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deferring to the Review Commission's decisions because of the Commission's experience with complex regulations and familiarity with the circumstances of each employer.[55] While the Fourth Circuit's liberal interpretation of OSHA provisions may present potential for agency abuse, the court noted that the Review Commission proceeds with circumspection in imposing its fines.[56]

JOHN B. YELLOTT, JR.

XIV. TAX

A. Principle of Net Gift Affirmed

In *Old Colony Trust Co. v. Commissioner*[1] the Supreme Court ruled that the payment by an employer of an employee's income tax liability results in additional taxable income to the employee. The Court further held in *Crane v. Commissioner*[2] that a seller of property realizes income from the disposal of mortgage liability to a purchaser, even though the seller is not personally liable on the mortgage. In light of *Old Colony Trust* and *Crane,* and in the absence of a statutory exclusion, the payment by a donee of his donor's gift tax liability might well be considered income to the donor under section 61 (a) of the Internal Revenue Code. This conclusion would follow from the fact that the donee paid the tax liability of another as in *Old Colony Trust* and relieved the transferor of a debt liability as in *Crane.* There has been, however, considerable litigation over this precise issue.[3]

[55] Brennan v. Gilles & Cotting, 504 F.2d 1255, 1262 (4th Cir. 1974). The Fourth Circuit policy of allowing broad discretion for OSHA enforcement is also in accord with the view of the Supreme Court and other circuits. *See* Atlas Roofing Co. v. OSHRC, 430 U.S. 442, 453 (1977); Bowman Trans. Inc. v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 285-86 (1974); Dunlop v. Rockwell Int'l, 540 F.2d 1283, 1287 (6th Cir. 1976); Budd Co. v. OSHRC, 513 F.2d 201, 204 (3d Cir. 1975); Brennan v. OSHRC, 501 F.2d 1196, 1198 (7th Cir. 1974).

[56] The Fourth Circuit noted that the fine for one of Hyman's repeated violations was only $140.00, indicating that penalties are sensibly weighted to the gravity of the offense. 582 F.2d at 842.

[1] 279 U.S. 716 (1929).

[2] 331 U.S. 1 (1947).

[3] The dispute between the IRS and taxpayers over the income tax consequences of the payment of the gift tax by a donee first arose in Estate of Staley v. Commissioner, 47 B.T.A. 260 (1942), *aff'd,* 136 F.2d 368 (5th Cir.), *cert. denied,* 320 U.S. 786 (1943). In *Estate of Staley* a donor had conveyed stock to a trust, reserving certain trust income to himself to pay the gift tax. Both the Board of Tax Appeals, predecessor to the Tax Court, and the Fifth Circuit held that this trust income was taxable to the donor as ordinary income. *See* 136 F.2d at 369-70. The decision was based on the earlier established principle that the settlor was liable for income taxes on any trust income over which he retained control. *See* Helvering v. Clifford, 309 U.S. 331 (1940); I.R.C. §§ 671, 677. Later decisions dealing with gifts in trust have determined that when any trust income is reserved to the donor or trustees to pay gift taxes, that income is taxable to the donor as ordinary income. When the trustees must sell trust corpora or borrow on the trust in order to pay the gift tax, however, no taxable gain is realized

Donors, who are primarily liable for payment of gift taxes,[4] have frequently sought to require the donee to pay the gift tax as part of the transaction.[5] The donor's gift tax liability is discharged if the donee pays the gift tax.[6] The current controversy concerns whether payment of the gift

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by the donor. *See* Commissioner v. Estate of Morgan, 37 T.C. 981 (1962), *aff'd,* 316 F.2d 238 (6th Cir.), *cert. denied,* 375 U.S. 825 (1963); Estate of Scheaffer v. Commissioner, 37 T.C. 99 (1961), *aff'd,* 313 F.2d 738 (8th Cir.), *cert. denied,* 375 U.S. 818 (1963); Estate of Craig R. Sheaffer, 25 T.C.M. (CCH) 646 (1966). In the foregoing cases the IRS had argued that the payment of the gift tax out of trust income or corpora amounted to ordinary income to the donor under § 677.

The courts' interpretation of § 677 allowed informed taxpayers to avoid paying income taxes on a trustee's payment of the gift tax merely by not allowing trust income to be used for such payment. Duhl & Cohen, *The Net Gift Technique: A Current Analysis of the Requirements for Its Successful Use,* 42 J. TAX. 158, 161 (1975). The IRS thus introduced the alternative argument that the payment of gift taxes by a donee amounted to a taxable capital gain to the donor where the amount of the gift tax paid exceeded the donor's adjusted basis in the gift. *Id.* The IRS first advanced this argument in Turner v. Commissioner, 49 T.C. 356 (1968), *aff'd per curiam,* 410 F.2d 752 (6th Cir. 1969), and has continued to argue similarly in subsequent cases in this area. *See, e.g.,* Johnson v. Commissioner, 495 F.2d 1079 (6th Cir. 1974), *aff'g* 59 T.C. 791 (1973), *cert. denied,* 419 U.S. 1040 (1974); Henry v. Commissioner, 69 T.C. 665 (1978); Owen v. Commissioner, 37 T.C.M. (CCH) 272 (1978); Estate of Davis v. Commissioner, 30 T.C.M. (CCH) 1363 (1971), *aff'd per curiam,* 469 F.2d 694 (5th Cir. 1972); Krause v. Commissioner, 56 T.C. 1242 (1971), *appeal dismissed,* (6th Cir. June 27, 1972).

[4] I.R.C. § 2502 (d). If the donor does not pay the gift taxes when due, the donee may be held liable for the gift taxes to the extent of the value of the gift. I.R.C. § 6324 (b); Treas. Reg. § 301.6324-1, T.D. 7238, 1973-1 C.B. 544; *see* note 79 *infra.*

[5] A donor may seek to require a donee to pay the gift tax because he lacks the liquid assets with which to pay the tax himself. *See* Hirst v. Commissioner, 63 T.C. 307, 307 (1974); Estate of Staley v. Commissioner, 47 B.T.A. 260, 261 (1942). In such cases the donor may be disposing of a tract of land or building solely because he lacks the liquid assets with which to pay the property taxes or upkeep. *See* Schriebman, *Structuring a Net Gift that Will Stand Up: How to Satisfy IRS and the Courts,* 39 J. TAX. 6, 6-7 (1973). In other cases the donor may merely feel that the gift tax is more properly the obligation of the beneficiary of his generosity, the donee. *Id.*

[6] *See generally* Morse v. United States, 494 F.2d 876 (9th Cir. 1974) (acknowledging that third party can pay income taxes for another). As of January 1, 1977 there is a single unified rate schedule for both gift and estate taxes. *See* I.R.C. § 2001 (c). To compute the taxable value of a gift, the gross value of the gift is reduced by the amount of any exclusions or deductions. *See* I.R.C. § 2503. The rate schedule is then used to obtain the tentative tax, *see* I.R.C. § 2001 (c), which is reduced by any credits to arrive at the actual gift tax due. *See* I.R.C. § 2012.

When a donee pays the gift tax as a condition of the transfer, the Tax Court has decided and the IRS has conceded that the gross value of the gift can be reduced by the ultimate gift tax paid in determining the value of the gift tax for gift tax purposes. Pamela N. W. Lingo, 13 T.C.M. (CCH) 436 (1954); Sarah H. Harrison, 17 T.C. 1350 (1952); Rev. Rul. 75-72, 1975-1 C.B. 310. For example, assume A gives B property worth $100,000 on condition that B pay the gift tax. B is entitled to subtract from the $100,000 valuation the amount of the gift tax he ultimately pays before computing his gift tax liability. An algebraic formula is necessary for this computation since the value of the ultimate gift tax paid is needed to compute the ultimate gift tax. *See* Rev. Rul. 75-72, 1975-1 C.B. 310.

If the donee was not obligated by the gift agreement to pay the gift tax, but nonetheless paid it, he would not be entitled to reduce the value of the gift by the gift tax paid since he received the full value of the gift without obligation to pay any gift taxes. *See* Sarah H. Harrison, 17 T.C. 1350, 1357 (1952).

tax by the donee when the gift tax exceeds the donor's basis in the gift results in income tax liability to the donor.[7] The Internal Revenue Service has maintained that the donee is relieving the donor of a financial obligation by paying the gift tax owed by the donor, that such payment amounts to consideration for the gift, and that the donor thus has received income under section 61 (a).[8] According to this part-sale, part-gift analysis, the donor realizes a taxable gain to the extent that the gift tax paid by the donee exceeds the donor's basis in the gift.[9] Taxpayers have countered that there should be no income attributed to the donee since the donor intended a net gift, consisting of the gross value of the gift less the gift tax paid by the donee.[10]

The Fourth Circuit addressed this issue in *Hirst v. Commissioner*[11] and held that payment of gift taxes by the donee as a condition to receipt of the gift resulted in no taxable income to the donor, even though the gift tax paid exceeded the donor's basis in the property. *Hirst* involved an 81 year old widow who gave her property to her son and his family in order to avoid burdensome property taxes and to benefit her family.[12] The widow, Edna Hirst, made the gifts subject to the condition that her son and his wife pay the applicable gift taxes. Accordingly, the son and his wife paid state and federal gift taxes amounting to $85,469.55.[13] Although the taxes exceeded Hirst's adjusted basis in the property by $77,092.55, Hirst did not include any of the gift tax payments in her gross income on her next income tax return.[14] The IRS asserted a deficiency against Hirst,[15]

[7] *See* note 3 *supra*.

[8] *See* Krause v. Commissioner, 56 T.C. 1242, 1248 (1971); Turner, 49 T.C. 356 (1968), IRS nonacquiescence, 1971-2 C.B. 4.

[9] *See* Krause v. Commissioner, 56 T.C. 1242, 1248 (1971).

[10] Turner v. Commissioner, 49 T.C. 356, 363 (1968).

[11] 572 F.2d 427 (4th Cir. 1978).

[12] *Id.* at 435.

[13] *Id.* The appraised value of the property transferred by Hirst was $444,588.50. The federal gift tax amounted to $68,277.00, while the Virginia gift tax paid was $17,192.55. *Id.* at 436.

The federal gift tax was computed on the basis of the gross value of the gift less the ultimate gift tax paid in accordance with Rev. Rul. 75-72, 1975-1 C.B. 310. Virginia refused to allow such a procedure and required the gift tax to be computed on the gross value of the gift, $444,588.50. 572 F.2d at 435-36.

