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THE REVENUE ACT OF 1951: ITS IMPACT ON INDIVIDUAL INCOME TAXES

JOHN C. O'BYRNE*

The Revenue Act of 1951 is a phantasmagoria of taxes, sections, ideas, philosophies, benefits and loopholes. Well over a hundred different tax matters are touched specifically; the indirect results are incalculable. Income, excess profits, estate, gift and excise taxes—all received the attention of Congress in greater or lesser measure, plus a few nonclassifiable items charged to miscellaneous. The scope of the Act is appalling. Many of its provisions received wide publicity, *inter alia* the rate increase, the removal of the tax free aspect of the President's expense account, the tax on bookies and wagers, the lowered admission taxes on cut-price ladies' day tickets, the "television formula," sale of a residence, and capital gains on livestock. Other provisions raised little hue and cry, few huzzahs, yet in limited areas they are of immense importance to particular taxpayers. Loophole closing made news copy, yet one is more impressed by the extent of the relief granted to special classes of taxpayers, quietly but effectively. It almost seems that each special group received a taste of pie, while the rank and file of taxpayers received its desserts in rate increases. Most of the special benefit provisions are quite legitimate, alleviating harsh results, or granting forgotten taxpayers consistent treatment. In other cases, the overall policy behind the relief is obscure.

The least that can be said is that many taxpayers came in for special recognition one way or another. Cooperatives, mutual financial institutions, and state colleges are possible new taxpayers. Farmers, miners, retailers, employees, executives, life insurance salesmen, members of the armed forces, railroads, public utilities, nonresident aliens, symphony orchestra societies, babies and chil-

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1. See text p. 833-834 infra.

2. As well as that of the Vice President, Speaker and Members of Congress, § 619 Revenue Act of 1951. Citation of a section without more refers to the Internal Revenue Code. Citations to the 1951 Act will carry the notation Rev. Act.


4. § 401 Rev. Act, amending § 1700(a).

5. § 459(d) added.

6. § 112(n) added.

7. § 117(j) amended.

8. It would be interesting to know, for example, how fishing trips came to be exempt from a transportation tax. § 493 Rev. Act, amending § 3469(b).
dren, sellers of homes, distillers who lost their spirits, etc., etc.,—
all received some measure of comfort from amendments to one or
another of the taxes. Other taxpayers, in addition to the rate rise,
were unfavorably touched. A wee drop, a cigarette, gasoline, a bet
on a horse, and many other more or less needful items cost more.
A few erstwhile tax dodges were denied to individual and cor-
porate taxpayers.

Scope of Article
It is obviously impossible to encompass very much of the new
Act in an article. A discussion of all the income tax sections would
be a larger bite than could be successfully chewed. Thus, it seemed
advisable to limit the discussion herein to the income tax sections
that are most likely to concern the individual and his attorney
in the normal preparation of returns and in planning the income
tax events of the year. No particular reference is made to other
taxes or taxpayers. Some of the innovations mentioned are of a
mechanical nature and have already become part of the working
kit of any lawyer who made out a 1951 return, e.g., increase of de-
pendent's gross income to $600. Other provisions, less well known
or more involved, are discussed in greater detail with such com-
ments as seem appropriate in the space allotted. For the most part
the provisions herein discussed became effective for taxable years
beginning after December 31, 1950. Comment on effective date will
be made only where there is an important deviation from that
pattern.

It is hardly necessary to admit that any attempt at generalized
treatment of many items inevitably leads to technical inaccuracy
and blurring of details. Any item of interest should be pursued in
the tax services or in specific articles.

I. Mechanical Provisions
Those provisions of the Revenue Act of 1951 that made changes
or additions that are important to the tax structure, but hardly
subject to extensive comment, are suggested below in rather sum-
mary fashion. In most instances, the practitioner has become
acquainted with these provisions during the taxable year of 1951
since most of them were applicable for that year.

A. Rate Increases
Enough has been said and written about the rate increases of

the last two Revenue Acts. Percentage comparisons abound, but few of them make much sense because the partial increase in the year of enactment of the Acts tends to cloud the extent of the jump. A more graphic illustration arises from the comparison of the tax due for each of the years 1949 through 1952. Most taxpayers are less concerned with the percentage rise, but greatly concerned over the relationship of the tax to gross income. Consider the tax history of the married man with two dependents and the single man, both earning $5,000 per year:

<table>
<thead>
<tr>
<th>Year</th>
<th>Married, 2 dependents</th>
<th>Single</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949</td>
<td>$345</td>
<td>$695</td>
</tr>
<tr>
<td>1950</td>
<td>361</td>
<td>724</td>
</tr>
<tr>
<td>1951</td>
<td>424</td>
<td>829</td>
</tr>
<tr>
<td>1952</td>
<td>461</td>
<td>906</td>
</tr>
</tbody>
</table>

The result is readily apparent, the small taxpayer upon whom any revenue system must rest, becomes more important each year to the Federal fisc. And he becomes more important to the attorney and tax adviser as part of a growing group to whom sound tax advice can mean taxes saved.

In respect to the taxation of capital gains, the first rate change in nearly a decade became effective in the Revenue Act of 1951. There has always been a certain amount of agitation for increased rates. In fact, the House bill recommended a rate of approximately 28%. The Revenue Act of 1951 compromised on an increase in the alternative tax rate to 26%, effective for the year 1952.

B. Head of A Household

The law as it existed prior to the Individual Income Tax Act of 1944 allowed a personal exemption to the "head of the family." With the passage of the 1944 Act that particular concept disappeared from the Code. Such benefit reappears in the new Act in the form of a special tax rate applicable to taxable years beginning after October 31, 1951. The Senate Finance Committee recognized the unequal tax treatment accorded a taxpayer who maintained a household for the benefit of other individuals as against

10. § 101(b) Revenue Act of 1950 and § 101(a) Rev. Act, amending § 12(b).
12. § 322(b) Rev. Act, amending § 117(c) (2) (B).
15. § 301(a) Rev. Act substituting a new § 12(c).
the married couple who might have their income treated as that of two single individuals. The Committee Report assumes that the sharing of one's income with a spouse is the rationale behind the existing joint return provisions and then argues that the income of the head of the household also is likely to be shared with a child or other dependent to the extent necessary to maintain the home and perhaps raise and educate the child or dependent. The result is fine, but the premise is none too valid.

Approximately 50% of the benefits of husband-wife income splitting are accorded a taxpayer who can qualify as head of a household under the definition in section 12(c)(3). He must not be married at the close of the taxable year, but must maintain as his home a household which is the principal place of abode of a son, stepson, daughter, stepdaughter, or a descendant of a son or daughter of the taxpayer, or any person who is a dependent of the taxpayer under section 25(b). Where the taxpayer maintains the household as the principal place of abode for his unmarried children, and stepchildren, or their descendants, he may qualify as the head of a household even though he may not be entitled to an exemption for those persons under section 25(b). Otherwise, the person living in the home must be a dependent for whom the taxpayer is entitled to an exemption under section 25(b). In any event, the taxpayer must furnish over half of the costs of maintaining the household during the taxable year.

It should be noted that an individual who files his return on a Form 1040A will lose this benefit, since the Collector will use the optional Tax Tables provided for a single person in computing the tax. The use of the short Form 1040, however, will permit the taxpayer to find his own tax under the column provided for a head of a household. On the long Form 1040, a special rate schedule applies to the head of a household.

