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Income Tax--Basis for Determination of Gain (Aluminum Casting Company v. Routzahn, 282 U.S. 92 (1930))

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EXCISE TAX—CONSTITUTIONAL LAW—POWER OF STATE TO TAX INCOME FROM COPYRIGHT.—Plaintiff, a domestic business corporation, derived its income solely from copyrights granted by the United States on motion picture films. These copyrights were not all held in the name of the plaintiff corporation, but the latter owned and received the income from all the copyrights. The State, in determining plaintiff's franchise tax, used the income derived from the copyrights as a measure of the tax. Plaintiff sought to enjoin defendant from collecting the tax on the ground that a direct tax on incomes from copyrights may not be levied by the State. On appeal from a decree dismissing the petition, *Held,* affirmed. This nondiscriminatory tax is not directly on income but is purely an excise. The copyright income was merely a casual incident in the determination of the franchise tax which directly imposes no burden on the federal government. Educational Films Corporation of America v. Hamilton Ward, Atty.-Gen. of N. Y., 51 Sup. Ct. 170 (1931).

For a discussion of this case in the Court of Appeals, see (1930) 5 St. John's L. Rev. 138.

W. H. S.

INCOME TAX—BASIS FOR DETERMINATION OF GAIN.—Petitioner, a manufacturer of metal castings, brought suit to recover income and excess profits taxes assessed and paid for the year 1917. Right to recover was asserted on the sole ground that a munitions tax levied under the Revenue Act of 1916,[1] which became due and was paid by petitioner in 1917 was correctly deducted from gross income in petitioner's tax returns for that year. Petitioner contends that its returns were made as "cash receipts and disbursements" returns under section 12 (a) and not under 13 (d), and that since by section 12 (a) taxes are required to be deducted only in the year when paid, its munitions tax was rightly deducted in the 1917 return.[2] The Commissioner, rejecting this contention, deducted the tax from gross income for 1916, the year when it accrued. and collected a correspondingly increased income and profits tax for 1917, which is involved in the present suit. On appeal from a decision in the Circuit Court for the government, *Held,* affirmed. In computing the Federal Income Tax the munitions manufacturer's tax for 1916 should have been deducted from 1916 income and not from 1917 income, although paid in the latter year, since the evidence indicated the books and tax returns were made on the accrual basis. Aluminum Casting Company v. Routzahn, 282 U. S. 92, 51 Sup. Ct. 11 (1930).

In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the

[1] Revenue Act of 1916 (c. 463, 39 Stat. 756, 780).

[2] Revenue Act of 1916 (c. 463, 39 Stat. 767, 771).

clear import of the language used.[3] In case of doubt, they are construed most strongly against the government and in favor of the taxpayer.[4] However, it is clear that whether a return is made on the accrual basis, or on that of actual receipts and disbursements, is not determined by the label which the taxpayer chooses to place upon it.[5] This is in direct refutation of much of the early legislation [6] and decisions.[7] It has been pointed out that the Excise Tax Law of 1909 and the Corporation Income Tax Law of 1913 contemplated an estimation on a "cash" as opposed to a "revenue" basis.[8] There, since the returns included inventories and other departures from the strict receipts and disbursements basis, it is evident that the "accrual" method had not yet been recognized.[9] The difficulty and the inexpedience of using the "cash" basis in the growing business firms necessitated recognition of the "accrual" method of ac-

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[3] U. S. v. Merriam, 263 U. S. 179, 183, 44 Sup. Ct. 69, 68 L. ed. 240 (1923); U. S. v. Field, 255 U. S. 257, 262, 41 Sup. Ct. 256, 65 L. ed. 617 (1920); Gould v. Gould, 245 U. S. 151, 153, 38 Sup. Ct. 53 62 L. ed. 211 (1917); Schwab v. Doyle, 258 U. S. 529, 534, 42 Sup. Ct. 391, 66 L. ed. 747 (1922).

[4] Smietanka v. First Trust & Savings Bank, 257 U. S. 602, 606, 42 Sup. Ct. 223, 66 L. ed. 391 (1922); Crocker v. Malley, 249 U. S. 223, 233, 39 Sup. Ct. 270, 63 L. ed. 573 (1918); Hecht v. Malley, 265 U. S. 144, 156, 44 Sup. Ct. 462, 68 L. ed. 949 (1923); Reinecke v. Northern Trust Co., 278 U. S. 339, 348, 49 Sup. Ct. 123, 73 L. ed. 410 (1928).

[5] Niles Bement Pond Co. v. U. S., 281 U. S. 357, 360, 50 Sup. Ct. 251, 74 L. ed. 901 (1929); U. S. v. Anderson, 269 U. S. 442 443, 46 Sup. Ct. 131, 70 L. ed. 347 (1925); U. S. v. Mitchel, 271 U. S. 9, 12, 46 Sup Ct. 418, 70 L. ed. 799 (1925). These cases are authority for the proposition that the use of inventories, and the inclusion in the returns of accrual items of receipts and disbursements, indicate the general and controlling character of the account.