[14] 572 F.2d at 435. The taxpayer's basis in property is normally its cost to the taxpayer when acquired. I.R.C. § 1012. The basis is adjusted up for certain expenditures properly allocable to the capital account and adjusted down to reflect certain deductions such as depreciation. *See* I.R.C. § 1016. Upon the sale of the property, the consideration received less the adjusted basis is the taxpayer's realized gain. *See* I.R.C. § 1001.

[15] 572 F.2d at 435-36. A notice of deficiency, also known as a ninety day letter, is formal notice to a taxpayer that the IRS has determined that some amount is owed by the taxpayer. The taxpayer is allowed ninety days to petition the Tax Court for redetermination of the deficiency before the IRS will move to assess and collect the deficiency. I.R.C. § 6212. The notice of deficiency normally follows an office or field audit and subsequent opportunities for a district conference and an Appellate Division hearing with the IRS. PRENTICE-HALL, FEDERAL TAX HANDBOOK 549-51 (1978).

The Commissioner's deficiency notice computed Hirst's tax deficiency as follows:

claiming that she received additional taxable income, to the extent the gift tax paid by the donee exceeded her adjusted basis in the property, in the form of a long term capital gain from a sale of property as described in section 61 (a) (3).[16]

On a petition for redetermination of the asserted deficiency,[17] the Tax Court, concluded that Hirst realized no income in the gift transaction.[18] In deciding the case, the Tax Court relied heavily upon *Turner v. Commissioner,*[19] a previous decision of the Tax Court which had been summarily affirmed by the Sixth Circuit. In *Turner,* the donor made several gifts of securities on the condition that the donees pay the gift taxes.[20] The IRS claimed that the transactions were part-sales, part-gifts because the donees had paid gift taxes exceeding the donor's basis in the securities.[21] The Tax Court in *Turner* rejected the part-sale, part-gift theory and characterized the transaction as a net gift, determining that the donor intended to convey a gift amounting to the gift's gross value less the gift tax paid.[22] Concluding that the facts in *Hirst* were indistinguishable from

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Federal gift tax	$68,277.00	.093
Virginia gift tax	17,192.55	094
Total gift tax paid	85,469.55	095
Less adjusted basis of ½	8,377.00	096
Interest in real estate		
Realized gain	77,092.55	098
Recognized gain - 50%	$38,546.28	099

572 F.2d at 436.

[16] Only 40% of long term capital gains, which are defined in § 1222 of the Internal Revenue Code, are taxable as of 1979. I.R.C. § 1202.

[17] The taxpayer has ninety days after the mailing of a deficiency notice to petition the Tax Court for redetermination of the deficiency. *See* note 15 *supra.* Alternatively, a taxpayer may pay the deficiency and file a claim for refund with the IRS. Such payment and filing entitles a taxpayer to sue for a refund in the Court of Claims or the federal district court. *See* I.R.C. § 7422.

[18] Hirst v. Commissioner, 63 T.C. 307 (1974).

[19] 49 T.C. 356 (1968).

[20] 49 T.C. at 358.

[21] *Id.* at 360. There were nine gifts of securities made in *Turner,* three outright to individuals and six in trust for the benefit of certain persons. *Id.* at 358. The IRS conceded that the six transfers in trust were not part-sales, *id.* at 362, attempting to distinguish the outright transfers from the transfers in trust. The IRS felt this distinction was in its interest since it had not raised the part-sale, part-gift argument in the previous gift in trust cases. *See* note 3 *supra.* The logic of the attempted distinction was based on the contrast between the contracted personal liability of the donee for gift taxes in the outright transfer and the absence of such personal liability on the part of the donee-trustee. The IRS argued that in the outright transfer the donor retained no interest in the transferred property but had accepted the mere promise of the donee to pay the gift taxes. 49 T.C. at 362-63. Thus, no net gift could be consummated since the net gift concept required that certain of the donated property be delegated to gift tax payment. *Id.* The IRS implicitly acknowledged that the net gift concept had some validity in the trust context since the trustee can only resort to the trust corpora, or to income or borrowed funds arising therefrom, to pay the gift taxes. The Tax Court in *Turner* rejected the IRS's distinction, preferring to focus on the intent of the donor rather than the form of the transaction. *Id.* at 363.

[22] *Id.* The Tax Court's decision in *Turner* was influenced by the effect an acceptance of the part-sale argument would have upon the computation of the donee's basis. *Id.* at 363-64.

those in *Turner,* the *Hirst* Tax Court followed *Turner*[23] and subsequent decisions employing the *Turner* analysis.[24]

In following *Turner,* the Tax Court declined to apply *Johnson v. Commissioner,*[25] a more recent Sixth Circuit decision which purported to limit *Turner* to its facts.[26] In *Johnson* a donor, using certain low basis securities as collateral, borrowed $200,000 from a bank without personal liability.[27] The donor then gave the pledged securities, which had a fair market value of over $500,000 to a trust for the benefit of his children. The trustees subsequently substituted their note for that of the donor's, pledging the same collateral. The donor used $150,000 of the $200,000 loan proceeds to satisfy the gift tax liability resulting from the gift of securities to the trust.[28] Concluding that this transaction was a part-sale, part-gift, the Tax Court in *Johnson* held that the donor realized a taxable gain of $200,000 less his basis in the securities.[29] The *Johnson* Tax Court considered the *Johnson* transaction distinguishable from that in *Turner* since the *Johnson* transaction failed to fulfill all the requirements for a net gift, most notably the requirement that the donor's retained interest be committed to gift tax payment.[30] While affirming the *Johnson* Tax Court's decision,

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The donee is allowed to add to his basis in the donated property the sum of any amount he paid for the property plus any gift tax paid on the transaction. *See* Treas. Reg. § 1.1015-4, T.D. 6693, 1963-2 C.B. 326. If the gift were a part-sale, part-gift, the donee would get double credit in his basis for the gift tax paid, once as an amount paid for the gift and once as the payment of the gift tax. 49 T.C. at 364.

[23] 63 T.C. at 314. The Tax Court has decided that it will follow a U.S. Court of Appeals precedent which is directly applicable to a pending case where the only appeal from its decision is to that circuit. *See* Golsen v. Commissioner, 54 T.C. 742 (1970), *aff'd on other grounds,* 445 F.2d 985 (10th Cir.), *cert. denied,* 404 U.S. 940 (1971). Since the *Hirst* case was appealable to the Fourth Circuit, not the Sixth, the Tax Court did not have to follow Turner under its self-imposed rule. However, in the interest of uniformity, the Tax Court will often follow decisions of other circuits when there is no appellate decision in the appropriate circuit which is directly applicable. *See* Banker's Union Life Ins. Co. v. Commissioner, 62 T.C. 661, 674-75 (1974).

[24] 63 T.C. at 314. The Tax Court cited Estate of Davis v. Commissioner, 30 T.C.M. (CCH) 1363 (1971) and Krause v. Commissioner, 56 T.C. 1242 (1971) as cases supporting the *Turner* analysis. In *Davis,* the Tax Court, following *Turner,* rejected the part-sale, part-gift argument when a donor transferred securities to his son on the condition that the son pay the gift taxes. 30 T.C.M. at 1368. The *Krause* Tax Court, citing *Turner,* rejected the part-sale, part-gift argument when a donor made gifts to trusts for the benefit of his grandchildren on the condition that the trustees pay the gift taxes. 56 T.C. at 1248.

[25] 495 F.2d 1079 (6th Cir. 1974).

[26] 63 T.C. at 314.

[27] 495 F.2d at 1080. The donor's basis in the securities in *Johnson* was $10,812.50. *Id.*

[28] *Id.*

[29] Johnson v. Commissioner, 59 T.C. 791, 813 (1973).

[30] *Id.* at 812-13. The Tax Court in *Johnson* considered that case to be governed by *Crane,* which had held that the discharge of a debt by a third party results in income to the relieved debtor. *Id.* at 810. The court suggested four ways in which the *Johnson* transaction did not meet the criteria for a net gift. First, the court noted that there was no condition in *Johnson* that the donees pay the gift tax. Second, the Tax Court determined that there was no retention of any interest by the donors in the securities transferred to the trustees. Third, the court pointed out that the loan liability assumed by the trustees exceeded the gift tax liability

the Sixth Circuit went further, declaring *Turner* a precedent limited to its own facts.[31] The Sixth Circuit considered the factual distinctions suggested by the Tax Court between *Johnson* and *Turner* of little import.[32] The court saw these distinctions, which consisted of differences between both the methods and the results of the *Johnson* and *Turner* transactions,[33] as only minor variations in the form of the transactions.[34] Consequently, the Sixth Circuit based its *Johnson* decision on three broader grounds, which it presumably would apply to typical net gifts as well as to the unusual *Johnson* transaction. The three grounds relied upon by the court were the *Crane* rule, the *Old Colony Trust* rule, and the broad language of section 61(a).[35]

The *Hirst* Tax Court agreed with the *Johnson* Tax Court that *Johnson* was distinguishable from *Turner*.[36] While recognizing the strength of the IRS's contention that a portion of the gift should not pass to the donee without being subject to either gift or income taxation, the *Hirst* Tax Court considered the net gift concept too well established to abandon.[37] The IRS appealed the *Hirst* case to the Fourth Circuit.[38] A three judge panel reversed the Tax Court decision,[39] finding the *Turner* decision incorrect and citing with approval the Sixth Circuit's limitation of *Turner* to its facts.[40] According to the panel, the *Old Colony Trust* rule, that the discharge of another's tax liability results in the receipt of income by the taxpayers so discharged, prevailed over the net gift concept.[41] The panel attached no significance to the pretransfer agreement between the donor and donee as to the payment of gift taxes.[42]

(*e.g.*, $200,000 loan liability, $150,000 gift tax liability). Finally, the Tax Court concluded that the substance of the *Johnson* transaction was a part-sale, part-gift, not a net gift. *Id.* at 812-13.

[31] 495 F.2d at 1085. In limiting *Turner* to its facts the Sixth Circuit emphasized that the IRS's concessions in *Turner* were crucial to the *Turner* result. *See* note 21 *supra*. The Sixth Circuit also considered the Tax Court's unwarranted concern about the possible double credit to the donee's basis crucial to the result in *Turner*. 495 F.2d at 1085; *see* note 22 *supra*. The Sixth Circuit considered the Tax Court's concern without justification, since Congress plainly did not intend a donee to get double credit to his basis. 495 F.2d at 1085-86.

[32] 495 F.2d at 1082.

[33] *See* note 30 *supra*.

[34] 495 F.2d at 1082.

[35] *See id.* at 1083.

[36] *See* Hirst v. Commissioner, 63 T.C. 307, 314 (1974); note 30 *supra*.