17. See Goodman, Observations on the Revenue Act of 1951, 20 Ford. L. Rev. 273 (1951), in which the author demolishes the premise, and in the bargain decries both the head of the household and split income provisions.
18. The Senate Finance Committee reasons that the limitations found under § 25(b) are unnecessary in the case of children, stepchildren and grandchildren, since these persons are part of the family unit, with a relationship similar to that between spouses. Sen. Fin. Comm. § III(B) (2).
20. In no case may the status rest upon a married dependent, child, stepchild or descendant who has filed a joint return with a spouse.
21. § 51(f)(1) and § 402, amended by § 301(b) Rev. Act.
C. Gross Income of Dependents

The Revenue Act of 1948 raised to $600 the amount of the dependency exemption, but left the gross income limit at $500.\(^2\) There seems to be no good reason why Congress did not then raise to $600 the gross income allowed a dependent before the taxpayer was denied an exemption for him. The Senate Finance Committee logically commented that "not only is the present treatment inconsistent but it leads inevitably to confusion on the part of the taxpayer."\(^2\) The 1951 Act raised the amount to $600.\(^2\)

D. Medical Expenses

The five per cent limitation on medical expenses of the taxpayer and his spouse is removed if either the taxpayer or his spouse is age 65 or over. The relief applies to the first year during which one or the other becomes 65 years old, and continues thereafter.\(^2\) Medical expenses for dependents of the taxpayer are still subject to the five per cent limitation. The maximum deduction allowable for medical expenses remains at $1,250 per exemption claimed (other than for age or blindness), up to a total of $2,500 on a separate return and $5,000 on a joint return.\(^2\)

The new provision makes tax planning of medical expenses more important than ever. In many cases, it may be possible to postpone expenses if one of the couple will reach 65 in the next taxable year. Lumping of medical payments in one year and electing the optional standard deduction in another is often feasible. Records take on added import since the taxpayer must be able to separate expenses relating to himself and spouse from those incurred for others.

E. Elections re Joint Returns and Standard Deduction

Under section 51 of the Code prior to the Revenue Act of 1951, married taxpayers had to elect whether to file a joint return or separate returns at the time of filing, and such election was irrevocable.\(^2\) The provisions of the new law now make it possible for married individuals who filed separate returns for a taxable year beginning after 1950 to elect to substitute a joint return even though

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22. § 201 Revenue Act of 1946, amending § 25(b) (1).
24. § 310 Rev. Act, amending § 25(b) (1) (b).
25. § 307 (a) Rev. Act, amending § 23(x) .
26. § 23(x) .
the time for filing the return for the taxable year has expired. The joint return must be filed within three years of the due date of the return for the taxable year, and any irrevocable election as to treatment of income, deductions, or credits may not be changed in the making of the joint return. Note that a decision to file a joint return is final on the due date of the return.

Likewise an election to take the standard deduction or to itemize deductions is no longer final upon filing the return for all taxable years after 1949. The net effect of this provision is that the taxpayer who itemized his deductions when he filed his return may now change that election and claim the standard deduction within three years after the due date. The converse is also true. However as to married taxpayers, both must elect to take the standard deduction or both must itemize.

F. Additional Withholding

Where an employee consistently found himself at the end of the taxable year with insufficient taxes withheld to cover his income tax liability, he had to dig deep and pay the amount of the excess due as well as the first payment on his declaration for the next year. Now he can avoid the March 15 willies by agreeing to have his employer withhold from his wages an additional amount each pay period. If the employer agrees to make the additional deduction for him, such withholding is then considered the tax required to be deducted.

G. Members of Armed Forces

As was true during World War II, so too during the present emergency, special tax treatment is granted to servicemen. All compensation received by enlisted personnel and the first $200 per month received by commissioned officers for any month during any part of which the taxpayer served in a combat zone has been tax exempt. The expiration date for such exemption had been January 1, 1952. The new Act extended the time period to January 1, 1954, and further provided that compensation received for any

28. § 312(a) Rev. Act, adding § 51(g).
29. § 51(g) (3) and (4). Other special rules appear in subsections (2) and (5)-(10).
31. Or other limitation period.
33. § 22(b) (13), added by § 202(a) Revenue Act of 1950.
month during any part of which the recipient was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone should be exempt on the same terms. There must have been during all of that month, however, combatant activities in any combat zone. June 25, 1950 is established as the date on which combatant activities commenced in Korea. ³⁴

During World War II individuals dying while in the military or naval forces of the United States or other United Nations were forgiven their income tax for the year of death and the prior year, in addition to being relieved of income taxes unpaid at the time of their death. Similar treatment is granted during the present emergency. Thus, a serviceman dying while in active service in a combat zone or as a result of wounds, disease, or injury incurred while so serving is entitled to an abatement for income taxes for the year of death and prior years ending on or after the first day of his service in a combat zone after June 24, 1950. In addition any income taxes due at the date of death are also abated. ³⁵ Thus a serviceman who entered a combat zone at some period prior to December 31, 1950, and who died in 1952 while in active service in that zone or as a result of wounds, disease, or injury incurred thereby, would have his income taxes for the taxable years 1950, 1951, and 1952 forgiven. Claims for refund may be in order.

II. RELIEF PROVISIONS

"Relief" for taxpayers is something of a misnomer. Any so called "relief" may well work to the disadvantage of some taxpayer somewhere. Relief provisions are so hedged about that the unwary taxpayer often finds the relief an additional headache. However, these were meant to aid the taxpayer, and for lack of better classification, it is adopted here.

A. Taxpayers Generally

Of all of the relief provisions of the new Act, only two can be regarded as applicable to the rank and file taxpayer, the sale and replacement of residence and the casualty loss carry-back and carry-over.

1. Sale and Replacement of Residence

For many years last past, taxpayers have lamented the unfair-

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³⁴. § 22(b) (13), amended by § 305(b) Rev. Act.
³⁵. § 154, added by § 334 Rev. Act.
ness of a tax law that accepted no part of the loss on the sale of a taxpayer's residence, but claimed a share of the gain.\textsuperscript{36} Nor were nontaxable exchange provisions applicable.\textsuperscript{37} The crushing blow, of course, followed the recent rise in land values. The taxpayer who sold a low basis home in a high price market and repurchased another home in the same market, discovered that his cash position and his tax liability were out of balance. Taxwise, he would have been better off to burn the house, and buy a new one with the insurance money.\textsuperscript{38}

Both the House and the Senate Bills provided relief from tax on the gain on the house sold if the sale proceeds were promptly reinvested, the two bills differing only in the time allowed within which the taxpayer could build and occupy a new house. The theory of the new law\textsuperscript{39} is simplicity itself. Gain on the sale of a residence from and after January 1, 1951 is deferred if the taxpayer purchases another residence within a year before or after the sale.\textsuperscript{40} Any excess of the sale price of the old residence over the purchase price of the new is recognized gain. To so defer the unrecognized gain, the basis of the new property is the purchase price reduced by the unrecognized gain on the sale of the old residence.\textsuperscript{41} When the new home is sold and not replaced, the accumulated gain will then be taxed.\textsuperscript{42} The recognition of gain will in many cases be postponed indefinitely. As the taxpayer moves from residence to residence, qualifying each time, successive gains will be hidden in the basis, and will be recognized only on the final sale without repurchase. Often, the gain will never be recognized, since the residence may pass by death and acquire a new basis, ready to begin again.\textsuperscript{43}

Purchase and selling prices in each case generally follow the usual concepts, a mortgage or other indebtedness being included in each.\textsuperscript{44} Purchase price deviates from the usual basis concepts where part of the new property is acquired by gift or inheritance. In such

\begin{itemize}
  \item \textsuperscript{36} U. S. Treas. Reg. 111, § 29.23(e)-1, § 29.22(a)-1 (1943).
  \item \textsuperscript{37} I. T. 1587, II-1 Cum. Bull. 26 (June, 1923).
  \item \textsuperscript{38} § 112(f) before 1951 amendment.
  \item \textsuperscript{39} § 112(n), added by § 318 Rev. Act.
  \item \textsuperscript{40} The new residence could have been purchased in 1950, so long as the sale of the old was in 1951.
  \item \textsuperscript{41} § 112(n) (4) ; § 113(b) (1) (K).
  \item \textsuperscript{42} For capital gain determination, the holding period of the new residence includes that of the old residence, § 117(h) (7).
  \item \textsuperscript{43} § 113(a) (5).
  \item \textsuperscript{44} If the house sold or bought includes furniture or other non-fixture items, they must be removed from the computation.
\end{itemize}
case only the taxpayer's own expenditures are considered "purchase price" for purposes of this section.\footnote{45}{Report of Committee on Ways and Means of House of Representatives on H.R. 4473, H.R. Rep. No. 586, 82d Cong., 1st Sess. \S VII, Title III, \S 303 (1951), hereafter cited Ways and Means Comm.}

For the average taxpayer, who sells his house and buys another for indefinite use, there should be little difficulty. If the opportunity arises to counsel from the beginning, the statute can be met with comparative ease. It should be noted that the provisions are mandatory, the taxpayer has no option. If he desires to recognize his gain, and thereby increase the basis of the new residence, he should be advised to wait out the time limit. This could be desirable, for example, where the taxpayer plans to use the house as his principal residence at once, but foresees the possibility of future rental permitting depreciation.

