on or before June 15 a sum sufficient, with the amount paid on March 15, to equal one-half the tax due as shown by the return on form 1120, together *with interest at the rate of one-half of* 1% *per month on any deficiency in the first intalment.*

It is not deemed necessary to grant an extension of time beyond the forty-five days originally granted for the completion of personal returns, except on special request therefor for sufficient reasons given, but the above ruling as to interest on deficient instalment applies to them.

An extension of time in which to file returns of corporations making returns for a fiscal year ended either on January 31 *or February* 28, 1919, *will on request be granted to June* 15, 1919, but such extension shall not operate to extend the due date of any instalment of tax after the first. Interest at the rate of one-half of 1% per month will be collected from the time the first instalment would have been payable if the extension had not been requested.

The time for filing returns of information (forms 1096 and 1099), fiduciary returns (form 1041), withholding returns (form 1042, accompanied by form 1098 and form 1013), returns of partnerships and personal service corporations required to file returns on a calendar year basis, and all other returns required under the income tax and profits tax provisions of the law, which are not the basis for the assessment of the tax, is also extended to June 15, 1919.

DANIEL C. ROPER,
Commissioner.

Washington, D. C., April 14, 1919.