[37] *See* 63 T.C. at 315. The *Hirst* Tax Court characterized the Sixth Circuit's limitation of *Turner* to its facts in *Johnson* as error, *id.* at 314-15, and stated that the Sixth Circuit's limitation of *Turner* was based on the mistaken conclusion that the IRS's concession in *Turner* as to the gifts in trust was crucial to the outcome. *Id.*; *see* note 21 *supra*.

[38] The Courts of Appeals generally have the same jurisdiction to review decisions of the Tax Court as they do decisions of federal district courts. *See* I.R.C. § 7482.

[39] Hirst v. Commissioner, 572 F.2d 427, 428 (4th Cir. 1978). The original majority opinion of the Fourth Circuit panel is the dissenting opinion from the subsequent en banc decision. *See* 572 F.2d at 434.

[40] *Id.* at 437. The Fourth Circuit panel specifically disagreed with the *Hirst* Tax Court's decision not to reconsider the correctness of the *Turner* decision. *Id.*

[41] *Id.* at 438-39.

[42] *Id.*

Upon rehearing en banc, the Fourth Circuit rejected the panel's conclusion and upheld the decision of the Tax Court.[43] The Fourth Circuit gave considerable deference to the Tax Court's finding of fact that a net gift was intended, rather than a part-sale, part-gift.[44] The Fourth Circuit stated that there was no economic gain to Hirst in the transaction, nor any intent on her part to sell her property. The court also emphasized the noncommercial, family context in which the transaction was consummated.[45] Accordingly, the Fourth Circuit concluded that the Tax Court's finding was not clearly erroneous.[46]

In reaching its decision, the Fourth Circuit relied heavily upon *Turner* while finding *Johnson* inapplicable to the facts.[47] The court reasoned that the crucial distinction between *Turner-Hirst* and *Johnson* was that in both *Turner* and *Hirst* there was a commitment of part of the transferred property to payment of the gift tax, whereas in *Johnson* the donor was unrestricted in his use of the retained funds.[48] Thus, the court concluded that the *Turner* and *Hirst* donors realized no economic gain from their gifts, in contrast to the *Johnson* donor who obtained $200,000 free from obligation.[49] Finally, the Fourth Circuit acknowledged the general applicability of the *Crane* principle,[50] but rejected its applicability to *Hirst* because of the close family relationship involved and the absence of any obligation between the parties other than the gift tax payment agreement.[51]

Although there is ample case and regulatory support for the conclusion that a part-sale, part-gift results in income to the donor to the extent that the compensation received exceeds the donor's basis,[52] courts have consis-

[43] *Id.* at 431. The majority adopted the reasoning of Senior Judge Bryan's dissent from the panel opinion in addition to Chief Judge Haynsworth's opinion for the en banc court. *Id.* at 428.

[44] *Id.* at 430.

[45] *Id.* at 431.

[46] *Id.* at 430.

[47] *Id.* at 428-31. Since the Fourth Circuit was not obligated to rule on the basis of either *Turner* or *Johnson,* it did not concern itself with whether the Sixth Circuit had abandoned *Turner* in its *Johnson* decision. *See* note 23 *supra.*

[48] *Id.* at 430-31.

[49] *Id.*

[50] *See* text accompanying notes 67-70 *infra.*

[51] *Id.* at 431. The Fourth Circuit rejected the application of *Crane* to *Hirst* on the basis of the close family relationship involved and the absence of any additional obligations between the parties. The Fourth Circuit suggested that *Crane* would also be inapplicable where a son borrows money from a bank and his father gratuitously pays off the loan for his son. Such a transaction would not result in taxable income to the son, but would be a gift. *Id.*

[52] *See* Malone v. United States, 326 F. Supp. 106 (N.D. Miss. 1971), *aff'd per curiam,* 455 F.2d 502 (5th Cir. 1972) (donor of property subject to mortgage realized income to extent mortgage disposed of exceeded his adjusted basis); Treas. Reg. § 1.1001-1 (e) (1957).

One commentator has suggested that allocation of the donor's basis should be required where a transaction is found to be a part-sale, part-gift. *See* Note, *Bad News for Net Givers: Donee Payment of Gift Taxes Results in Taxable Income to Donor,* 36 PITT. L. REV. 517, 534-35 (1974) [hereinafter cited as *Bad News*]. Allocation would result in the seller-donor being able to use only that proportion which is sold in computing his gain. For example, assume A has property with a $30,000 basis and a fair market value of $60,000. A transfers the property

tently refused to view the donee's payment of the gift tax as compensation.[53] By rejecting the part-sale, part-gift argument in *Hirst*, the Fourth Circuit has left the *Johnson* Tax Court as the only court which has applied the part-sale, part-gift characterization to a gift tax arrangement with a donee.[54] Despite the persuasiveness of the *Hirst* court's rejection of the part-sale characterization, the Fourth Circuit's analysis does not explain adequately why the acceptance of the net gift characterization of a transaction should result in a finding of no taxable gain to the donor.[55] Relying on the Tax Court's findings, the Fourth Circuit simply declared that Hirst received nothing for herself in this transaction.[56]

An important aspect of the Fourth Circuit's opinion is the application of *Old Colony Trust* and *Crane* to the *Hirst* transaction.[57] The *Hirst* court accepted *Turner* and the net gift characterization of the *Hirst* transfer.[58] The Fourth Circuit's implicit rejection of *Old Colony Trust's* applicability to *Hirst* follows from such acceptance.[59] In *Old Colony Trust*, a company paid the income taxes of certain of its officers.[60] The Supreme Court held that this discharge of the officers' obligation resulted in taxable income to the officers.[61] The Court viewed the payment as consideration for the officers' services and not a corporate gift. The Fourth Circuit acted properly by refusing to invoke the *Old Colony Trust* rule in *Hirst*. The logic of the

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to his son for $40,000. A has made a $40,000 sale and a $20,000 gift. *See* Treas. Reg. § 1001.1(e)(2). A's gain without allocation of his basis is $10,000, while with allocation it is $40,000—(2/3 X $30,000) or $20,000. Such allocation is required by § 1011(b) for bargain sales to charitable organizations, where a § 170 deduction for charitable contributions is allowed. Since there is a public policy supporting charitable transfers, it has been argued that the seller-donor of a part-sale, part-gift to a non-charity should be subject to the same allocation requirements. *See Bad News, supra* at 534-35.

[53] *See* Hirst v. Commissioner, 572 F.2d 427, 430 (4th Cir. 1978); Krause v. Commissioner, 56 T.C. 1242, 1248 (1971); Richard H. Turner, 49 T.C. 356, 363 (1968).

[54] The Tax Court in *Johnson* labelled the transaction at issue a part-sale, part-gift. Johnson v. Commissioner, 59 T.C. 791, 813 (1973). However, the Sixth Circuit in *Johnson*, while affirming the Tax Court's decision, refused to label the transaction at issue a part-sale, part-gift. Johnson v. Commissioner, 495 F.2d 1079, 1083 (6th Cir. 1974). The Circuit Court considered the term part-sale, part-gift a mere appellation without any significance. *Id.*

[55] *See* Hirst v. Commissioner, 572 F.2d 427, 430-31 (4th Cir. 1978). The Fourth Circuit is not the only court which has declined to become involved in any rigorous analysis of why a net gift should not result in taxation. The Tax Court in *Turner* essentially limited its inquiry to whether there was a part-sale, part-gift or a net gift. *See* 49 T.C. at 362-63. The court concluded that a net gift was made and held that the donor therefore incurred no income tax liability. *Id.* The *Turner* Tax Court did not adequately explain why a net gift should not result in income taxation. Subsequent Tax Court decisions have been even less helpful in explaining why a net gift should not result in income the donor. *See* Estate of Davis v. Commissioner 30 T.C.M. (CCH) 1363, 1368 (1971); Krause v. Commissioner, 56 T.C. 1242, 1248 (1971) (relying on *Turner*, both decisions found net gifts not taxable).

[56] 572 F.2d at 430.

[57] *See* text accompanying notes 1-3 *supra*.

[58] 572 F.2d at 428.

[59] The Fourth Circuit majority opinion did not mention *Old Colony Trust* despite the fact that the original panel majority relied upon it. *See* 572 F.2d at 438.

[60] 279 U.S. 716, 719-20 (1929).

[61] *Id.* at 729.

net gift characterization belies the contention that the donee pays the tax liability of the donor out of his own funds. The net gift concept contemplates a retention of ownership by the donor in a portion of the transferred assets which is equal in value to the resultant gift tax liability.[62] Under the net gift theory, the subsequent payment of the gift tax is not a payment by the donee with his own assets.[63] The donee is, in a sense, the agent of the donor, paying the gift taxes with that portion of the gift agreed by both parties to be the donor's property.[64] This situation is clearly distinguishable from that in *Old Colony Trust* where the corporation was paying the taxes out of its own funds and in consideration for the officers' services.[65]

Similarly, acceptance of the net gift characterization supports the Fourth Circuit's express refusal to apply *Crane* to the *Hirst* transaction.[66] In *Crane,* the taxpayer inherited an apartment building subject to a large mortgage and subsequently sold the building for a relatively small amount of cash.[67] The taxpayer claimed that she had realized a taxable capital gain only to the extent the cash received exceeded her adjusted basis in the property.[68] The Supreme Court disagreed, holding that the taxpayer realized a taxable capital gain to the extent the principal of the transferred mortgage plus the cash received exceeded her adjusted basis.[69] The Court reasoned that the taxpayer realized a gain because a mortgagor of property must treat the mortgage as his personal obligation as long as he owns that property.[70] *Hirst* is distinguishable from *Crane* since in *Hirst* the transferee did not accept the primary liability of the transferor. Under the net gift concept, Hirst merely discharged her own debt through her agent, the donee.[71] In the sale transaction in *Crane,* the mortgage liability passed to the transferee with the property.[72] In contrast, in the gift transaction in *Hirst,* the primary gift tax liability remained with the donor after the property transfer.[73]

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[62] *See* Duhl & Cohen, *The net gift technique: A current analysis of the requirements for its successful use,* 42 J. TAX. 158, 163 (1975) [hereinafter cited as *Technique*].

[63] *Id.*

[64] *Id.*

[65] Cases which have invoked the *Old Colony Trust* rule invariably involved a payor who used his own funds to satisfy another's obligation. *See* United States v. Boston & M. R. R., 279 U.S. 732 (1929) (lessee's payment of lessor's income tax liability pursuant to provision of lease was taxable income to lessor); United States v. Britt, 335 F.2d 907 (5th Cir. 1964) (borrower's payment of brokerage fees to lender who held funds to satisfy broker's obligation to lender was taxable income to broker); Wallin Coal Corp. v. Commissioner, 71 F.2d 521 (9th Cir. 1934) (facts and result similar to *Boston & M.*); Levey v. Helvering, 68 F.2d 401 (D.C. Cir. 1933) (corporation's reimbursement to certain officers for their income tax payments were taxable income to officers).