In addition to purchase and sale, the statute encompasses exchange, compulsory or involuntary conversion, and construction.\footnote{46}{\S 112(n)(2) (A) (B) (C) (D). Involuntary conversion of residence property has been removed from \S 112(f) and falls exclusively under \S 112(n).}

A specific provision covers a tenant stockholder in a cooperative apartment corporation.\footnote{47}{\S 112(n)(5).} Houseboats and house trailers are included by implication.\footnote{48}{Sen. Fin. Comm. \S VI(A) (5).}

The complexities of the statute result from the effort to prevent use of the relief measure as a tax evasion (or avoidance, if that has a mellower sound) scheme, and from the attempt to foresee all possible variations of the vagaries of casual taxpayers. Therein, as always, lie the traps for the nonplanning taxpayer.

There are these important rules: (a) the taxpayer must "use" the new property as his residence within the time period;\footnote{49}{There is no requirement that he be using the old residence at the time of the sale.} (b) if the taxpayer purchases a new residence and reconstructs or improves it, he can credit only so much of the cost of acquisition, reconstruction and improvements as fall within the time period; (c) if the taxpayer's purchase precedes the sale of his old residence and the new one is disposed of by sale or otherwise before the sale of the old one, he has forfeited the opportunity to defer the gain; (d) if the taxpayer voluntarily buys and uses more than one residence, only the last one within a year from the sale of the old residence is used for nonrecognition treatment, gain on intermediate sales being taxable; but if destruction, loss, condemnation, or sale under threat
of condemnation of an intermediate residence occurs, a gain there-
on will not be recognized, and a new year begins with that event;  
(e) the nonrecognition treatment can be used on a voluntary basis  
only once in a year’s time, the gain on a second sale within a year  
of the first being fully recognized and taxed; but an involuntary  
conversion or sale under threat of condemnation receives non-  
recognition treatment even though within a year of a previous non-
recognized gain.  

The same rules apply generally to a taxpayer  
who constructs a new house, except that he has until 18 months  
from the date of sale of the old residence to qualify.  

"Principal residence" is the persistent statutory phrase, but  
no definition is offered. Little difficulty should ensue on the usual  
facts involving the bona fide home of the taxpayer, but one can fore-
see certain troublesome fact situations and problems of allocation.  
Temporary rental of the old or new residence may or may not  
affect the taxability of the gain, though it would seem wise to avoid  
it if possible, or at least to limit the rental period since the require-
ment of "use" of the new residence, the concept of "principal resi-
dence", and the time limits militate against renting. Often the tax-
payer's residence and business occupy the same structure, or prop-
erty, or some portion of the property is devoted to the production of  
income. Only gain from the residential portion (including environs  
and out-buildings) is entitled to nonrecognition, and only the pro-
cceeds allocable to the old residence need be reinvested in the new  
residence. Allocations can range from the relatively simple, e.g.,  
a duplex, to the complex, e.g., house and store, or farm property.  
The problem can be compounded by a double allocation, e.g., sale of  
a farm and purchase of another. The values of the respective resi-
dences must be separated out for section 112(n) treatment. Limited  
experience so far suggests a tendency to be overly generous in  
the allocation to the residence, which lends a certain instability to  
the transaction.  

Careful attention must be given to the basis records of residential  
property. The new provision can create a "fluttering basis" where  
a residence is purchased before sale. At the time of purchase, the  
basis is cost. Additions or reductions may occur before the sale of  
the old residence. On the sale of the old residence, the basis of the

51. § 112(n) (2) (G).  
52. § 112(n) (4).
new one will drop by the amount of the gain unrecognized. If any gain remains to be recognized at that point, improvements within a year from the sale will decrease the recognized gain, and the basis. Improvements thereafter increase the basis again.

Two additional problems arise in connection with the new sale of residence provisions that demand careful compliance by the taxpayer or his attorney. Because of the common pattern of placing all or part of the title to residential property in a spouse’s name, provision is made to apply the nonrecognition treatment to such property if the parties consent to an allocation between them of the unrecognized gains and the resultant basis adjustment.53 This is proper even though the title to the new residence is different than the old, so long as one or both hold it. The Secretary is directed to promulgate regulations relative to the mechanics of consent and allocation, which should be examined with care upon issue.

Implicit in the law is the possibility that the transactions of sale and purchase will occur in more than one taxable year. A taxpayer whose taxable year ended after sale of the old residence but before purchase of the new one, might fail to qualify for nonrecognition by proper purchase within the time limit. Even though the whole transaction occurred within a taxable year, unless there is a change of return form or policy, no specific report of the transaction would be made. Therefore, the reporting burden is thrown upon the taxpayer by forcing him to start the running of the statute of limitations. The statute will not begin to run on the assessment of a deficiency on such transactions until three years from the date that the taxpayer notifies the Bureau of (a) the cost of the new residence, (b) an intention not to purchase within the time limit or (c) his failure to purchase within the period.54

It would seem advisable to bring such report into the office routine at two points, first as an adjunct to the normal income tax preparation routine, and second as part of the aftermath of any real estate closing involving residential property. Here again, regulations will be forthcoming which will establish the mechanics of reporting.

2. Casualty Loss Carry-Back and Carry-Over

One of the few provisions of the Revenue Act of 1951 that applies generally to all taxpayers is one that few people hope to use. The new casualty loss treatment was motivated by the desire to

53. § 112(n) (6).
54. § 112(n) (7) ; § 276(e).
relieve victims of the 1951 floods, but the relief will extend to many taxpayers.

Losses arising from theft, fire, storm, shipwreck or other casualty, even though the property is not business property nor used for the production of income, are now treated as a net operating loss. If the loss is not fully offset by the income of the year in which the loss is incurred, the unexhausted portion may be carried back one year and offset against the income of that year, and then forward for five years as an offset against the income of those years.

The new law applies to losses suffered in 1951 (even though the tax year began in 1950) and thereafter. An unexhausted 1951 theft or casualty loss may warrant the filing of an amended return and a claim for refund for the year 1950 (or prior fiscal year). The loss cannot be used to offset 1952 income until it has been applied to reduce 1950 income. Any unexhausted portion of the loss may then be carried forward and offset against income of 1952, 1953, 1954, 1955 and 1956. Losses incurred in 1952 that do not exhaust 1952 income will be used as an offset first against income of 1951, and then carried forward against the years 1953-57.

B. Business and Farm

Five provisions relative to businessmen, farmers, and ranchers are noteworthy. Two represent partial legislative solutions to problems that have resulted in too much litigation, i.e., family partnerships and sales of livestock held for draft, breeding or dairy purposes. One settles the sharply drawn issue involving the taxability of growing crops sold with the land. The others are limited, relating to replacement of LIFO inventories and net operating losses of 1948 and 1949.

1. Family Partnership

The 1951 Act attempts to set the family partnership squabbles on a somewhat firmer base henceforward. For pre-1951 years, the taxpayer and the Bureau must hammer out their own conceptions of "really and truly" under the decisions.

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55. § 122(d) (5), amended by § 344(a) Rev. Act.
56. § 122(b).
57. § 344(a) Rev. Act.
58. At this writing, the 1952 flood losses have piled up. Mechanics of record keeping and proofs should be restudied so that full losses can be supported.
59. The Culbertson boys have come full circle. The fifth and latest (hopefully, the last) time around, the Court of Appeals for the Fifth Circuit found a partnership. Culbertson v. CIR, 194 F. 2d 581 (5th Cir. 1952). On the same day, the same court handed down an opinion in Alexander v. CIR, 194 F. 2d 921 (5th Cir. 1952), involving a family partnership under pre-1951 law, which contains an excellent statement of the philosophy of analysis.
The new law has no bearing on pre-1951 years and it expressly states that no inferences shall be drawn from the fact that the section is not made applicable to earlier years. This was the House's idea. The Senate would have made the new law retroactive to and including the year 1939 at the election of a partner.60

The new provisions61 really amount to a statement of principles, rather than a detailed set of rules, and it is indeed doubtful that anything more than that could be successfully phrased. In a sense, the statement of policy is a general directive to the courts and Bureau pregnant with the danger that both the courts and Bureau will assume that they have been following the policy all along.

