Calendar No 907

71ST CONGRESS } SENATE { REPORT
2d Session } { No. 888

EXTENSION OF PERIOD OF LIMITATION IN CASE OF COMMUNITY INCOME

JUNE 9 (calendar day, JUNE 11), 1930.—Ordered to be printed

Mr. SMOOT, from the Committee on Finance, submitted the following

REPORT

[To accompany H. J. Res. 340]

The Committee on Finance, to whom was referred the joint resolution (H. J. Res. 340) extending the time for the assessment, refund, and credit of income taxes for 1927 and 1928 in the case of married individuals having community income, having had the same under consideration, report it back to the Senate without amendment and recommend that the resolution do pass.

Following is the House report on the joint resolution:

[House Report No. 1608, Seventy-first Congress, second session]

The Committee on Ways and Means, to whom was referred the joint resolution (H. J. Res. 340) extending the time for the assessment, refund, and credit of income taxes for 1927 and 1928 in the case of married individuals having community income, having had the same under consideration, report it back to the House without amendment, and recommend that the resolution do pass.

The legislation herein proposed extends for one year the periods of limitation in respect of the assessment, refund, and credit of income taxes in the case of any married individual where such individual or his or her spouse filed a separate income-tax return and included in such return the income which, under the laws of the State, upon receipt became community property. The period for the taxable year 1927 under the revenue act of 1926 was three years. The period for the year 1928 under the revenue act of 1928 was two years. Sections 1 and 2 of this resolution extend such periods to four and three years, respectively.

The effect of section 3 is to make the extended periods of limitation provided in the joint resolution as if they were the periods provided in sections 277 and 284 of the revenue act of 1926 and sections 275 and 322 of the revenue act of 1928 respectively, so that wherever in those acts the period of limitation or the statute of limitations provided in section 277 or 284 of the 1926 act or in section 275 or 322 of the 1928 act is referred to, such period or statute as extended by this joint resolution will be included. For example: Section 275 of the revenue act of 1928 provides a 2-year period of limitation on the assessment of income taxes imposed by that act, and section 277 provides that the "running of the statute of limitations provided in section 275 * * * on the making of assessments * * * in respect to any deficiency, shall (after the mailing of a notice under section 272 (a)) be suspended for the period during which the commissioner is prohibited

from making the assessment * * * and for 60 days thereafter." By virtue of the provisions of section 3 of the joint resolution the statute of limitations "provided in section 275" comprehends not only the 2-year period but the 2-year period as extended for an additional year by section 2 of the joint resolution. As a result the extended period of limitation is made effective to the same degree as if the limitation sections of the revenue acts of 1926 and 1928 were themsevles amended to provide for the extended periods of limitation provided in the joint resolution.

The necessity for the enactment of this resolution is fully set forth by the Acting Secretary of the Treasury in his letter to the chairman of the committee under date of May 10, 1930, as follows:

MAY 10, 1930.

Hon. WILLIS C. HAWLEY,
Chairman Committee on Ways and Means,
House of Representatives.

DEAR MR. CHAIRMAN: Transmitted herewith is a draft of a proposed joint resolution extending the periods of limitation in respect of assessments, refunds, and credits of income taxes for the taxable year 1927 and the taxable year 1928, in the case of a married individual where such individual or his or her spouse filed a separate income-tax return and included therein community income.

The enactment of this proposed legislation at the present session of the Congress is essential to the solution of the problem which has arisen in connection with the community property test case (Poe *v.* Seaborn), now pending before the United States Supreme Court. The Solicitor General of the United States has advised the department that this case will go over to the fall term of the court, and that it is highly improbable that a decision will be handed down prior to the first decision day in January, 1931. There is no assurance that a decision will be handed down even then.

