

Income Tax--Basis for Determination of Gain (James Richardson et al. v. William J. Conway et al. (W.D. Wis. 1930))

St. John's Law Review

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Recommended Citation

St. John's Law Review (1930) "Income Tax--Basis for Determination of Gain (James Richardson et al. v. William J. Conway et al. (W.D. Wis. 1930))," *St. John's Law Review*: Vol. 5 : No. 1 , Article 34.

Available at: <https://scholarship.law.stjohns.edu/lawreview/vol5/iss1/34>

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However, in *Long v. Rockwood*,¹⁹ the Supreme Court denied the state of Massachusetts the right to tax income received from one of her residents as royalties for the use of patents issued to him by the United States, as it was a direct tax on an instrumentality of the Federal Government. Mr. Justice Holmes dissented in a strong opinion in which Mr. Justice Stone, Mr. Justice Brandeis, and Mr. Justice Sutherland concurred.²⁰ The learned justices (excepting Mr. Justice Sutherland) also dissented from the prevailing opinion in *Macallen v. Massachusetts*²¹ where the decision would seem to make no distinction between direct and excise taxes when levied on Government instrumentalities, thus departing from the rule as stated in *Flint v. The Stone Tracy Company*.²²

As shown from the study of the strong dissenting opinions in past decisions on the point involved the sound rule from a legal, economic and political view would be that advanced in the instant case which follows the dissenting opinion of Mr. Justice Stone in *Macallen v. Massachusetts*.²³ Once the income from the copyright has become the personal property of the owner and intermingled with his assets, it is difficult to ascertain how an indirect state tax thereon is an interference with an "instrumentality of the Federal Government." A substantial distinction between gross returns and net receipts clearly shows that the tax is in effect imposed upon the franchise and not directly upon exempt property. The present decision, it is clear, is supported by the weight of authority and should be upheld.

C. A. B.

INCOME TAX—BASIS FOR DETERMINATION OF GAIN.—Prior to November 19, 1925, the plaintiff, Jessie P. Richardson, owned all the issued capital stock of the Waupaca Electric Service and Railway Company, consisting of 501 shares, and on the date last mentioned sold the same to Wisconsin Valley Electric Company; 101 shares to be delivered and paid for immediately, \$36,791.25 being paid therefor, and 400 shares to be paid for and delivered in eight installments, in lots of fifty shares each, over a period of four years, \$18,213.50

¹⁹ 277 U. S. 142, 48 Sup. Ct. 463 (1928).

²⁰ *Supra* Note 19. Mr. Justice Holmes dissenting: "The fact that the franchise came from a grant by the United States is no more reason for exemption standing by itself, than is the derivation of the title of a lot of land from the same source. *Baltimore Shipping and Drydock Company v. Baltimore*, 195 U. S. 375, 25 Sup. Ct. 50 (1904). Why cannot a state tax a patent by a tax that in no way discriminates against it? Obviously it is not true that patents are instrumentalities of the government—they are used by the patentees for their private advantage alone."

²¹ *Supra* Notes 1, 9.

²² *Supra* Notes 10, 11.

²³ *Supra* Note 9; see (1930) 4 St. John's L. Rev. 314.

being paid for each lot; the 400 shares to be held in escrow by the Minnesota Loan and Trust Company. Purchaser was to have voting power on all the shares, and pay interest on the unpaid portion of the purchase price. This was an isolated transaction, and not in the usual course of business.¹ Plaintiff now seeks to enjoin the defendants, who constitute the Tax Commission of Wisconsin, from assessing the entire purchase price as 1925 income. The taxpayer did not reside in Wisconsin after 1925. For that reason the gain from the sale of stock to be delivered during 1926 to 1929, inclusive, could not be taxed in Wisconsin unless it was 1925 income. Jurisdiction is predicated on the residence of plaintiffs in Minnesota, and the amount in controversy being more than \$3,000. *Held*, that the full beneficial interest in the stock passed to the vendee in 1925, and its liability to pay therefor and to pay interest then became absolute, and the gain thereof was taxable as income. *James Richardson et al. v. William J. Conway et al.*; District Court for the Western District of Wisconsin (1930).