In any event, the statute is aimed primarily at clarification of the tax status of the partnership interest obtained by gift. To that end it declares that where capital is a material income producing factor, the distributive share of a partnership interest received by gift is to be taxed to the donee, and such share is not to be diminished because of the partner's absence due to military service. Then follow the "except" clauses which remove some of the apparent force of the previous sentence, but are necessary restraints on overzealous taxpayers and counsel. If the share of the donee partnership is determined without allowance for reasonable compensation for the services of the donor, or if the allocation of earnings to the donated capital is out of proportion to the donor's remaining capital, a rejuggling of the distributive income will be in order. It would seem that the "reasonable compensation" restriction lays open about the same problems as have arisen in connection with salary deductions in close corporations.62 The other restriction ought not to be overly troublesome. A "purchase" by a family member (defined as an individual's spouse, ancestors, lineal descendants, and any trust for them63) is regarded as a gift, and the value of the capital interest acquired is the fair market value of that interest.64

The provisions are short and general in nature making it necessary to seek the Congressional philosophy in the Committee Re-

60. Sen. Fin. Comm. § VI(A) (7).
61. Amendment of definition in § 3797(a) (2) and addition of § 191 by § 340 Rev. Act.
63. This would suggest approval of those cases recognizing that a trust may be a partner, e.g., Maiatico v. CIR, 183 F. 2d 836 (D.C. Cir. 1950); Louis R. Eisenmann, 17 T. C. No. 173 (Feb. 29, 1952). Contra: Hanson v. Birmingham, 92 F. Supp. 33 (N.D. Iowa 1950). The Bureau assumes it. See Mm. 6767, 1952 Int. Rev. Bull. No. 7 at 6 (1952). Note that "family" does not include in-laws.
64. § 191.
ports, which show surprising unanimity of thought and purpose. Both reports considered the treatment of the family partnership at odds with that of other business forms, reiterated the basic principle of taxing income from capital to the owner of capital and income from services to the renderer of the service. They criticized tests based upon "intention," "business purposes," "reality," and "control" which have resulted in a tendency to ignore the change of ownership that results from a completed gift. In a word, the Congressional test of the right to income from a donated partnership interest is "ownership," as recognized for property law purposes. This, of course, is tempered by the recognition of shams, and of the gloss on so much of the Code resulting from the Clifford-Horst concepts. Tongues must have tickled cheeks when the Committees wrote that the "... amendment leaves the Commissioner and the courts free to inquire ... whether the donee actually owns the interest. ... All the facts and circumstances ... may be taken into consideration in determining the bona fides ... of a purported gift or sale".

It is obvious that no simple answer has been achieved by statute, though some areas of respectability have been more clearly defined. The completed gift will be recognized as creating a valid partnership where capital is a material income producer, and the distributive shares are reasonable. A trust may be regarded as the owner of a partnership interest. Restrictions on the donated property will be considered proper, if of a character incident to the normal relations between partners, or if held in a fiduciary capacity, a recognition of possible arrangements involving a managing partner, a limited partnership, or a donor-trustee. However, any taxpayer would be well advised to use extreme caution in creating these powers, even though permitted by local business or property law, since they make the basis for an intensive factual haggle.

Thus despite the new provisions, the post-1951 family partnership is subject to scrutiny in these respects: (a) bona fides of the gift or sale, (b) retention of powers of control by the donor or seller regardless of the vehicle for retention, (c) determination of

65. Helvering v. Clifford, 309 U. S. 331 (1940); Helvering v. Horst, 311 U. S. 112 (1940) and their innumerable progeny, legitimate and otherwise. See also U. S. Treas. Reg. 111, § 29.22(a)-21, 22 (1943).
66. Sen. Fin. Comm. § VI (A) (7); Ways and Means Comm. § V (M).
67. It is not likely that this will be passed over. See Mim. 6767, 1952 Int. Rev. Bull. No. 7 at 6 (1952) for pre-1951 Bureau position, which suggests lines of attack that may be pursued for 1951 and subsequent years.
68. This is Committee talk; no such statement appears in the statute. See note 66 supra.
the extent to which capital is an income producing factor, (d) propriety of the allocation of the distributive shares, and (e) reality of the distribution. Although the family partnership often results from the effort to spread income, a factor justifying the suspicious attitude of courts and Bureau, the current provision tends to eliminate motive or at least to soft pedal it.

2. Sale of Livestock

Some of the storms that raged about the Bureau's interpretation of section 117(j) have been stilled by the Revenue Act of 1951, but it is not yet permissible for farmers and ranchers to convert feeders to breeders by any of the sleight of hand suggestions currently made. It is not conceivable that the Bureau will be any less interested in methods and records of farmers and ranchers, even though prior Bureau tests have been roughly handled by the Congress. Less trouble should arise on draft and dairy animals, the problems of proof being relatively easier. Most of the bitterness comes in connection with the determination of breeding stock.

Though section 117(j) did not previously mention livestock, it was conceded that these were covered. The House amendment to the new law would have done no more than spell this out and extend the holding period to 12 months, without specific reference to the beginning of the period. The Senate version, which became law, added specificity, providing that the age of the animal is not material and measuring the 12 months period from the date of acquisition of the animal, not from the date it was put to use for draft, breeding, or dairy purposes. Poultry was eliminated from capital gain treatment by the Senate.

The amendment to section 117(j) draws a sharp line between pre-1951 and post-1951 transactions. For the years 1942 through 1950, the taxpayer's holding period is six months. For 1951 and

69. But see the Alexander case, supra note 59 and Mim. 6767, 1952 Int. Rev. Bull. No. 7 at 6 (1952) for a more realistic approach. The emphasis must be upon the reality of the partnership, not the tax consequences of recognition.

70. § 117(j), amended by § 324 Rev. Act.

71. And by the courts: in Lasater v. Scofield, Civ. No. 577 (W.D. Tex. Jan. 29, 1952) the taxpayer beat the "culled from the herd" argument by a motion for summary judgment under Fed. R. Civ. P. 56(c). And by the taxpayer's counsel: Ver Ploeg, Income Tax on Sales of Livestock as Confused by Mimeograph 6660, 37 Iowa L. Rev. 57 (1951). In fairness to prior practice it must be said that the "culled from the herd" position of the Bureau has considerable logical justification. The same cannot be said for the more recent "substantial useful life" test.

succeeding years the holding period is 12 months. It is arguable that poultry is included for years before 1951, since the provision banning poultry was effective for years beginning in 1951.

Several problems have cropped up since the passage of the Act, and others are to be expected. The retroactive aspect of the statute raises the advisibility of filing claims for refund on open years if capital gain treatment was not claimed. It is not to be expected that the Bureau will look with greater favor on these claims than any others, even though recent instructions may have authorized settlement of cases presently in issue. Careful examination of the taxpayer's books, records, proof and returns, and consideration of his position upon an audit must precede the decision to file.

Some confusion has existed in connection with the method of handling such livestock. The raised animal of the cash basis taxpayer presents no problem, but some taxpayers apparently do not claim depreciation on purchased animals. Such depreciation normally must be recognized when computing gain on the sale, and failure to claim it results in a loss of a deduction against ordinary income.

The accrual basis taxpayer, who kept draft, breeding or dairy animals in his inventory has discovered that his treatment is not as favorable as his cash basis neighbor. It seemingly gives him no comfort to point out that he adopts an accounting system and takes the bitter with the better. Both the House and Senate Committee reports state that such gains shall be computed according to the taxpayer's accounting method. Inventoried animals take as their basis for computing gain the value in the opening inventory.

It is true that the accrual basis taxpayer may have paid tax at ordinary rates on the increase in inventory value from year to year while the cash basis taxpayer did not, but that is a concomitant of his selected method. Partial recovery might be achieved by removing the livestock from inventory to depreciation schedule and claiming depreciation thereafter. The suggestion has been made by revenue

73. Glenn E. Magee, 17 T. C. No. 195 (Mar. 21, 1952). Taxpayer entitled to capital gain treatment on liquidation of turkey flock against Commissioner's argument that no distinction existed between breeding turkeys and non-breeding turkeys because of the short life and single breeding year.