[66] *See* note 51 *supra.*

[67] 331 U.S. 1, 3 (1947).

[68] *Id.*

[69] *Id.* at 14.

[70] *Id.*

[71] *See Technique, supra* note 62, at 163.

[72] Crane v. Commissioner, 331 U.S. 1, 14 (1947).

[73] *See* note 4 *supra.* Of course, a gift of property subject to indebtedness will be subject to the *Crane* principle if the primary liability passes to the donee. *See* Malone v. United

Despite the non-applicability of *Old Colony Trust* and *Crane*, the net gift technique arguably should not free Hirst from income tax liability on the gift tax payments. A strong argument can be made, even under the net gift characterization, for the proposition that Hirst did receive something of value and that the gift tax payment was therefore properly taxable as income to Hirst. Section 1001(a), which describes the computation of gain, includes in its purview not only sales and exchanges, but also "other dispositions of property."[74] Several cases have held that certain transfers of property which did not amount to a sale or exchange were nonetheless taxable events because they amounted to "dispositions of property."[75] In all these cases, the court concluded that the transferor had received some taxable economic benefit from the transfer. Arguably *Hirst* is analagous to these cases, since *Hirst* used a portion of her property to discharge her gift tax liability.[76] Under the net gift concept, Hirst obtained discharge from a gift tax liability of $85,469.55 by transferring through her donee to the government property with a fair market value equal to that amount, but with a basis which was considerably less.[77] Gain from such a disposition of property can be computed under section 1001(a) and in this case the gain would be equal to Hirst's gift tax liability less her basis in the property.[78]

States, 326 F. Supp. 106 (N.D. Miss. 1971), *aff'd per curiam,* 455 F.2d 502 (5th Cir. 1972) (donor of property subject to mortgage realized income to extent mortgage disposed of exceeded his basis); Bacas, *Gifts of Property Subject to Indebtedness:* Johnson v. Commissioner, 44 GEO. WASH. L. REV. 86, 97-98 (1975). The Sixth Circuit held *Crane* was applicable to *Johnson.* Johnson v. Commissioner, 495 F.2d 1079, 1083 (6th Cir. 1974). This holding was proper since the net gift characterization could not be applied to the *Johnson* transaction. *See* note 30 *supra.* The funds retained by the donors were uncommitted to gift tax payment and therefore the donor could properly be said to have gained something of value from the donees, a third party. Although the Sixth Circuit stated that the *Turner* net gift transaction resulted in income to the donor, it did not expressly rely on *Crane* in so concluding. *Id.*

[74] I.R.C. § 1001(a). The gain from a sale or other disposition of property is the excess of the amount realized in the transaction over the adjusted basis of the taxpayer in the property. *Id.*

[75] *See* United States v. Davis, 370 U.S. 65 (1962) (transfer of appreciated stock by husband to his wife as part of property settlement was taxable disposition); United States v. General Shoe Corp., 282 F.2d 9 (6th Cir. 1960) (employer was liable for capital gains taxes in amount his tax deductions for contributions of property to employee's trust exceeded his basis in property); International Freighting Corp. v. Commissioner, 135 F.2d 310 (2d Cir. 1943) (corporation realized a taxable capital gain to the extent the cost to it of securities donated by it to employees was less than their fair market value); 18 WASH. & LEE L. REV. 69, 72-73 (1961).

[76] *See Technique, supra* note 62, at 163.

[77] *See* 572 F.2d at 431.

[78] *See* I.R.C. § 1001(a). The characterization of a *Hirst*-type transaction as a net gift or a part-sale, part-gift may affect whether the gain is afforded capital gains treatment if the net gift is considered a disposition of property under § 1001(a). The gain realized in the part-sale, part-gift is entitled to capital gains treatment since it results from a sale or exchange of a capital asset. *See* I.R.C. §§ 1001(c), 1222. The gain realized in a net gift can be treated as ordinary income since it results from a disposition of property not amounting to a sale or exchange. *See* I.R.C. § 1001(c); J. R. Hopkins, 15 T.C. 160 (1950) (payments received by licensor of patent from licensee were ordinary income since no sale or exchange of patent rights occurred).

Thus, although the net gift characterization may serve to distinguish *Crane* and *Old Colony Trust,* such characterization should not necessarily result in a finding of no taxable gain to the donor.[79]

The Tax Court in *Hirst* recognized that if Hirst's gain was not taxed at the time of the gift it would escape taxation altogether, since the donee's basis will be equal to the donor's pre-gift basis plus the amount of gift tax paid.[80] The Tax Court did not act on this problem only because it considered the *Turner* rule too well established to abandon.[81] This response aggravates the damage to tax revenues in a *Hirst*-type transaction, since the taxes which arguably are due on the donor's gain are not merely deferred, but are excused altogether.

Despite this problem, the Fourth Circuit's decision in *Hirst* produces a beneficial social result. The decision allows a cash poor person, such as Hirst, to keep her property within the family rather than being forced to sell a portion of it outside the family simply to raise money for gift or property taxes. Of course, the donee could give the donor cash to pay the gift tax, but this transaction itself could generate gift tax liability. Congress could partially solve the net gift problem by amending section 1015 of the Internal Revenue Code to disallow the addition of the gift tax paid to the donee's basis in the transferred property in the case of net gifts. Such an amendment would delay the taxation of donor's appreciation until the donee sold or disposed of the property, rather than allowing the appreciation to avoid taxation altogether as in *Hirst.* While such an amendment would not eliminate the potential application of section 1001(a) to the net gift, courts would be unlikely to so apply section 1001(a) after such an expression of legislative support for the net gift. The social benefits of the net gift policy could thus be retained without loss to the government of revenues from the taxable appreciation of property.[82]

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[79] A related question is whether the collection of gift taxes from the donee by the IRS pursuant to the IRS's lien on the gift property should result in income to the donor. Presumably it should since *Old Colony Trust* would apply. The donee could be said to have relieved the tax liability of the donor with the donee's own funds. *See* note 4 *supra.* Several cases, however, have treated the donee's obligation for gift taxes as independent of the donor's, with the IRS having the option to collect from the donee without seeking to collect from the donor. *See* Mississippi Valley Trust Co. v. Commissioner, 147 F.2d 186 (8th Cir. 1945); Estate of M.J. Burrell, 3 T.C.M. (CCH) 489 (1944); E. K. Vogel, 3 T.C.M. (CCH) 306 (1944). This principle could be extended to viewing collection of the gift tax from the donee as dispositive of his own debt and not that of donor's. Such a view would refute the application of *Old Colony Trust. See* text accompanying notes 60-62 *supra.*

[80] *See* Hirst v. Commissioner, 63 T.C. 307, 315 (1974); I.R.C. § 1015. Section 1015(d)(6) reduces somewhat the increase in the donee's basis for gift tax paid on gifts made after December 31, 1976. This change does not alter the principle that the appreciation used to pay gift tax in a *Hirst*-type transaction may be improperly escaping all taxation.

[81] *See* Hirst v. Commissioner, 63 T.C. 307, 315 (1974).

[82] The Tax Court has reaffirmed its commitment to the net gift doctrine in two cases analagous to *Hirst. See* Henry v. Commissioner, 69 T.C. 665 (1978); Owen v. Commissioner, 37 T.C.M. (CCH) 272 (1978). Both the cases involved gifts in trust given on condition that the trustees pay the gift taxes. These cases are now on appeal to the Sixth Circuit, which may have to decide whether it will reject the net gift concept as it indicated it would in *Johnson.* [1979] 9 FED. TAXES (P-H) 61,000 at 61,035; [1978 Federal Taxes Citator] FED. TAXES (P-H) at 13,106; *see* Johnson v. Commissioner, 495 F.2d 1079, 1083 (6th Cir. 1974).

B. Deductibility of Expenses Incurred by Existing Businesses Expanding into New Activities

Section 162(a) of the Internal Revenue Code allows for the deduction of all ordinary and necessary expenses incurred in carrying on a trade or business.[1] Neither the Code nor the Treasury Regulations, however, define "carrying on a trade or business,"[2] thus creating uncertainty for existing businesses expanding into peripheral areas of operation. If a new enterprise[3] is adjudged to be part of an existing business, section 162(a) deductions for the expenses of the new enterprise are proper.[4] When the company's new enterprise is found to be a separate and distinct business, however, the company may not deduct the new enterprise's expenses until that enterprise functions as a going concern.[5] The denial of a section 162(a)

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[1] *See* I.R.C. § 162(a). The question of whether an expense is ordinary and necessary is normally one of fact. Commissioner v. Heininger, 320 U.S. 467, 475 (1943). Ordinary and necessary expenses are not defined in the Code or the Treasury Regulations. Cases dealing with whether an expense is ordinary and necessary generally turn on the reasonableness of the expense under the circumstances. *Compare* Commissioner v. Heininger, 320 U.S. 467 (1943) (attorney's fee ordinary and necessary expense to business faced with receiving potentially destructive fraud order from government agency) *with* Trebilcock v. Commissioner, 557 F.2d 1226 (6th Cir. 1977) (amounts paid by sole proprietor of wood brokerage business to minister for spiritual advice not deductible as ordinary and necessary expense).

[2] *See* [1978] 1 STAND. FED. TAX REP. (CCH) ¶ 1332.107.

[3] The terms "new enterprise" and "peripheral area of operation" are used to describe those new activities of an existing business which are so different in character or separate from the previous activities of the business that a question is raised as to whether a new business has been created for § 162(a) deduction purposes. *Compare* Cornelius Vanderbilt, Jr., 16 T.C.M. (CCH) 1081 (1957) (lecturer allowed to deduct expenses incurred in unsuccessful attempt to obtain employment as television narrator since latter occupation found not to be new and separate from lecturer profession) *with* Estate of Brawner, 36 B.T.A. 884 (1937) (manager of rental properties denied deduction for expenses incurred in preparations for buying apartment house, since buying and selling of apartment houses is separate business from managing rental property).

[4] *See* York v. Commissioner, 261 F.2d 421 (4th Cir. 1958) (commercial developer allowed to deduct expenses in industrial development).