The following is a brief history of the community property income issue:

The Attorney General of the United States in an opinion dated September 10, 1920 (32 Op. Atty. Gen. 298, T. D. 3071, C. B. 3221, the date being stated as August 24 in the Treasury Decision), with respect to Texas, and in an opinion dated February 26, 1921 (32 Op. Atty. Gen. 435, T. D. 3138, C. B. 4, 238), with respect to Washington, Arizona, Idaho, New Mexico, Louisiana, and Nevada, held that in rendering income-tax returns a husband and wife might each report one-half of the income which under the laws of the respective States became, simultaneously with its receipt, community property. On January 4, 1926, the United States Supreme Court in the case of United States *v.* Robbins (46 S. Ct. 148, 269 U. S. 315, T. D. 3817, C. B. V–1, 188) sustained the position of the department in taxing all community income to the husband under the laws of the State of California in effect at that time. The Supreme Court of the United States in the course of its opinion stated as follows:

"* * * Even if we are wrong as to the law of California and assume that the wife had an interest in the community income that Congress could tax if so minded, it does not follow that Congress could not tax the husband for the whole. Although restricted in the matter of gifts, etc., he alone has the disposition of the fund. He may spend substantially as he chooses, and if he wastes it in debauchery the wife has no redress. * * * That he may be taxed for such a fund seems to us to need no argument. The same and further considerations lead to the conclusion that it was intended to tax him for the whole. * * * he who has all the power [should] bear the burden * * * the husband [is] the most obvious target for the shaft * * * ."

Under date of July 16, 1927, in a letter addressed to this department (35 Op. Att. Gen. 265), the Attorney General withdrew his two former opinions relating to community-property income for the reason that the decision in the case of United States *v.* Robbins had raised a very substantial doubt as to the soundness of the two former opinions, leaving the Treasury Department to take any position it might consider proper under the laws of the several States with respect to the reporting of community income.

This situation resulted in the preparation of a proposed Treasury decision applicable to all the community-property States, amending the income-tax regulations of the department and denying to husband and wife the right to divide community income in making income-tax returns. While this Treasury decision was in the course of preparation, Representatives in Congress from community-property States urged upon the department that the regulations should not be so amended until required by a decision of the Supreme Court of the United States. They insisted that the language in the Robbins opinion which supported

the proposed amendment was dicta, and that it was unjust to reverse the prior practice and procedure of the department in effect over a long period of years on account of mere dicta, particularly when such reversal would affect over a hundred thousand taxpayers in the community-property States.

Attention was called to the fact that if the department made the amendment and eventually was found to be wrong, it would have to make refunds to this vast number of taxpayers, resulting in a large amount of unnecessary administrative work. In accordance with the views thus urged upon the department it was finally decided that the proposed Treasury decision should not be issued until test cases with respect to the community property issue should have been litigated through the Supreme Court and final decisions obtained. It was the concensus of opinion at that time that any change in the prior practice and procedure of the department should not be made retroactive beyond the taxable year 1927. Expectations were that a decision of the Supreme Court would be handed down during the 1930 spring term of the court, leaving ample time for the department satisfactorily to close all community-income cases for the taxable years 1927 and 1928 before the running of the statute of limitations. Upon such understanding the department published I. T. Mimeograph Coll. No. 3723 dated April 6, 1929 (C. B. VIII–1, 89), a copy of which is attached hereto. The following rules, among others, were laid down in the mimeograph governing the procedure to be followed in the audit of such returns for 1927 and subsequent taxable years:

"(2) The audit of returns filed upon the so-called community-property basis for 1927 and subsequent taxable years will be governed by the following rules:

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"(c) If the adjustment of all of the other issues results in no change in tax liability, the returns will be filed in the collector's office or the Income Tax Unit in Washington, as the case may be, after the usual review, and the returns will be appropriately flagged in the files so that they may be readily withdrawn and assembled for a supplemental audit in the event the final decision of the court sustains the bureau's position. (But see par. (i) below.)

"(d) If the taxpayer acquiesces in the proposed adjustment of the other issues and such adjustment results in a change in tax liability, the administrative file in the case, after the usual review, will be appropriately labeled, and, pending the final court decision, will be held in the office of the internal-revenue agent in charge. This type of cases will be treated by collectors in the same manner as protest cases and will be transmitted to the appropriate internal-revenue agent in charge. The taxpayer will be advised to protect his interests with respect to any overpayments by filing a claim for refund within the statutory period of limitation properly applicable thereto.

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"(h) Those returns which are closed and filed, or which may hereafter be accepted and sent to the files as properly prepared (except for the community property issue), will be flagged in the files as in paragraph (c) above. This paragraph does not apply to those cases which may have been finally closed under section 1106 (b) of the revenue act of 1926 or section 606 of the revenue act of 1928.