74. 1952 Int. Rev. Bull. No. 7 at 5 (1952) revokes I.T. 3666 without reinstituting I.T. 3666 or I.T. 3712, and informs collectors, agents in charge, and heads of field divisions of the Appellate Staff that they may dispose of cases "if, under the circumstances of the case, the treatment prescribed by section 117(j) of the Code, as amended, is clearly applicable."


76. § 113 (a)(1).
officials that removal from inventory to depreciation schedule is a change of accounting method, requiring permission of the Commissioner. It is believed that the accrual basis taxpayer has the option to inventory purchased livestock for his convenience, but that they properly are depreciable items, and that to adjust to proper treatment represents no change of method. Similar removal of raised livestock from inventory would not do violence to accounting theory, although regulations relating to the farm price and unit livestock methods of inventories infer otherwise.\textsuperscript{77}

The most acute problems in this connection are expected in proving the fact of holding for breeding purposes. Proof of draft or dairy purposes seems less troublesome. Undoubtedly the Bureau will take some comfort from the pre-1951 cases\textsuperscript{78} which seemed to require that an animal produce, or be old enough to, before it was proved to be so held. This seems to go too far; but it must be admitted that the quantum of proof is troublesome.\textsuperscript{79} It would seem that the tax adviser should examine the method of separation and bookkeeping used by the taxpayer and insist that some formalized method or pattern be adopted to set aside, select, or determine the animals to be held as breeders. Such should be provable on physical facts and as a matter of record. It would seem clear that confusion in the taxpayer’s selection or recording methods will weight heavily against his assertions of sales of breeding stock.

3. Sale of Unharvested Crop

The new Act\textsuperscript{80} settles the sharp difference that arose between the Tax Court and the district courts over the tax treatment of growing crops sold with land. Both the Bureau\textsuperscript{81} and the Tax Court\textsuperscript{82} saw the crops as held primarily for sale to customers and therefore required the value of the crops treated as ordinary income. The Federal district courts drew upon their property law to see the crops as part of the land and non-separable for tax purposes.\textsuperscript{83}

The new amendment to section 117(j) regards crops as part of

\textsuperscript{77} U. S. Treas. Reg 111, § 29.22(c)-6 (1943).
\textsuperscript{78} William Wallace Greer, Jr., 17 T. C. No. 114 (Dec. 7, 1951); James L. McDonald, 17 T. C. No. 25 (Aug. 14, 1951); Walter S. Fox, 16 T. C. No. 854 (April 20, 1951). See also colloquy and letters, 97 Cong. Rec. 12, 585 et seq. (Sept. 28, 1951).
\textsuperscript{79} For recent discussion, see Comment, 24 Rocky Mt. L. Rev. 231, 234 (1952).
\textsuperscript{80} § 117(j) (3), 24(f), and § 113(b) (1)(L), added by § 323 Rev. Act.
\textsuperscript{82} Earnest A. Watson, 15 T. C. 800 (1950); Thomas J. McCoy, 15 T. C. 828 (1950).
the land and permits capital gain treatment of the proceeds if the usual 117(j) tests are met, (i.e., used in trade or business, held for more than six months, etc.) and if the crops and land are sold, or exchanged (or compulsorily or involuntarily converted), to the same person at the same time.

However, recognition of the fact that the cost of producing the crop would normally be deducted against ordinary income results in a denial of the deduction of the costs of raising the crop. Thus, a new section 24(f) denies the deductions pertaining to raising the crop and a new section 113(b)(1)(L) provides that the total amount of such costs shall be the basis of the crop for purposes of determining the gain on the sale. It is difficult to see how well this requirement can be met practically. In theory, the mill would grind so fine as to reach the proportionate share of the depreciation on the pump that provides water to quench the thirst of the hired man on the days he works in the fields. Where the whole farm is sold, with crops, and the crops represent the only produce, presumably all expense items went to produce that crop. Expenses deducted in a previous year applicable to the crop sold would also be disallowed. The seller no longer cares about allocation of selling price to land and crops. Failure to make such a segregation in the sale contract can trap the buyer. When he harvests and sells the crops, he receives ordinary income measured by the difference between the proceeds on the sale and the amount that he can prove to be the basis of the crops in his hands.84

4. Replacement of LIFO Inventories

The Act fills a hole in the provisions relating to replacement of LIFO inventories involuntarily liquidated.85 Previous provisions permitted replacement of inventories depleted during World War II prior to the end of 1952, thereby qualifying for refunds for the year of liquidation.86 Subsequent legislation provided for similar replacement of liquidated inventories prior to the end of 1955.87 However, the law required that replacement be attributed to the most recent liquidations not replaced.88 The overlapping of the two periods meant that a replacement before the end of 1952 had to be

84. For a taxpayer in such straits, see Marian L. Bloxom, ¶ 52,079 P-H Memo TC (March 24, 1952).
85. § 22(d) (6) (F) (iii) before amendment.
86. § 22(d) (6) (A); Min. 6361, 1949-1 Cum. Bull. 126, providing for interim or accelerated refunds.
87. § 22(d) (6) (F).
88. § 22(d) (6) (C).
regarded as replacement of liquidation resulting from the emergency, thus making it difficult to replace World War II liquidations within the qualifying time.

The new law solves that problem by providing that replacements made prior to 1953 are to be first considered as replacements of World War II liquidations. It applies to taxable years ending after June 30, 1950. The effect of this provision will of course be limited to taxpayers who made timely notification of intent to replace such liquidated inventories.

5. Net Operating Loss

In 1950, the Revenue Act of that year changed the treatment of the net operating loss carry-back and carry-over from two years each way to one year back and five years forward. This was effective for losses occurring in 1950 and later years, while losses of prior years remained on the old basis of four years.

The latest enactment, the Revenue Act of 1951, permits net operating losses of the years 1948 and 1949 (or fiscal years beginning in 1948 or 1949) to be carried forward for one additional year for a total of three years. The two year carry-back for those years remains, making a total of five offsetting years for 1948 and 1949 losses. Thus, if a 1948 net operating loss was not exhausted by the income of 1946, 1947, 1949 and 1950, it should have been used to offset 1951 income. Such a loss for 1949 would be applied against the income of 1947, 1948, 1950, 1951 and 1952. Losses in 1950 and subsequent years fall into the regular six year pattern, one year back and five years forward.

C. Mines and Minerals

Tax advantages for mines flow from the 1951 Act in four specific areas. The percentage depletion provisions have been liberalized; limited deductions for exploration expense are now permitted; development expense of mines may be currently deducted, if the taxpayer so elects; and special capital gains treatment is granted to coal royalty contracts. None of these provisions refer to oil and gas wells.

1. Extension of Percentage Depletion

The Act extends percentage depletion to additional minerals

89. § 306 (b) Rev. Act.
90. U. S. Treas. Reg. 111, § 29.22(d) -7 (1943).
91. § 215 (a) Revenue Act of 1950, amending § 122 (b).
92. § 215 (b) Revenue Act of 1950; § 122 (b) (2) (B).
93. § 122 (b) (2) (A) before amendment by 1951 Act.
94. § 330 (b) Rev. Act, adding § 122 (b) (2) (C).
and increases the allowable percentage on some others, effective for years beginning after December 31, 1950.

Percentage depletion at the rate of five per cent (5%) is extended to the following minerals: sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine.

Coal is increased to a ten per cent (10%) rate, and there is added to the list entitled to such rate: wollastonite, asbestos, calcium carbonates (other than marble and oyster and clam shell), perlite, dolomite, brucite, magnesite, and magnesium carbonates.

At a fifteen per cent (15%) rate, the following are added: borax, fuller's earth, tripoli, refractory and fire clay, quartzite, aplit, garnet, diatomaceous earth, and metallurgical and chemical grade limestone. With respect to thenardite, previously in the fifteen per cent class, the parenthetical limitation “from brines or mixtures of brine” is stricken.