[5] *See* Richmond Television Corp. v. United States, 345 F.2d 901, 907 (4th Cir.), *remanded on another issue,* 382 U.S. 68 (1965) (denied § 162(a) deduction to television station for expenses incurred in training its staff prior to obtaining broadcasting license from FCC); Vincent W. Eckel, 33 T.C.M. (CCH) 147 (1974) (businessman involved in gun sales business denied business deduction for expenses incurred in trip to Africa for purpose of obtaining information to be used in business of training big game hunters); Estate of Browner, 36 B.T.A. 884 (1937) (manager of rental properties denied deduction for expenses incurred in preparations for buying apartment house, since buying and selling of apartment houses is separate business from managing rental property). The expenses of a new enterprise which is determined to be an immature new business for § 162(a) purposes may, however, be added to the basis of the company as a capital expenditure. *See* Richmond Television Corp. v. United States, 345 F.2d 901, 905 (4th Cir. 1965). Alternatively, if the company is seeking a net operating loss deduction under § 172, it may use these new enterprise expenses in computing a net operating loss, but only to the extent of the company's income from the new enterprise. *See* I.R.C. § 172(d)(4).

The justification for not allowing § 162(a) deductions for startup expenses is the probability that a contrary rule would result in the granting of business deductions to expenses which

deduction may be a considerable burden to a business which has undertaken an expensive new operation which has produced little income.[6] Facing such a situation in *Malmstedt v. Commissioner,*[7] the Fourth Circuit concluded that a residential real estate development firm had not entered a new business when it became involved in commercial real estate development. Therefore, the Fourth Circuit held that the company's commercial development expenses were deductible from its total residential-commercial gross income under section 162(a).

The *Malmstedt* case was the unexpected conclusion to an ambitious real estate development scheme. Bertil Malmstedt and Margaret Johnson formed a real estate development partnership in 1958.[8] Initially the partnership engaged in two residential real estate development projects. In 1959, however, the partnership purchased property adjacent to one of its residential projects for the purpose of commercial development.[9] The partnership subsequently spent a substantial sum of money in an unsuccessful attempt to develop this commercial property.[10] Concurrent with the development of this property, which was called Gold Mine, the partnership became involved in a third residential development. These two projects overextended the resources of the partnership and forced it to refinance its indebtedness on the Gold Mine property. The partnership was required to pay a high refinancing fee in order to obtain the new loan. Subsequently the partnership failed to meet the interest payment on this debt and its creditors foreclosed on both Gold Mine and the third residential development. The Gold Mine property was sold in 1964 at a judicial sale.[11]

The IRS asserted deficiencies against Malmstedt on his 1963 income tax return and against Johnson on her 1964 return. Malmstedt and Johnson, who married in 1965, subsequently filed a petition for redetermination with the Tax Court.[12] The controversy concerned the amount of taxable gain realized by the Malmstedts in the forced sale of the Gold Mine property. The Malmstedts contended, among other things,[13] that the interest

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are actually personal. *See* Buell, *Business Start Up Costs: Analyzing and Planning for Current Deductibility,* 43 J. TAX. 278, 280 (1975) [hereinafter cited as *Start Up Costs*].

[6] Capitalizing a large expenditure made in a new venture does not produce the immediate tax advantages of a deduction. Thus, an expanding company will prefer to deduct such expenses. *See generally Start Up Costs, supra* note 5, at 278.

[7] 578 F.2d 520 (4th Cir. 1978).

[8] *Id.* at 521.

[9] *Id.* at 522. The partnership planned to construct a luxury hotel on the purchased property. *Id.*

[10] *Id.* The partnership claimed to have spent over $500,000 in their unsuccessful attempt to develop the Gold Mine property. *Id.*

[11] *Id.* at 523. In 1963 Bertil Malmstedt had assigned his interest in Gold Mine to Margaret Johnson. *Id.*

[12] *Id.* Once a deficiency has been asserted against a taxpayer by the IRS, he may file a petition for redetermination with the Tax Court and have the deficiency reconsidered by the Tax Court. I.R.C. § 6213(a).

[13] There were numerous questions pertaining to the tax consequences of the Malmstedts' business activities which were addressed by the Tax Court which are not relevant to the issues addressed by the Fourth Circuit. *See generally* Malmstedt v. Commissioner, 35 T.C.M. (CCH) 199 (1976).

payments, property taxes, and refinancing fee on the Gold Mine property were deductible business expenses of the partnership, which could be included in computing a net operating loss deduction.[14] The IRS disagreed, arguing that the expenses failed to qualify as business deductions.[15]

The Tax Court, while rejecting the IRS's further contention that the expenses should be capitalized,[16] agreed with the IRS that the expenses were not deductible under section 162(a) since the commercial development was an immature new business rather than a part of the taxpayer's previous residential development enterprise.[17] Thus the expenses were deductible only under section 172(d)(4), which allows the deduction of non-business expenses in computing a net operating loss only to the extent of non-business income. Losses from Gold Mine consequently were deductible only to the extent of any Gold Mine income, which was non-existent in most of the years in question.[18] The Tax Court recognized that in *York v. Commissioner*[19] the Fourth Circuit found commercial development and industrial development to be but one business.[20] Nevertheless, the Tax Court distinguished the Malmstedt's situation on the basis of the qualitative differences between modest residential development and large-scale

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[14] *Id.* at 207-09. If the taxpayers could have convinced the Tax Court that their Gold Mine activities were simply a part of their general real estate development business, they could have deducted their heavy losses from Gold Mine against their total residential-coommercial income by means of the net operating loss deduction. *See* I.R.C. § 172(a). If the Tax Court had agreed with the taxpayers on this point, their deficiency would have been eliminated or substantially reduced. 578 F.2d at 524.

If the Gold Mine venture, however, was an attempt at a new business, no deduction would be allowed under § 162(a) for its expenses. A deduction which is not attributable to a trade or business can only enter into the computation of a net operating loss to the extent permitted by § 172(d)(4). Malmstedt v. Commissioner, 35 T.C.M. (CCH) 199, 209 (1976). That section allows non-business expenses to contribute to the computation of a net operating loss, but only to the extent of the taxpayer's non-business income, which here would include any Gold Mine income, but not the residential development income. Since the taxpayers realized no income from the Gold Mine venture in those years in which the greatest portion of its claimed deductible expenses were incurred, the § 172(d)(4) deduction was of negligible value to the taxpayers. *See generally* 35 T.C.M. (CCH) at 202-04.

[15] 35 T.C.M. (CCH) at 209.

[16] *Id.* at 208-09. The Tax Court in *Malmstedt* agreed with the IRS that certain other expenses of Gold Mine, such as insurance and legal and architectural fees, should be capitalized. *Id.* at 208. This holding was not contested on appeal.

[17] *Id.* at 209-10.

[18] *See* note 14 *supra*.

[19] 261 F.2d 421 (4th Cir. 1958). In *York* a developer experienced in apartment and shopping center development deducted an expenditure for an expert survey on the feasibility of certain land for industrial development. The Fourth Circuit found this industrial expense to be properly deductible, since the industrial development business was within the compass of York's previous development activities. *Id.* at 422.

[20] 35 T.C.M. (CCH) at 209 n.22. The Tax Court has decided that it will follow a U.S. Court of Appeals' decision which is directly applicable where the only appeal from its decision is to that circuit. *See* Golsen v. Commissioner, 54 T.C. 1242, *aff'd on other grounds,* 445 F.2d 985 (10th Cir.), *cert. denied,* 404 U.S. 940 (1971). Since *York* was a Fourth Circuit decision and *Malmstedt* was appealable only to the Fourth Circuit, the Tax Court either had to follow *York* or distinguish it.

commercial development.[21] The contrast in size between the Malmstedt's previous residential development and the Gold Mine scheme was the sole qualitative difference cited by the court.[22]

Both the IRS and Mrs. Malmstedt appealed the Tax Court's decision to the Fourth Circuit.[23] The Fourth Circuit reversed the decision of the Tax Court, finding clearly erroneous the lower court's ruling that commercial development is a separate business from residential real estate development.[24] According to the *Malmstedt* court, the *York* decision controlled, since in both cases the business movement into commercial or industrial development was reasonable, natural, and in the normal scope of a real estate development business.[25] The Fourth Circuit criticized the Tax Court's use of supposed qualitative differences between residential and commercial development in distinguishing *York*, stating that the varying sizes of two activities are not determinative of whether the activities are one business or two.[26]

In determining that Malmstedt was not engaging in a new business at Gold Mine, the Fourth Circuit closely examined the conduct of the partnership since its formation. The *Malmstedt* court found that the partnership had intended general real estate development from its inception and not merely residential real estate activity.[27] Important to the court's determination was the location of Gold Mine across the street from the partnership's prior residential development and the initiation of the Gold Mine project only a year after the formation of the partnership.[28] Accordingly,

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[21] 35 T.C.M. (CCH) at 209 n. 22.

[22] *See id.* at 209.

[23] 578 F.2d at 523. Bertil Malmstedt initially filed an appeal but withdrew his appeal before the Fourth Circuit heard the case. Telephone conversation with Sylman I. Euzent, Attorney for Malmstedts. (Oct. 20, 1978).

The IRS challenged the Tax Court's calculation of the taxpayers' basis in a corporation they controlled. The Fourth Circuit remanded this issue, instructing the Tax Court to explain how it calculated the taxpayers' basis in the subject stock. 578 F.2d at 528. The IRS did not renew its argument that the Gold Mine expenses ought to be capitalized.

[24] 578 F.2d at 527. The Courts of Appeals are required to employ the same standard of review for findings of fact made by the Tax Court as utilized in ruling on federal district court findings of fact in cases tried without a jury. I.R.C. § 7482(a). Findings of fact made by the Tax Court are not reversible by the Courts of Appeals unless clearly erroneous. *See* Road Materials, Inc. v. Commissioner, 407 F.2d 1121, 1123-24 (4th Cir. 1969); FED. R. CIV. P. 52 (a).

[25] 578 F.2d at 527.

[26] *Id.* The Fourth Circuit found the Malmstedt case analagous to Cornelius Vanderbilt, Jr., 16 T.C.M. (CCH) 1081 (1957) in which a lecturer was allowed to deduct expenses in an unsuccessful attempt to obtain employment as a television narrator since the latter occupation was directly related to being a lecturer. The Fourth Circuit distinguished Frank B. Polachek, 22 T.C. 858 (1954), and Morton Frank, 20 T.C. 511 (1953), in which the Tax Court denied claimed business deductions, on the ground that those two cases involved taxpayers who were not engaged in any business at all, but were only seeking to establish one. 578 F.2d at 526.

[27] 578 F.2d at 526.

