St. John's Law Review

Volume 4
Number 1 *Volume 4, December 1929, Number 1*

Article 32

June 2014

Income--Recoupment of Losses–Long Term Contracts (Sanford and Brooks Co. v. Commissioner, IV U.S. Daily, Oct. 24, 1929 at 2056))

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Governments from taxing the instrumentalities of each other. Willcuts etc. v. Bunn, (C. C. A. 8th), IV U. S. Daily 1804, Sept. 28th, 1929.

It is well settled that the Federal Government may not tax the income arising from the obligation of a state or any of its governmental subdivisions.[1] The question presented by this case, however, is whether the Federal Government may tax income derived by a tax-payer from the *resale* of securities issued by a State Government, or any of its subdivisions. It will be noted that such income (*i.e.*, income from resale of governmental securities) is not paid by the state. Hence the argument that the taxation of such income will virtually be taxing governmental instrumentalities, for the support of government, should not avail. But, the decision holds that inasmuch as a profit from a resale on governmental securities is income, that income is derived from such governmental securities even though it is not paid by the state, as would be interest income, on these obligations.

E. S.

INCOME—RECOUPMENT OF LOSSES—LONG TERM CONTRACTS.—Plaintiff was engaged, under a long term contract, to do dredging work for the United States. After expenditures had been made during the years 1913, 1914 and 1915, plaintiff learned that certain vital representations on the faith of which the contract had been accepted, were untrue, whereupon it brought suit against the United States and in 1920 was awarded and collected damages, compensatory only, to reimburse for actual expenditures made and, in addition, interest for the elapsed period. In its returns for the years 1913 to 1916 it had made deductions for losses which consisted of the excess of expenditures over receipts under the contract. When in 1920 plaintiff was reimbursed for his losses, he sought to amend his former returns and apply the amount recovered by the judgment against the losses for which deductions had already been taken. The Commissioner denied plaintiff this right, ruling instead that the sum thus realized should be included as income received during the taxable year 1920. This decision was upheld by the Board of Tax Appeals. Plaintiff appeals. *Held*, judgment reversed. Recoupment of losses under a long term contract is not income taxable in the year in which recovered. Proper allocation of the realized judgment should be effected to offset the losses indicated on the returns of the years in question. Sanford and Brooks Co. v. Commissioner, IV U. S. Daily, Oct. 24, 1929 at 2056.

[1] Collector v. Day, 78 U. S. 113, 124-5, 20 L. ed. 122 (1870); Pollock v. Farmers Loan and Trust Co., 157 U. S. 429, 583, 588, 15 Sup. Ct. Rep. 673, 39 L. ed. 759 (1895).

The very words "long term contract" suggest a practical inability ordinarily to determine in any one taxable period the net profit or loss realized on such an agreement. Provisions for just such a situation are found in the Federal Regulations where long term contracts are defined to mean building, installation or construction contracts covering a period in excess of one year.[1] The case under consideration is within the spirit if not within the letter of the present law [2] and was so deemed to be under the act in force at that time.[3] "The mere diminution of loss is not gain, profit or income." [4] Recoupment of losses by plaintiff does not come within the purview of gain derived from capital, from labor or from both combined, including profit gained through sale or conversion of capital assets.[5] The interest recovered does constitute income within the meaning of the income tax law; not so with the principal. A dissenting opinion in the case was founded upon the theory that a year is necessarily the unit for determination of income for tax purposes.[6]

A. K. B.

INCOME—SALARIES—DIVISION OF PROFITS.—Plaintiff is an Illinois corporation with a capital stock of $10,000 invested by two of its directors, each of whom had subscribed for 49% of the corporate stock. These directors were also president and treasurer and vice-president and secretary respectively and were to receive a yearly salary of $5,000 plus 10% commission of all the business done by the corporation. As officers they devoted all their time and effort to the affairs of the corporation but waived payment of their commissions for the years 1919 and 1920, the profits being small. However, in the year 1921 the gross business of the corporation was $123,748.78. Each of the officers was allowed and received his salary of $5,000 and also a commission of $12,374.88, making the total payment to the two officers, $34,749.76. The Commissioner determined that of this sum $9,813.27 had been excessively allowed the officers as salaries and commissions and assessed a deficiency against the corporation for deducting this amount from its income tax return for 1921. The petitioner now seeks a redetermination of the Commissioner's holding. *Held,* when officers' compensation absorbs practically all of the profits under normal conditions and effects a partial

[1] Regulations 74, Art. 334 (1928).
[2] *Supra* Note 1.
[3] Regulations 33, Art. 121, based upon Treasury Decision 2161, promulgated Feb. 19, 1915, construing the Act of 1913.
[4] Bowers v. Kerbdaugh-Empire Co., 271 U. S. 170, 175, 46 Sup. Ct. Rep. 449, 451, 70 L. ed. 886 (1926).
[5] Marshall v. Commissioner, 10 B. T. A. 1140 (1928).
[6] Per Northcutt, *J.*