2. Exploration Expenses

Prior to the 1951 Act, exploration expense was capitalized and recovered through the allowance for depletion, or taken as a loss if no results were obtained. Where percentage depletion was used, the capitalized cost had no relationship to the amount of the depletion deduction.

The new law permits deduction of expenditures “for the purpose of ascertaining the existence, location, extent, or quality” of mineral deposits, except oil and gas. Two limitations exists: (a) the costs are those paid or incurred prior to the development stage of the mine or deposit, and (b) the total deductible expense under this section for any one year cannot exceed $75,000. The latter is a limitation on expenses for each taxpayer, not for each mine or exploratory venture. In addition the statute spells out a limitation that is logically inherent; to wit, the cost of depreciable property is not an exploration expense, but the actual depreciation allowance on such property may very well be an exploration cost.

95. § 319(a) Rev. Act.
96. § 319(c) Rev. Act.
97. § 114(b) (4) (A) (i).
98. § 114(b) (4) (A) (ii).
99. § 114(b) (4) (A) (iii).
101. § 342(a) Rev. Act adding § 23(ff).
102. § 23(ff) (f)
The provision is optional with the taxpayer, up to a point. He may elect whether to deduct or treat as a deferred expense the first $75,000 of exploration expense; any excess is to be capitalized in either event. His election is made each year, and is binding only for that year. However, this is a four strike game. When the taxpayer (including any predecessor whose basis he had to adopt), has taken the deduction or made the election to defer the expense in any four years, his privilege under the section expires, and all such costs must be capitalized thereafter.

Exploration costs treated as deferred expenses under the option are subject to amortization and deductible on a ratable basis as the units of produced ores or minerals are sold. These deferred expenses will go to increase the adjusted basis of the property for gain or loss, and the amortization thereof will decrease the basis, but such expenses will not affect the basis for depletion. The deferred exploration expenses thus stand alone, and are not absorbed into the depletion deduction. It would appear that for taxpayers using cost depletion, the exploration expense deduction serves in lieu of the depletion deduction, while under percentage depletion, it may be in addition to the allowance for depletion. Capitalization of expenses beyond the limitations fall into the old pattern of recovery by depletion.

3. Development Expenses

Costs of developing mining property prior to the productive stage have hitherto been capitalized and recovered through the allowance for depletion. After the production stage is reached continued expenditures necessary to maintain production are generally deductible currently, while extraordinary expenditures are treated as deferred expenses allocable to the production and sale of the ores or minerals benefited thereby.

Now, the taxpayer is authorized to deduct development expenses in the year paid or incurred, but he may elect to treat them as deferred expenses recoverable on a ratable basis as the ores or minerals so benefited are sold. The amount deferrable in any

103. § 23(ff) (2).
104. § 23(ff) (3).
105. § 23(ff) (4).
106. To the extent that there were net receipts, such costs were offset, and the excess capitalized. U. S. Treas. Reg. 111, § 29.23(m)-13 (1943).
107. Ibid. Problems of determining when the production stage begins are unchanged.
108. § 23(cc), added by § 309(a) Rev. Act. The deduction is not allowed for costs deferred by a prior owner from whom the property was purchased.
one year is limited to the excess over net receipts from ore or minerals produced. The election to defer may be made annually, and must include all of the development expenses (or excess, as the case may be) for the particular mine or deposit involved.\textsuperscript{109}

This section ties in with the exploratory section, and the development stage is assumed to begin "after the existence of ores or minerals in commercially marketable quantities has been disclosed."\textsuperscript{110} As in the exploratory expense rules, here too cost of depreciable property is not a proper development expense, but the allowance for depreciation may be. Similarly, if election is made to defer the expense, the basis for gain or loss is thereby increased, and as the deferred expense is amortized, the basis is adjusted downward.\textsuperscript{111} Such expenditures, however, are not to affect the basis for depletion. The latter point is justified as a means of preventing duplication of tax benefit.\textsuperscript{112} This is true with respect to cost depletion, but it could redound to the additional advantage of the taxpayer using percentage depletion.\textsuperscript{113}

Regulations to be promulgated by the Secretary under the exploration and development provisions will probably not be notable for their brevity. Much detailed explanation can be expected as well as provisions relating to the method of electing the options for exploration and development expenses. It will behoove the taxpayer to examine each year with care and to forecast his future operations and the fate of his industry. Each election will bind him for that year, although he is free to shift in another year. The four time limitation on exploration elections and the overall limit should be an important guide. It may be as easy to start exploring after the turn of the taxable year as before, thus building the expense deduction close to the limit rather than spreading it over two years to waste the dollar limit and an extra strike.

4. \textit{More Capital Gains}

The owners of timber contracts had it.\textsuperscript{114} Now the owners of coal royalties have it, and for this purpose "coal" includes lignite.\textsuperscript{115}

By amendment to section 117(k) (2) if coal in place, held for

\begin{itemize}
  \item \textsuperscript{109} § 23(cc) (2). Note the absence of dollar or time limitations. \textit{Cf. Exploration Expenses, text p. 851 supra.}
  \item \textsuperscript{110} § 23(cc) (1).
  \item \textsuperscript{111} \textit{Ibid.}
  \item \textsuperscript{112} Sen. Fin. Comm. § VI (A) (10).
  \item \textsuperscript{113} But see argument of Sen. Fin. Comm. that percentage depleters were discriminated against. \textit{Ibid.}
  \item \textsuperscript{114} § 117(k) (2), added in 1943.
  \item \textsuperscript{115} § 325(b) Rev. Act, amending § 117(k) (2).
\end{itemize}
more than six months is sold under a contract by which the owner retains an economic interest in the coal, the difference between the amount realized and the adjusted depletion basis shall be regarded as a gain or loss upon the sale of the coal. This brings the transaction within the scope of section 117(j) so that the net gain (from this and other section 117(j) assets) is treated as a long term capital gain. However, the owner is thereby denied an allowance for percentage depletion. The date of disposal of the coal is specified as the date that it is mined, not the date of the leasing or royalty contract\textsuperscript{116} thus fixing the holding period. This makes it possible to fix the holding period at more than six months,\textsuperscript{117} while firming the deal at an earlier date. The new provision applies regardless of the contract date, but only to amounts received in years beginning after December 31, 1950.

A possible trap exists in the provision of the statute that denies capital gain treatment on this type of transaction if the owner of the coal is involved in the mining of it as a co-adventurer, partner, or principal. It is proper to assume that sham transactions arranged to cloud the owner-operator aspect will be quickly challenged.

D. Employees

Several provisions redound to the benefit of particular employees. These provisions are limited to special situations, and some represent no new conceptions but are extensions or clarifications of positions taken under previous acts. However, it seems advisable to mention them since affected persons may be unaware of the provisions and it becomes counsel's responsibility to recognize the tax advantages.

1. Termination Payments

Where an employment contract provides for payments to an employee, after termination of employment, based upon a sharing of future profits or receipts, such payments are in the nature of deferred compensation, taxable as ordinary income, whether received as a lump sum, or in installments.\textsuperscript{118} To leave his retirement funds to the risk of the business after the taxpayer left it, or to take a lump sum payment and share a substantial amount of it with his fellow taxpayers was a choice that would shake Hobson. The new Act dulled the second horn of the dilemma.

\textsuperscript{116} Cf; U. S. Treas. Reg. 111, § 29.117-8 (1943).
\textsuperscript{117} To qualify under § 117(j).
\textsuperscript{118} U. S. Treas. Reg. 111, § 29.22(a)-2 (1943).
In certain cases an employee may now release all such rights and accept a lump sum payment, which will be treated as a long term capital gain. The statutory provision is highly restrictive, requiring (a) employment by the contracting employer for more than 20 years, (b) that the released rights be a part of the employment terms for not less than 12 years, (c) that the released rights extend for life or for not less than five years, (d) that the release be made after termination of employment, and convey all rights to future profits, but no other rights, and (e) that the funds be received after termination of employment and in one taxable year.

Any attempt to convert ordinary income to capital gain under this provision amounts to an exercise in meeting the exact statutory conditions. Some factual arguments will appear, but generally it should be clear whether or not the statute can be met.