[28] *Id.* The Fourth Circuit also noted that the Gold Mine property was purchased from the same owner as the earlier residential development property. *Id.*

the court held that the interest, tax, and refinancing fee payments were properly deductible under section 162(a).[29]

The *Malmstedt* decision is a sound application of stare decisis, since it strongly reaffirms the *York* principle. Indeed, the facts of *Malmstedt* lead more easily than the facts of *York* to the conclusion that the new enterprise was a part of the old business. The Malmstedts' venture into commercial development was with property located directly across the street from its previous development and was begun only a year after the formation of the partnership.[30] In contrast, York's industrial site was not geographically adjacent to his previous commercial development, and he had spent seven years in commercial development before beginning his industrial development.[31]

Other jurisdictions have faced situations similar to *Malmstedt*. As in *Malmstedt*, these jurisdictions have made a finding of fact as to whether a new enterprise is part of the existing business.[32] In making this determination these courts have looked at the circumstances of the business expansion in a realistic and nontechnical manner, with due regard for the pressures upon businesses to innovate and diversify.[33] Certain characteristics, however, have been particularly prominent in the courts' analysis. One such characteristic is the geographic proximity of the new activity to the existing business,[34] a factor which influenced the Fourth Circuit in

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[29] *Id.* at 527-28. The Fourth Circuit also held that the Tax Court was correct in holding that the refinancing fee could not be deducted in the year paid but must be amortized over the life of the loan. *Id.* at 527-28. Upon foreclosure, however, the unamortized portion could be deducted in its entirety in the year of foreclosure. *See* Enoch v. Commissioner, 57 T.C. 781, 795 (1972); Metropolitan Prop. Corp., 24 B.T.A. 220, 225 (1931).

[30] 578 F.2d at 522.

[31] York v. Commissioner, 261 F.2d 421, 422 (4th Cir. 1958).

[32] *See* Colorado Springs Nat'l Bank v. United States, 505 F.2d 1185, 1190 (10th Cir. 1974) (bank's new credit card operations were part of existing business); Schulumberger Tech. Corp. v. United States, 443 F.2d 1115, 1123 (5th Cir. 1971) (loan made by physical phenomena measuring firm to corporation engaged in computer business was within scope of existing business, since loan was in furtherance of firm's business interests in obtaining computer analysis of its scientific data); Baltimore Aircoil Co. v. United States, 333 F. Supp. 705, 707 (D.C. Md. 1971) (parent corporation's expenses incurred in opening of subsidiary's plant were within scope of parent's existing business); O'Donnell v. Commissioner, 62 T.C. 781, 786 (1974) (accountant involved in rental property in Nevada was commencing separate business when he incurred expenses on trip to Florida for purpose of investigating purchase of rental property); Best Universal Lock Co., 45 T.C. 1, 12 (1965) (lock company did not enter new business when it engaged in research and development in air compressors).

[33] *See* Colorado Springs Nat'l Bank v. United States, 505 F.2d 1185, 1190 (10th Cir. 1974) (Tenth Circuit considered bank's expansion into credit card industry logical extension of bank's business of providing consumer credit); Baltimore Aircoil Co. v. United States, 333 F. Supp. 705, 711 (D.C. Md. 1971) (court recognized that subsidiary may be treated as part of parent for tax purposes when its activities are substantially directed to benefit of its parent).

[34] *See* O'Donnell v. Commissioner, 62 T.C. 781, 786 (1974) (denied deduction to Nevada rental property business for expenses incurred in investigating Florida property). *But see* Baltimore Aircoil Co. v. United States, 333 F. Supp. 705, 707 (D.C. Md. 1971) (allowed deduction to Maryland parent corporation for costs of operating California subsidiary's plant, since parent's existing business was well served by California expansion).

Malmstedt.[35] A second usual factor, also relied upon by the *Malmstedt* court,[36] is whether the new enterprise is in some way functionally related to the activities of the existing business, so as to supplement or assist them.[37] Thus, the Fourth Circuit's approach is *York* and *Malmstedt* is consistent with that taken by the few jurisdictions which have faced this issue.

The Tax Court has made a brief statement of its position on the business expansion issue.[38] The court has asserted that there is an imprecise line between what is an integrated enterprise and what are two separate businesses.[39] That line, reasons the Tax Court, must be drawn on a case by case basis, with consideration given to both geographic and functional factors.[40] The Fourth Circuit in *Malmstedt* and *York,* while overruling the Tax Court's findings of fact in those cases, has employed analysis consistent with the Tax Court's position. As the reversals in *Malmstedt* and *York* indicate, however, the Fourth Circuit is more reluctant than the Tax Court to draw a line between two activities and label them separate businesses.[41] The Fourth Circuit has preferred to give businesses greater latitude in which to operate when new activities are commenced in a good faith effort to make a profit.[42]

The Fourth Circuit's decisions on the issue of whether a new activity is part of an existing business do not establish a definite standard and therefore do not provide the business planner with certainty as to the tax consequences of every expansion. As the results in cases such as *Malmstedt* and *York* show, however, businesses acting in good faith to make a profit have been very successful in obtaining deductions for expenses incurred in new enterprises related in some manner to the existing business.[43] The nature of the existing business will in large measure determine the relative importance a court will place on the geographic and functional factors. When dealing with a business already operating in many geographic areas, a court will be little concerned with the location of the new enterprise and will concentrate on whether the new enterprise is functionally related to the existing business.[44] On the other hand, a business operating in a limited geographic area, such as those in *Malmstedt* and *York,* may be presumed to be opening a new business when it commences operations in a distant

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[35] 578 F.2d at 526.

[36] *Id.* at 527.

[37] *See* Briarcliff Candy Corp. v. Commissioner, 475 F.2d 775 (2d Cir. 1973) (promotional expenses incurred in expansion of retail candy selling operation into franchising of candy stores deductible under § 162(a)); note 33 *supra.*

[38] *See* O'Donnell v. Commissioner, 62 T.C. 781, 786 (1974); note 30 *supra.*

[39] 62 T.C. at 786.

[40] *Id.*

[41] *See* 578 F.2d at 527; York v. Commissioner, 261 F.2d 421, 422 (4th Cir. 1958).

[42] *See* 578 F.2d at 527.

[43] *See, e.g.,* Best Universal Lock Co., 45 T.C. 1 (1965) (lock company allowed to deduct expenses of developing isothermal air compressor); notes 32 and 37 *supra.*

[44] *See* Schulumberger Tech. Corp. v. United States, 443 F.2d 1115 (5th Cir. 1971) (*see* note 32 *supra*).

state.[45] Similarly, a conglomerate which manufactures a wide assortment of goods should have little difficulty in demonstrating that a new product is functionally within the scope of its existing business; while a specialized firm will have more difficulty in showing that a new enterprise is part of its existing specialized concern.[46] Thus, although the *Malmstedt* decision does not provide universally applicable standards for the new activity issue, it does, when combined with other case law employing similar analysis, illustrate useful factors for business tax planning.

C. Timeliness Requirements for Filing a Petition for Redetermination of a Deficiency

The Internal Revenue Code authorizes the Secretary of the Treasury to send deficiency notices to taxpayers deemed deficient in payment of income, gift, estate, or certain other federal taxes.[1] The taxpayer who receives such a notice and wishes to challenge the deficiency determination has several methods available to him.[2] One such method is provided by section 6213(a), which grants taxpayers the right to a redetermination of a deficiency in the Tax Court if a petition for redetermination is filed within ninety days of the mailing of the deficiency notice.[3] Prior to 1954 the courts generally considered a petition for redetermination timely filed only if it was received by the Tax Court within the ninety-day period.[4]

[45] *See* O'Donnell v. Commissioner, 62 T.C. 781, 786 (1974).

[46] *See* Estate of Brawner, 36 B.T.A. 884 (1937) (manager of rental properties denied deduction for expenses incurred in preparations for buying apartment house, since buying and selling of apartment houses is separate business from managing rental property).

[1] I.R.C. § 6212(a).

[2] A taxpayer may challenge the Commissioner's assessment of a deficiency by paying the deficiency, making a claim for refund with the IRS, and suing for refund in the Court of Claims or the federal district court. I.R.C. § 7422. Alternatively, a taxpayer may petition the Tax Court for redetermination of the deficiency. I.R.C. § 6213(a). Finally, a taxpayer may, in extenuating circumstances, obtain an IRS Appellate Division hearing if he has not had one, or a rehearing if he has. INTERNAL REVENUE MANUAL ¶ 8320 (1977). This final alternative will not toll the statutory period for filing a petition for redetermination in the Tax Court. *Id.*

[3] I.R.C. § 6213(a) allows taxpayers 150 days for the filing of a petition for redetermination if the notice is addressed to a person outside the United States. A Saturday, Sunday, or holiday in the District of Columbia is not counted as the last day of the 90 or 150 day period. I.R.C. § 6213(a). During this period the IRS is not allowed, with some exceptions, to assess a deficiency or move to collect the amount owed. *Id.* Likewise, once a petition for redetermination has been filed with the Tax Court, the IRS may not assess a deficiency or move to collect until the Tax Court's decision has been finalized. *Id.*

[4] *See, e.g.*, Di Prospero v. Commissioner, 176 F.2d 76 (9th Cir. 1949) (delay in mail service does not excuse late filing); Stebbins Estate v. Helvering, 121 F.2d 892 (D.C. Cir. 1941) (failure of air mail service due to bad weather does not excuse late filing); Edward Barron Estate Co. v. Commissioner, 93 F.2d 751 (9th Cir. 1937) (court without power to disregard strict language of statute despite equitable considerations in favor of taxpayer).

Thus taxpayers needed to anticipate sufficiently the statutory deadline in order to allow for the vagaries of postal service. However, with the enactment of section 7502 in 1954, Congress adopted the postmark date on the cover of a petition as the date of filing.[5] Since the enactment of section 7502 there has been considerable litigation concerning whether a timely postmark date is absolutely essential to obtaining the jurisdiction of the Tax Court.[6] In *Curry v. Commissioner*[7] the Fourth Circuit decided that a prisoner's petition for redetermination bearing a late postmark should be considered on the merits where the petition was postmarked late solely due to errors of prison employees.