Every method or system of taxation is based upon a definite and clearly understood method of accounting. There are several such methods, the ones in which we are presently interested being the cash receipts and disbursements method,² the accrual method,³ and the installment method.⁴ These are the recognized accounting methods, on one of which the Tax Commission must have based its assessment. The question now arises on what basis is one to be taxed who, because a transaction was merely casual, has kept no books, as in the instant case. Section 71.02 (3) (a) of the Wisconsin statutes⁵ gives the Tax Commission the right to determine upon what accounting basis an assessment shall be made where no books are kept, or when the

¹ An isolated or casual sale means "a chance transaction and one not regularly occurring in the business." *Installment Sales Pamphlet*, Bureau of Internal Revenue, p. 13. Also G. M. C. 1162. C. B. VI-1, 22.

² In order to keep books on the basis of actual receipts and disbursements, credits yet to become due or obligations yet to be paid, would have to be ignored. *Aluminum Castings Co. v. Routzahn*, 24 F. (2nd) 230 (1928).

³ The books are kept on an accrual basis whenever entries are made of credits and debits as the liability arises, whether then received or disbursed. *Aluminum Castings Co. v. Routzahn*, *supra* Note 2.

⁴ "Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan, may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price." Rev. Act of 1928, sec. 44.

⁵ Persons who customarily estimate their incomes or profits on a basis other than cash receipts and disbursements may, with the consent and approval of the tax commission, return for assessment and taxation the income or profits earned during the income year, in accordance with the method of accounting regularly employed in keeping their books, except as hereinafter provided; but if no such method of accounting has been employed, or if the method used does not clearly reflect the taxable income, the computation shall be made upon such basis and in such manner as in the opinion of the Tax Commission will clearly reflect such income.

method used does not clearly reflect the taxable income. Under this provision the Commission's determination, which the Court sustained, was that the accrual method should be the basis of the assessment, since the instant the plaintiff received the contract she surrendered the benefits of her stock and possessed the unqualified obligation of a vendee fully able to meet it, which was assignable and undoubtedly convertible into money, and therefore taxable as present income. This rule of the Wisconsin court is diametrically opposed to the Federal rule. The Board of Tax Appeals has held that most taxpayers are not compelled to keep books, but unless they do, they cannot report on any other basis than the cash receipts and disbursements basis.⁶ On the basis of this holding, therefore, the plaintiff was taxable in 1925 only on the money she actually received during that year, since she kept no books she is taxable on the cash receipts and disbursements basis. However, the Federal Income Tax Law makes further provision for the accounting of sales made on the installment plan: "In the case (1) of a casual disposition of personal property * * * for a price exceeding \$1,000, or (2) of a sale or other disposition of real property if in either case the initial payments do not exceed forty per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision."⁷ "As to this type of transaction (casual sale on the installment plan) it is apparent that to fulfill the statutory requirement and thus be privileged to compute the reportable gain on the installment basis, four tests must be met."⁸ In a conflict between the decision of a court and statutory provision, the statute must prevail so that under the Federal rule the plaintiff would be taxable under section 44. It is submitted that the Federal rule seems both more reasonable and equitable, since the primary reason for such regulation as provided by section 71.02 (3) (a)⁹ is to regulate accounting by merchants of their business gains¹⁰ rather than individual transactions by people not engaged in business.

V. B.

⁶ "An accrual method without accounting records is an anomaly." Brander, 3 B. T. A. 231, 235 (1926); Thompson, 7 B. T. A. 391 (1927).

⁷ *Supra* Note 4.

⁸ "(1) The sale or other disposition must be of personal property; (2) It must be a casual sale or other casual disposition; (3) The selling price must be more than \$1,000; (4) The initial payment must not exceed forty per cent. of the selling price." (Klein, Federal Income Taxation, 814.) Clearly, on the basis of this test, the case falls directly within the provisions of the statute. The contract was a casual one for the sale of personal property for more than \$1,000 on the installment plan, the initial payment being less than forty per cent. of the selling price.

⁹ *Supra* Note 5.

¹⁰ State *ex rel.* Waldheim Co. v. Tax Commission, 187 Wis. 539, 204 N. W. 481 (1925).