2. *Stock Purchase Option*

Favorable treatment was granted to an employee exercising a "restricted stock option" granted by his employer corporation under section 130A of the Code. No taxable income resulted from the exercise of such an option if at the time of granting the option the option price was at least 85% of the market price, even though at the time of exercise the market price far exceeded the purchase price.

Where the option had to be approved by stockholders, normal delay in securing such approval could result in disqualifying the option under the 85% limitation if the market rose. To insure continuous qualification of this "incentive device," the current Act provides that the market value on the date of granting rather than on the date of approval of the option shall determine whether the 85% limit is met. Thus, the provision is limited to those options which must be approved, whether the requirement of approval is express or implied or arises by voluntary submission. The amendment covers any modification, extension or renewal of the option. It is effective as if it had been enacted as part of section 218.
3. Stock Distributions under Profit Sharing Plans

This provision is also designed to bolster up a benefit or relief provision previously existing. Where, in a single year, an employee withdraws from a pension or profit sharing fund, exempt under section 165, the total amount payable to him because of his leaving the service of his employer, the excess of the cash or market value of stock received over the amount he contributed to the fund is treated as a long term capital gain. Where the fund had been invested in stock of the employer corporation and the stock had appreciated in value, the employee, under this rule, was being taxed upon the appreciation at the time he received the stock, although he had not realized the income through disposition of the stock.

The new Act reaches this feature and provides that the appreciation in value of securities of the employer corporation, accruing between the time of deposit in the fund and the time of distribution to the employee, shall be taxed when the securities are sold or disposed of, rather than in the year received. Thus the “amount realized” in the year of withdrawal will be the cash plus the amount that the fund or trust paid for the securities. Regulations to be issued will fill in the details of the statute relative to the amount of unrealized appreciation, basis adjustments, holding period, and definition of securities.

The amendment suggests two lines of tax planning. If such stock or securities are retained and passed through the employee’s estate the unrealized gain will never be picked up for income tax purposes. Where an employee withdraws his share on retirement, a judicious plan of liquidation over the subsequent years while his income is low can reduce the taxes on the total appreciation to a negligible figure.

124. § 331(b) Rev. Act.
125. § 218(b) Revenue Act of 1950. See T. D. 5911 (June 5, 1952).
126. Certain trusts or plans set up for the benefit of employees which meet the specifications of § 165 result in current deductions to the employer, no income tax to the trust, and deferment of taxability of the income of the employee until distribution. §§ 23(p), 165(a), 165(b).
127. § 165(b) ; U. S. Treas. Reg. 111, § 29.165-5 (1943).
128. § 335(a) Rev. Act, amending § 165(b).
129. No suggestion is made in the statute whether the holding period begins at the time of acquisition by the trust, or distribution to employee.
130. A partial definition of “securities” is included in the amendment: stocks and bonds or debentures, with interest coupons or in registered form, of the employer corporation, its parent or subsidiaries (as defined in § 130A (2) and (3)).
4. **Life Insurance Salesmen**

In connection with stock bonus, pension, profit sharing and annuity plans and trusts, a very harsh result was manifest in the case of a full time life insurance salesman. Because he was technically not an "employee," on retirement when the rights became non-forfeitable the entire fund available to him in excess of his contributions thereto, became immediately taxable as ordinary income.\(^{131}\)

The Revenue Act of 1951\(^ {132}\) adds a new subsection (20) to section 3797(a) specifying that if a full time life insurance salesman is considered as an employee for Social Security purposes, he shall be considered as an employee with respect to contributions under a stock bonus, pension, profit sharing or annuity plan or trust. The definition is made retroactive to taxable years beginning in 1939.\(^ {133}\) Claims for refund may be in order on open years.

Digressing for a moment, comment on the general impact of these plans may not be amiss at this point. The provisions concerning employee benefit plans in the last Revenue Act are not unexpected, since such plans are just burgeoning into full bloom. Other hardship cases may arise and receive more or less gentle treatment in subsequent acts. It would seem that no case involving an apparent harsh result under the words of the statute should be closed as long as the possibility exists of corrective legislative action or liberalized Bureau policy based upon the apparent intent of the Congress to avoid arbitrary results under the benefit plan pattern. For some years now, interest in such plans was pretty well limited to corporate attorneys, retained counsel, and specialists in establishing qualified plans. It is already becoming apparent, as the plans increase and as they begin to pay off to employees and their beneficiaries, that the lawyer in general practice must add to his working kit a knowledge of the employee's rights and the tax results to the individual that inevitably stem from distributions under the plans, not only for income tax purposes, but also in connection with his efforts in estate work and planning.

E. **Beneficiaries of Decedents**

The estate, beneficiary and survivor of a decedent receive favorable income tax treatment in three specific situations.

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132. § 343(a) Rev. Act.
133. § 343(b) Rev. Act.
1. Redemption of Stock to Pay Death Taxes

Under section 115(g) a redemption of stock may be regarded as “essentially equivalent” to the issuing of a dividend and so taxed. In 1950, the Revenue Act provided that redemption of stock in a decedent’s estate in an amount no more than enough to pay combined death taxes would not be treated as equivalent to a dividend. However, stockholdings of the decedent had to comprise more than 50% of the value of the net estate. Apparently, the cries of persons whose stock would comprise a lesser share were heard by the Senate and it recommended that the restriction be reduced to 25% of the value of the net estate. The provision of the Revenue Act of 1951 sired by the Senate Bill and “damned” by the Conference Committee, came out as “more than 35 per centum of the value of the gross estate.” This may or may not relieve—it could well be a higher figure than 50% of the net estate.

In a recent article, Mr. Gordon D. Simons offers a plausible, if depressing, explanation and points out, logically, that the section should be re-examined. Such relief as is afforded goes to the estate with shares in a single corporation, but no relief is extended to the estate with shares in two corporations, each block amounting to 30% of the gross estate. Such a percentage limitation makes estate planning difficult since a variation in value of the other items to be included in the gross estate, a failure to estimate 811(c) vagaries of valuing the stock itself, inopportune borrowings that increase the gross estate but not the net, as well as other factors, increase the hazard of meeting the percentage limitation on the gross estate. The amendment applies to distributions made after the date of the Act, October 20, 1951.

2. Joint and Survivor Annuities

Prior law provided that annuity payments made to a survivor

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134. Rather than as a “liquidating” dividend under § 115(c) giving rise to capital gain.
135. § 115(g) (3), added by § 209(a) Revenue Act of 1950.
136. Ibid.
137. Sen. Fin. Comm. § VI (B) (10).
139. Simons, Redemption of Stock to Pay Death Taxes, 30 Taxes 42 (1952), in which the author draws the analogy to two farmers arguing about the price of corn. One wanted to sell for 50c; the other would buy for 25c a bushel. So they compromised on 35c per half bushel.
140. “... Provided, that the value of the stock in such corporation ...” § 115(g) (3).
141. Life time transfers included in gross estate, joint interests, power property, and insurance.
142. § 320(b) Rev. Act.
under a joint and survivor annuity policy were subject to income tax as a continuation of the original policy.\textsuperscript{142} Thus the basis to the survivor for purposes of applying the 3% rule was the original cost of the policy.\textsuperscript{144}

Sections 22(b)(2) and 113(a)(5) were amended by the Revenue Act of 1951 to provide that where the value of the annuity is includible in the decedent's gross estate, the survivor's basis for income tax purposes is the value assigned to the survivor's rights in the decedent's gross estate.\textsuperscript{146} It applies to survivors of decedents who died after December 31, 1950.\textsuperscript{146}

3. Payments to Beneficiaries of Deceased Employees

A death benefit paid by an employer to a beneficiary of an employee up to $5,000 is excluded from gross income of the beneficiary. In effect, such payments are treated like life insurance proceeds through amendment of the insurance provision, section 22(b)(1).\textsuperscript{147} The payment must be made under a contract binding the employer to make such payments. The $5,000 exclusion refers to a payment by a single employer for a single employee. If payments are made by more than one employer or if a beneficiary receives death benefits under contracts of more than one employee, there can be more than one exclusion. Several beneficiaries who share the benefit will apportion the exclusion. Payments may be made in a single sum or otherwise, but if the amount is held by the employer under an agreement to pay interest the interest is taxable.