The facts in *Curry* were not complex. On April 14, 1975, the Internal Revenue Service mailed a notice of deficiency to Willie A. Curry, a prisoner at Leavenworth Penitentiary. Curry placed a petition for redetermination in a prison mailbox on July 8, 1975, prior to the expiration of the statutory period for filing under section 6213(a). A staff member of the prison, mistakenly believing the petition to be incorrectly addressed, returned it to Curry on July 18 before the petition reached the U.S. mails.[8] The petition finally received a postmark on July 24, seven days past the statutory deadline for mailing a petition for redetermination. All prison employees in-

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A few courts chose to mitigate the harshness of § 6213(a) by establishing the rebuttable presumption that a petition for redetermination properly addressed and deposited in the U.S. mail was received in the ordinary course of the mail. *See* Detroit Automotive Prod. Corp. v. Commissioner, 203 F.2d 785 (6th Cir. 1953). If a taxpayer could show that he mailed his petition early enough to reach the Tax Court in a timely manner, the court presumed that the delay was due to an internal failure in the Tax Court machinery, and granted jurisdiction unless there was evidence that the delay was actually due to Post Office inefficiency. *See* Arkansas Motor Coaches, Ltd. v. Commissioner, 198 F.2d 189 (8th Cir. 1952) (Johnson, J., concurring in part). One court in a pre-1954 decision employed equitable principles in holding that the negligence of the Post Office could not operate to deprive a faultless taxpayer of his day in the Tax Court. *See* Arkansas Motor Coaches, Ltd. v. Commissioner, 198 F.2d 189 (8th Cir. 1952).

[5] I.R.C. § 7502(a)(1) provides that the date of the United States postmark stamped on the cover of a claim or other document required to be filed before a prescribed date shall be deemed the date of delivery. Section 7502(a)(2) expressly limits the application of § 7502(a)(1) to documents bearing a postmark dated no later than the prescribed date for filing.

Section 7502(c) provides that for registered mail the date of registration shall be deemed the postmark date. Treasury Regulation § 301.7502-1(c)(2) provides that for certified mail the date postmarked on the sender's receipt is the date of postmark. Treas. Reg. § 301.7502-1(c)(2), T.D. 6444, 1960-1 C.B. 673.

[6] *See, e.g.*, Ruegsegger v. Commissioner, 68 T.C. 463 (1977) (Tax Court accepted jurisdiction of petition without postmark where petitioner adequately demonstrated that he mailed petition early enough to receive timely postmark); Mason v. Commissioner, 68 T.C. 354 (1977) (Tax Court accepted jurisdiction of petition with illegible postmark where petitioner adequately demonstrated that he mailed petition early enough to receive timely postmark); Perry Segura & Assoc. v. Commissioner, 34 T.C.M. (CCH) 406 (1975) (Tax Court accepted jurisdiction where original cover for petition destroyed in postal handling and petition rewrapped in cover with late postmark).

[7] 571 F.2d 1306 (4th Cir. 1978).

[8] *Id.* at 1307. The prisoners' mailbox at Leavenworth Penitentiary was not a U.S. mailbox and therefore prison employees transferred the mail placed in it to the U.S. mails. *Id.*

volved stated that Curry had done all he could to get the petition mailed on time.[9]

Nonetheless, the Tax Court determined that Curry's petition for redetermination had not been timely filed and dismissed the petition for lack of jurisdiction.[10] In an unpublished opinion, the Tax Court expressed sympathy for Curry, but felt bound to dismiss his case[11] because of the factually indistinguishable circuit court precedents of *Bloch v. Commissioner*[12] and *Rich v. Commissioner.*[13] In both of these cases the courts concluded that they were without power to entertain the taxpayers' petitions for redetermination since the ninety-day period of section 6213 was not merely a limitation, but a rigid line of demarcation upon the jurisdiction of the Tax Court.[14] Both courts treated section 7502 as the exclusive remedy for the earlier harsh operation of section 6213(a).[15] Since the prisoners had failed to file a petition for redetermination with a timely postmark, the courts concluded that they lacked jurisdiction.[16]

On appeal in *Curry,* the Fourth Circuit reversed the Tax Court and remanded the case for a decision on the merits.[17] Initially the Fourth Circuit reasoned that the equitable principles of *Arkansas Motor Coaches, Ltd. v. Commissioner*[18] survived the passage of section 7502 and that these

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[9] *Id.*

[10] *Id.*

[11] *Id.* The Tax Court has decided that it will follow a Court of Appeals precedent which is directly applicable where the only appeal from its decision is to that circuit. Golsen v. Commissioner, 54 T.C. 1242, 1256-56 (1970), *aff'd on other grounds,* 445 F.2d 985 (10th Cir.), *cert. denied,* 404 U.S. 940 (1971). Since the *Curry* case was appealable to the Fourth Circuit, not the Fifth or the Ninth, the Tax Court was not obligated to follow *Rich* or *Bloch.* For the sake of uniformity, however, the Tax Court will often follow decisions of other circuits where there is no appellate decision on point in the applicable circuit. *See* Bankers Union Life Ins. Co. v. Commissioner, 62 T.C. 661, 674-75 (1974).

[12] 254 F.2d 277 (9th Cir. 1958). In *Bloch,* a prisoner placed a petition for redetermination in the hands of a prison employee for mailing on two separate occasions. Prison regulations required prisoners to give their mail to prison employees, who were then to mail the items. Both petitions were given to the proper employee within the 90 day period, but neither was mailed until after the statutory period for filing had passed. *Id.* at 277-78.

[13] 250 F.2d 170 (5th Cir. 1957). In *Rich,* a prisoner gave a petition for redetermination to the prison official in charge of the mail room within the 90 day period for filing, with instructions to send it by registered mail. For unexplained reasons, the petition then lay in the prison mail room for a month before it was finally mailed, one day beyond the statutory period for filing. *Id.* at 172.

[14] *See* 254 F.2d at 279; 250 F.2d at 174.

[15] *See* 254 F.2d at 279; 250 F.2d at 174. Prior to the enactment of § 7502, courts generally considered a petition for redetermination timely filed only if it was received by the Tax Court within the 90 day period of § 6213(a). *See* note 4 *supra.*

[16] 254 F.2d at 279; 250 F.2d at 175.

[17] 571 F.2d 1306 (4th Cir. 1978). The IRS had decided not to seek certiorari in *Curry* at the Supreme Court. [1979] 8 STAND. FED. TAX. REP. ¶ 5322.5216.

[18] 198 F.2d 189 (8th Cir. 1952). In *Arkansas Motor Coaches* the taxpayer mailed his petition six days prior to the close of the § 6213(a) filing period. Normal mail service would have brought the petition to the Tax Court in one day. *Id.* at 190. The Tax Court's records,

principles allowed the Tax Court to assume jurisdiction of Curry's case.[19] In *Arkansas Motor Coaches,* the Eighth Circuit directed the Tax Court to accept jurisdiction of a petition for redetermination which was filed late, when there was evidence that it was mailed sufficiently in advance to reach the Tax Court on time.[20] The Eighth Circuit concluded that it would be inequitable to allow the government to use the negligence of its own employees, whether they be postal workers or Tax Court employees, to defeat a taxpayer in his effort to obtain the jurisdiction of the Tax Court.[21] The Fourth Circuit found *Curry* analogous to *Arkansas Motor Coaches* and rejected the Commissioner's contention that passage of section 7502 superseded the principle of that case.[22] The court reasoned that section 7502 was limited in scope to the problem of late postal delivery and inferred that the statute was not the exclusive means of mitigating the section 6213(a) filing requirement.[23]

The Fourth Circuit refused to follow *Bloch* and *Rich,* noting that subsequent developments in the law had eroded their usefulness.[24] One of these subsequent developments was the Supreme Court's decision in *Fallen v. United States,*[25] a decision in which the Fourth Circuit found support for its position on the continuing vitality of the equitable doctrine of *Arkansas Motor Coaches.* In *Fallen,* the Supreme Court directed the Court of Appeals to accept jurisdiction of a prisoner's criminal appeal where the notice of appeal was not timely filed due to the prison's unexpeditious handling of the prisoner's outgoing mail.[26] The presence in the governing statute of

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however, indicated actual receipt by the Tax Court seven days after mailing and after the close of the § 6213(a) filing period. *Id.* The court could not determine the specific reason for the delay in receipt but concluded that the fault was with either Post Office or IRS employees. *Id.* at 191-92.

[19] *See* 571 F.2d at 1307-08.

[20] *See* 198 F.2d at 193.

[21] *Id.* at 192-93.

[22] *See* F.2d at 1308.

[23] *Id.* In rejecting the Commissioner's argument for the exclusivity of § 7502, the court stated that it found no indication in § 7502 that it was designed to repudiate the principle that the government could not deny a taxpayer his day in court by its own negligence. *Id.*

The court also rejected a second attempt by the IRS to distinguish *Arkansas Motor Coaches. Id.* The IRS pointed out that although the taxpayer in *Arkansas Motor Coaches* had no alternative but to proceed in the Tax Court, Curry could have paid the deficiency and sued for a refund in federal district court. The court dismissed this distinction as insubstantial, noting that the Tax Court had rejected such a distinction in an earlier case and pointing out that a refund suit was not a viable alternative for Curry, who could not pay the $53,000 deficiency. *Id.; see* Sylvan v. Commissioner, 65 T.C. 548, 566 (Drennan, J., dissenting).

[24] *See* 571 F.2d at 1307 n. 2. The court suggested that the subsequent developments which eroded the value of *Bloch* and *Rich* were the acceptance of jurisdiction by courts on the basis of equity, as exemplified in Fallen v. United States, 378 U.S. 139 (1964), the relaxation of the strict interpretation of § 7502, and the constitutional rights of prisoners to access to the courts. *Id.*

[25] 378 U.S. 139 (1964).

[26] *Id.* at 143-44. In *Fallen,* the prisoner's notice of appeal was governed by the now deleted Rule 37(a)(2) of the Federal Rules of Criminal Procedure, which required actual filing in the Court of Appeals within the stated period. Criminal appeals are now governed by a similar provision in the Federal Rules of Appellate Procedure. *See* FED. R. APP. P. 4(b).

an admonition to interpret the statute with fairness and sympathy influenced the Supreme Court in its decision.[27] The Fourth Circuit acknowledged that the Internal Revenue Code contains no direction to enforce its rules with fairness and sympathy, but concluded that such a provision was not necessary for a court to employ standards of fairness in its analysis of statutes.[28] The court considered *Fallen* analogous to *Curry* since in both cases the government had asserted its own negligence as grounds for the denial of jurisdiction to the claims of faultless prisoners.[29]

In an alternative rationale for its decision, the Fourth Circuit stated that even if section 7502 was the exclusive means of mitigating the ninety-day requirement for filing, Curry's petition should not be barred. The court reasoned that, as a remedial statute, section 7502 should be liberally construed. Under such a construction the actions of Curry, who did all he could to place his petition in the U.S. mail, should be deemed a constructive delivery of the petition prior to the expiration of the ninety-day period.[30] In support of this reasoning the court noted that section 7502 has been interpreted to allow petitions with illegible or missing postmarks.[31] Accordingly, the court concluded that the statute was flexible enough to include similar situations in which events outside the taxpayer's control prevented a petition from receiving a timely postmark.[32]

The Fourth Circuit's decision in *Curry* is a questionable intrusion into the legislative domain.[33] The Tax Court is not an article III but an article I court,[34] and as such only exerts judicial power to the extent provided by

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[27] *See* 378 U.S. at 142; FED. R. CRIM. P. 2. Rule 2 requires that the Rules of Criminal Procedure be construed to secure simplicity in procedure, fairness in administration, and the elimination of expense and delay.