[6] Corporation Excise Tax Law, 1909 (38 Stat. 112-117); Corporation Income Tax Law, 1916 (c. 16, 38 Stat. 114, 166).

[7] Lumber Mutual Fire Ins. Co. v. Malley, 256 F. 380 (D. C., Mass.) (1916); Maryland Casualty Co. v. U. S., 251 U. S. 342, 40 Sup. Ct. 155, 64 L. ed. 297 (1919); Mutual Benefit Life Ins. Co. v. Herold, (D. C., N. J.), 198 F. 199, *aff'd* 201 F. 918 (C. C. A., 3rd, 1913), *cert. den.* 34 Sup. Ct. 323 231 U. S. 755, 58 L. ed. 468 (1912).

[8] Lumber Mutual Fire Ins. Co. v. Malley (*supra* note 7): "Only premiums actually received in cash can properly be regarded as income."

[9] In reference to Sec. 38, cl. 2 (36 Stat. 112-117), it is important to note that in both the Maryland Casualty Co. case (*supra* note 7), and the Mutual Benefit Life Ins. Co. case (*supra* note 7), the language used by the Court in U. S. v. Schillinger, 14 Blatchf. 71, Fed. Cas. No. 16228, Fed. A. M. Tax Rep. 2126, is quoted with approval: "In the absence of any special provision to the contrary, income must be taken to mean money, and not the expectation of receiving it, or the right to receive it."

counting.[10] Beginning with U. S. v. Anderson,[11] progress in the development of the law was rapid, and the archaic rule of the Lumber Mutual Fire Ins. case was disregarded for scientific principles of accounting.[12] The instant case serves notice that hybrid returns, consisting of mixed items determined on both the "accrual" and the "receipts and disbursements" basis will no longer be tolerated, and that the law in this respect will henceforth be narrowly construed.

T. S. W.

INCOME TAX—CONSTITUTIONALITY OF TAX ON PROFITS DERIVED FROM SALE OF COUNTY BONDS.—Plaintiff purchased as an investment certain bonds issued by counties and municipalities of Minnesota in 1919. In January, 1924, he realized a profit of $736.26, through their sale, paid an income tax on such, under protest, and claimed a refund, which he seeks to recover charging the Revenue Act of 1924,[1] as void since it taxes a government instrumentality. The claim was rejected, demurrer to the complaint was overruled, judgment entered for the plaintiff, and affirmed by the Circuit Court.[2] On appeal, judgment reversed, *Held,* tax is not upon obligations of a state, or any political subdivision; but is upon profits realized upon the sale of such obligations. As a practical consequence there is no basis for the conclusion that the borrowing power of the states are adversely affected, nor can sale by private individuals in any way be

[10] Montgomery, Income Tax Procedure (1925) p. 497: "Nothing can be more obvious than the proposition that true net income cannot be determined by looking over one's cash account." See also Holmes, Federal Income Tax (1917) pp. 299-301. Of interest is the Report of the Committee on Ways and Means (House Report No. 992, 64th Cong., 1st Sess., p. 4) with reference to the income tax provisions of the Revenue Act of 1916: "As two systems of bookkeeping are in use in the United States, one based on the cash or receipt basis and the other on the accrual basis, it was deemed advisable to provide in the proposed measure that an individual or corporation may make return of income on either the cash or accrued basis, if the basis selected clearly reflects the income."

[11] U. S. v. Anderson, 269 U. S. 442, 443, 46 Sup. Ct. 131, 70 L. ed. 347 (1925). Justice Stone turns our attention to "a consideration of the difficulties involved in the preparation of an income account on a strict basis of receipts and disbursements for a business of any complexity." In this case we have recognized for the first time the principle that while the first problem in income taxation is to define income, the second and equally important problem is to allocate income in respect to time; and furthermore, that income is said to be accrued when it is definitely receivable, although its payment may not be due. (See also note 10.)

[12] W. S. Barstow & Co. v. Bowers, 15 F. (2nd) 75 (D. C., N. Y.) (1926); Becker v. U. S., 21 F. (2nd) 1003 (C. C. A., Ga.) (1927); R. P. Hyams Coal Co. v. U. S., 26 F. (2nd) 805 (D. C., La.) (1928); Weed & Bros. v. U. S., 38 F. (2nd) 935, 51 Sup. Ct. 25 (1930).

[1] 43 Stat. 253 (1924). U. S. C. A. Tit. 26, Sec. 954 (1926).

[2] 35 F. (2d) 29 (C. C. A., 8th, 1929).