III. LOOPHOLES

"Loophole," as any friend of Groucho Marx will agree, is a word to warm political hearts. Great speeches can be built around closing Big Tax Loopholes. It is true that a few are closed here and there, but it would be interesting for someone to assess the revenue protected against the cost of the fuss. The Revenue Act of 1951 was touted as a "loophole closer," even though it opens a few questionable ones. It is hard to find many real revenue savers.

A few additional taxpayers are added to the rolls, e.g., state col-

\textsuperscript{143} I. T. 3653, 1944 Cum. Bull. 75; Anna E. Curtis, 8 T. C. 266 (1947); Ella B. Higgs, 16 T. C. No. 2 (Jan 8, 1951); U. S. Treas. Reg. 111, § 29.22
\textsuperscript{144} I. T. 3077, 1937-1 Cum. Bull. 136; § 22(b)(2).
\textsuperscript{145} § 303(a) Rev. Act, amending § 22(b)(2); § 303(b) Rev. Act, amending § 113(a)(5).
\textsuperscript{146} § 303(b) Rev. Act.
\textsuperscript{147} § 302(a) Rev. Act, adding § 22(b)(1)(B).
leges and universities for unrelated business income,\textsuperscript{148} farmers' cooperatives for unallocated dividends,\textsuperscript{149} savings banks and building and loan associations,\textsuperscript{150} and Federal savings and loan associations.\textsuperscript{151} Certain controls have been tightened up, e.g., collapsible corporations,\textsuperscript{152} and investments of security dealers.\textsuperscript{153} Informational techniques are strengthened in the reporting of interest income.\textsuperscript{154}

Two loopholes previously available to the not-much-above-average taxpayer have been sealed off. The first is the new capital gain computation; the other is the ban on the sale of depreciable property to a spouse or a controlled corporation.

A. \textit{Capital Gains and Losses}

A provision, friendly to many taxpayers for many years, passed into oblivion with the year 1951. Every tax planner knew the ropes of offsetting \$2 of long term gain with a \$1 of short term loss, and as much as any other provision it became a by-word for year-end planning.

The new law changes the method of computation of gain or loss on the sale or exchange of capital assets.\textsuperscript{155} Long and short term gains and losses are segregated as before but long term as well as short term gains and losses are taken into account in full instead of at 50\%. If the taxpayer's net long term gain exceeds the net short term loss (or zero, as the case may be), then the taxpayer is entitled to a deduction in the amount of 50\% of the excess of the net long term gain over the net short term loss. This is effected by a new section 23(ee).

As far as the individual taxpayer is concerned, the new law may or may not result in a tax different than under the old system. If the taxpayer has only a long term gain or a net long term gain, the new method comes out the same as the old. If he has a net long term

\begin{flushleft}
\textsuperscript{148} § 339 Rev. Act, amending §§ 421(b) (1) and 422(b).
\textsuperscript{149} § 314(a) Rev. Act, amending § 101(12).
\textsuperscript{150} § 313(b) Rev. Act, amending § 101(4); § 313(a) Rev. Act, repealing § 101(2).
\textsuperscript{151} § 313(d) Rev. Act, amending HOLC Act, thereby removing the exemption under § 101(15).
\textsuperscript{152} § 326 Rev. Act, amending § 117(m).
\textsuperscript{153} § 327 Rev. Act, adding § 117(n).
\textsuperscript{154} § 333 Rev. Act, amending § 147. The Commissioner may now require information returns in the case of interest payments regardless of amount.
\textsuperscript{155} § 322 Rev. Act, amending § 117(c) (2) and § 117(b), “effective for years beginning after October 20, 1951.”
\end{flushleft}
gain and a net short term loss, he loses under the new method. If the
taxpayer has a net long term capital loss (in excess of net short
term gain), he may be better off under the new method, since
100% is taken into account against the $1,000 limit\textsuperscript{156} and carried
over for five years.\textsuperscript{157}

The alternative tax computation for 1952 and later years will
be changed somewhat because of the capital gains tax rate increase
to 26% and the new method of handling long term gains. Capital
loss carry-over from 1951 is computed under the old law, and
under the new law from 1952 forward.\textsuperscript{158}

Two matters expressly affect trusts and estates. The fiduciary
does not include in computing the 50% deduction the amount of
capital gain to be reported by income beneficiaries.\textsuperscript{159} Where any
part of a capital gain is included in a charitable deduction, appro-
 priate adjustment must be made in the 23(ee) deduction.\textsuperscript{160}

\section*{B. Sale of Depreciable Property}

It is elementary that a piece of property may be depreciated anew
in the hands of each purchasing taxpayer. A hitherto method of con-
verting ordinary income to capital gain used this simple principle.
Suppose low basis property owned by a husband is sold to his wife,
capital gain being recognized and the tax paid. The wife with a new
high basis determined by the cost to her, takes annual deductions
for depreciation offsetting ordinary income. Thus within the family
circle a capital gain is traded for an offset of the same amount against
income taxable at regular rates over a period of years. The same
arrangement could have been worked out between an individual and
his controlled corporation. It is an advantageous deal when the asset
does not leave the inner circle. Such a scheme could be challenged
as sham and if so would fall; but if the sale was complete, it would
stand.

The Revenue Act of 1951 seeks to dissuade the taxpayer by
denying to the seller capital gain treatment.\textsuperscript{161} He may of course
go ahead with the plan, but the result will be a piling of ordinary

\begin{itemize}
\item \textsuperscript{156} § 117(d).
\item \textsuperscript{157} § 117(e).
\item \textsuperscript{158} § 322(d) Rev. Act.
\item \textsuperscript{159} § 117(b), amended by § 322(a) (2) Rev. Act.
\item \textsuperscript{160} § 162(a), amended by § 322(c) (5) Rev. Act.
\item \textsuperscript{161} § 117(o), added by § 328 Rev. Act, treats the gain as one from
the sale or exchange of property which is neither a capital asset nor property
included under § 117(j).
\end{itemize}
income in a single year for the seller, while the offsetting deductions of the buyer are spread over a period of years, normally a disadvantageous trade.

The new section 117(o) is narrow, reaching a sale or exchange of depreciable property only if it is directly or indirectly between husband and wife, or individual and his controlled corporation. For this purpose, "control" means more than 80% of the stock owned by the individual, his spouse and his minor children and grandchildren. The section applies to taxable years ending after April 30, 1951, and sales made after May 3, 1951.162

Two points are worth noting. First, the section can be a trap for a taxpayer who makes such a sale for perfectly legitimate business reasons without tax advice. Second, the tax advantage still exists in the family corporation that does not meet the test of control, e.g., shares held by adult children, among other relatives and friendly third parties (though reciprocal sales would hardly be advisable), in some partnership situations, and in other arrangements whereby the taxpayer moves through or around the words of the statute.

IV. CONCLUSION

The foregoing represents but a sketch of a part of the Revenue Act of 1951. It serves only to suggest and invite attention to some of the sections that may be important to individual taxpayers. Many other provisions are important to attorneys in general practice. Too often it is felt that narrow provisions of a tax statute are fodder for experts in plush offices, and not the concern of little taxpayers and their attorneys. Yet so many apparently limited, special, or technical sections reach out and affect the individual taxpayer that the attorney in general practice is hard pressed to maintain his awareness in so many unrelated areas. The small cooperative, the operator of a little quarry, the teacher who took a job abroad, all affected by the new act, may not be aware of it. The attorney who settles the farm cooperative's squabbles, who handles the quarry's property problems, who drafts the will upon the teacher's sudden realization of the hazards of travel, must also point out that the cooperative may need to plan for the 1952 tax change, that it would be worthwhile to determine whether the quarry is entitled to percentage depletion, that the teacher's foreign income might be tax exempt. A more vivid example indicates the effect of a new section

162. § 328(b) Rev. Act.
of the Code upon an apparently unrelated taxpayer. The new gambling taxes are popularly considered to be designed to cope with organized crime, yet the Bureau has already had occasion to explain how small merchants can be liable for the wagering tax as a result of previously accepted merchandising schemes.163

The taxpaying base becomes broader. The Revenue Acts pile up more detailed provisions. Tax consciousness increases. It seems to lead to the unhappy result that the little taxpayer's problems approach those of the big fellow in number and complexity, albeit not in amount.