"(i) If the final decision of the court is in favor of the bureau's position, the return sent to the files will be subject to a supplemental audit only in those cases where the additional tax will be sufficient in amount to justify the time and expense in taking such action."

Under the above-quoted provisions of the mimeograph there are now approximately 100,000 returns for the calendar years 1927 and 1928 being held in the Income Tax Unit in Washington awaiting the decision of the Supreme Court. There are also approximately 200 returns for the fiscal years 1927 and 1928 which are being so held. In addition, there are at least 10,000 returns for the taxable years 1927 and 1928 being held in the offices of the several internal-revenue agents in charge. The amount of additional taxes to be collected on account of the taxable years 1927 and 1928, if the community property income issue is decided in favor of the Government, is estimated to be approximately $50,000,000.

The following alternatives have been considered by the department in an attempt to solve the problem, all of which are unsatisfactory since they would result in confusion, inconvenience, and embarrassment both to the Government and the taxpayers:

"1. The department might await a possible decision of the Supreme Court as of January, 1931, before finally determining deficiencies for the taxable years

1927 and 1928 resulting from the refusal to permit the division between husband and wife of community income."

It is readily apparent that if the department should thus await the decision of the Supreme Court, even though the decision is handed down early in January, 1931, the department, in order to protect the interests of the Government against the running of the statute of limitations, would have to proceed now to reaudit over a hundred thousand returns on the basis of refusing to permit the division of community income, and, when the Supreme Court renders its decision, would have to prepare and issue immediately and without sufficient time for adequate preparation 60-day deficiency letters in all these cases. It is obvious that a most unsatisfactory and embarrassing situation would result from the haste which would be necessary in completing the task in the insufficient time which would be available to the Government. In general, the period of limitation on assessment with respect to the calendar years 1927 and 1928 will expire from January 1 to March 15, 1931, dependent upon the dates the returns were filed, with the peak around March 15, 1931, while the period of limitation on assessment with respect to the fiscal years 1927 and 1928 will expire before those dates.

"2. The department might proceed at once finally to determine deficiencies for the taxable years 1927 and 1928, resulting from the refusal to permit the division between husband and wife of community income."

This would require the preparation and issuance of 60-day deficiency letter to the husband and letters suggesting the filing of refund claims by the wife in order to protect her interests. The result would be the filing of thousands of petitions with the United States Board of Tax Appeals which would cause a serious congestion of cases before the board. The forcing of taxpayers in these thousands of cases to file petitions with the United States Board of Tax Appeals or to pay the tax and file claims for refund would entail an expense and inconvenience to the taxpayers which should be avoided, if possible.

"3. The department might endeavor to hold these cases for the taxable years 1927 and 1928 open by soliciting consents extending the period of limitation."

This would entail a tremendous administrative expense, and, in the great number of cases where such consents could not be obtained, it would be necessary to follow the unsatisfactory procedure outlined in the preceding paragraph. Furthermore, a wholesale soliciting of waivers would probably cause a reaction against the Government on the part of the taxpayers.

In view of the foregoing it is believed that the legislation suggested by the proposed joint resolution is the best possible solution to the problem which confronts the department. The proposed legislation does not extend the periods of limitation in respect of assessments, refunds, and credits generally, but only in those cases in which the community property income issue is involved for the taxable years 1927 and 1928, and is designed to avoid the expense and inconvenience which would result to taxpayers if the Government, prior to the decision of the Supreme Court in the community property test cases, should be forced to issue 60-day deficiency letters in order to suspend the running of the statute of limitations as to those years. If such legislation is not enacted during the present session of Congress, the only way the department can fully protect the interests of the Government is to proceed with the determination of deficiencies and the issuance of 60-day deficiency letters in these cases without awaiting a decision of the Supreme Court, which procedure, as has been shown, would result in the filing of thousands of petitions with the United States Board of Tax Appeals, a congestion of cases before the board, and undue expense and inconvenience to taxpayers. The department therefore recommends that every effort be made to enact the proposed legislation at the present session of the Congress.

Very truly yours,

OGDEN L. MILLS,
Acting Secretary of the Treasury.

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