[28] *See* 571 F.2d at 1309.

[29] *Id.* at 1308-09.

[30] *Id.*

[31] *Id.; see* Skolski v. Commissioner, 351 F.2d 485 (3rd Cir. 1965) (taxpayer whose petition for redetermination has an illegible postmark should be granted jurisdiction in Tax Court if he can show that postmark was timely); Sylvan v. Commissioner, 65 T.C. 548 (1975) (taxpayer whose petition has no postmark should be granted jurisdiction in Tax Court if he can show that petition should have received timely postmark).

[32] *See* 571 F.2d at 1309. The Fourth Circuit also suggested a third rationale for its decision. The court postulated that the constitutional right of a prisoner to access to the courts might necessitate a decision in favor of Curry. *Id.* The Court, however, did not develop this argument, deciding to avoid a constitutional decision since the case could be disposed of on the basis of its equitable and constructive delivery theories. *Id.; see* Ashwander v. Tennessee Valley Auth., 297 U.S. 288, 341 (1936) (Brandeis, J., concurring).

[33] *See* 571 F.2d at 1310 (Hall, J., dissenting).

[34] Congress specifically designated the Tax Court an article I court with passage of I.R.C. § 7441 in 1969. Article I courts, or legislative courts, are not authorized by any specific constitutional language, but by the general power of Congress to exercise sovereignty. Note, *Legislative and Constitutional Courts: What Lurks Ahead for Bifurcation,* 71 YALE L. J. 979, 981 (1962). Article III courts, or constitutional courts, are those established by Congress under article I, section 8 of the Constitution. These courts are governed by article III, which contains the requirements that judges hold their offices during good behavior and without risk of pay reduction. The distinction between the two types of courts was recognized in American Ins. Co. v. 356 Bales of Cotton, 26 U.S. 511 (1828), where the Supreme Court recognized Congress' power to set up courts which did not fulfill the strictures of article III.

statute.[35] To date Congress has not granted the Tax Court power to accept jurisdiction in the interests of equity.[36] Therefore, the Tax Court lacks the power to invoke principles of equity to justify the acceptance of jurisdiction. Since Curry's petition was received by the Tax Court after the statutory period and carried an untimely postmark, the Tax Court was powerless to accept jurisdiction under either section 6213(a) or section 7502.[37]

The Fourth Circuit's first rationale, that the Tax Court may accept jurisdiction of a tardy petition in the interests of equity,[38] conflicts with the exclusively statutory nature of the Tax Court's jurisdiction. Prior to *Curry*, the Ninth Circuit acknowledged that section 7502 superseded *Arkansas Motor Coaches* and had even suggested that the passage of section 7502 was a reaction by Congress to the decision in *Arkansas Motor Coaches.*[39] Thus, the *Curry* Court's reliance on that case may be unwarranted. Furthermore, the Fourth Circuit's reliance on *Fallen* is misplaced, as that case involved an Article III court and a statute which authorized a construction of sympathy, neither of which was present in *Curry.*[40] Thus, the Fourth Circuit has expanded the jurisdiction of the Tax Court without recent case support or statutory justification.

Even assuming that the Tax Court may expand its jurisdiction on the basis of equitable considerations,[41] *Curry* was not a proper case in which

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[35] In *Ex parte* Bakelite Corp., 279 U.S. 438 (1929), the Supreme Court examined the differences between article I and article III courts and stated that the full judicial power is not deposited in the former. *Id.* at 449-50. In Lasky v. Commissioner, 352 U.S. 1027 (1957), *aff'g per curiam* 235 F.2d 97 (9th Cir. 1956), the Supreme Court affirmed the Ninth Circuit's holding that the Tax Court had no authority to reopen a final decision in the interests of equity. The Tax Court had reopened a final decision on the equitable ground of excusable neglect. When the Tax Court again decided against the taxpayer on the merits in its second decision, the taxpayer appealed to the Ninth Circuit. The Ninth Circuit refused to rule on the merits, concluding that the Tax Court exceeded its powers in reopening the case for a second decision. 235 F.2d at 100. *Cf.* Commissioner v. Gooch Milling & Elevator Co., 320 U.S. 418 (1943) (Board of Tax Appeals had no authority to reopen proceedings in tax case which by statute became final thirty days after Supreme Court affirmed findings of Board of Tax Appeals). *But cf.*, Toscano v. Commissioner, 441 F.2d 930 (9th Cir. 1971) (court allowed judgment of Tax Court to be reopened after time for appeal had expired where IRS as well as taxpayer urged reopening, although court admitted it was not on firm precedential ground in reopening).

Article III courts, on the other hand, may invoke equity to justify acceptance of jurisdiction in proper cases. *See* Wayne United Gas Co. v. Owens-Illinois Glass Co., 300 U.S. 131 (1937) (district court sitting as bankruptcy court could set aside its decision after time for appeal had expired); Kelly v. Greer, 334 F.2d 434 (3rd Cir. 1964) (federal district court has power to vacate its own orders in civil actions whenever such action is appropriate to accomplish justice).

[36] I.R.C. § 7442 grants jurisdiction to the Tax Court only in cases in which a deficiency has been asserted and in certain declaratory judgment actions. *See also* I.R.C. §§ 7428, 7476, 7477.

[37] *See* Drake v. Commissioner, 554 F.2d 736 (5th Cir. 1977) (court denied jurisdiction to petition mailed within statutory period but not postmarked until ninety-first day of the statutory period).

[38] *See* text accompanying notes 18-23 *supra.*

[39] *See* Bloch v. Commissioner, 254 F.2d 277, 279 (9th Cir. 1958).

[40] *See* Fallen v. United States, 378 U.S. 139, 139 (1964).

[41] *See* Toscano v. Commissioner, 441 F.2d 930, 932-33 (9th Cir. 1971) (court allowed

to do so. Courts will generally invoke equity only in favor of a party who has done all he could to pursue his legal remedy.[42] Curry could have done more than he did to ensure a timely filing. Curry originally could have requested that his petition be sent by certified mail and obtained a dated sender's receipt, which is recognized as conclusive evidence of a timely filing.[43] Certainly certification is of minimal inconvenience to a taxpayer sending out an important document for which time may be of the essence. Since Curry did not do all he reasonably could have done to protect himself, the jurisdictional prerequisites should not have been stretched to accomodate him.

In addition, the first *Curry* rationale is not limited in its application to prisoners. Accepting jurisdiction of Curry's petition will, in the interests of consistency, require granting jurisdiction to petitions in other analogous circumstances. The principles of this decision are equally applicable to citizens who place their petitions in the custody of any government employee responsible for handling the mail whose subsequent negligence results in a late postmark being placed on the petition. The expansion of litigation into these areas is not conducive to the efficient administration of the tax laws. Such litigation, undesirable in itself, is further complicated by the scarcity of evidence available to show or dispute a timely mailing when an untimely postmark is affixed.[44]

The court's second rationale, which endorsed a liberal construction of section 7502 so as to provide for a constructive filing by Curry,[45] is without direct support in the language of the statute or the case law dealing with the statute. Section 7502 is clearly limited to those areas where a petition carries a timely postmark.[46] There is no statutory language supporting the concept of a constructive delivery, nor had any court prior to *Curry* allowed a taxpayer to obtain jurisdiction with an untimely postmark on the original cover of the petition. Prior decisions allowing jurisdiction where there was an illegible[47] or missing postmark[48] merely allowed the taxpayer to show his

judgment of Tax Court to be reopened after time for appeal had expired where IRS as well as taxpayer urged reopening, although court admitted it was not on firm precedential ground in reopening).

[42] *See* Arkansas Motor Coaches v. Commissioner, 198 F.2d 189, 191 (8th Cir. 1952) (Eighth Circuit directed Tax Court to accept jurisdiction of petition for redetermination filed late where equities were very strongly on side of petitioner); Bailey v. Williams, 215 Ga. 395, 110 S.E.2d 673 (1959) (court refused to cancel deed in interest of equity noting that equity will grant no relief to one who through use of normal diligence could have prevented the injury claimed).

[43] Treasury Regulation § 301.7502-1(c)(2) provides, as authorized in I.R.C. § 7502(c)(2), that the date on the sender's receipt for certified mail is the date of postmark. Treas. Reg. § 301.7502-1(c)(2), T.D. 6444, 1960-1 C.B. 673.

[44] *See* Brief for Appellee, Curry v. Commissioner, 571 F.2d 1306 (4th Cir. 1978). There was no evidence supporting Curry's allegation that he had promptly mailed his petition other than his word. The dependence on such evidence involves a considerable danger of successful perjury.

[45] *See* text accompanying notes 30-32 *supra*.

[46] *See* note 5 *supra*.

[47] *See* Skolski v. Commissioner, 351 F.2d 485 (3rd Cir. 1956); Mason v. Commissioner,

petition had a timely, but illegible postmark or, in the case of a missing postmark, should have had a timely postmark placed upon it. These cases did not validate an untimely postmark. Thus, these decisions do not support the Fourth Circuit's decision to accept jurisdiction of a petition with a postmark plainly not within the jurisdictional prerequisites.[49]

Although the *Curry* decision is consistent with a trend to relax the requirements for obtaining jurisdiction under section 7502,[50] practical considerations may limit the expansion of the decision beyond the prisoner context. The most significant potential expansion of *Curry* would be to ordinary citizens seeking to introduce extrinsic evidence to show a timely mailed petition when, for some reason beyond their control, their petition receives a late postmark.[51] However, the courts' traditional reluctance to allow jurisdictional litigation to expand into questions of fact which are often inherently difficult to decide[52] as well as expensive and time consum-

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68 T.C. 354 (1977); Alexander Molosh, 45 T.C. 320 (1965); *see also* Hugh Boyd, 23 T.C.M. (CCH) 1616 (1964).

[48] *See* Ruegsegger v. Commissioner, 68 T.C. 463 (1977); Sylvan v. Commissioner 65 T.C. 548 (1975).

[49] The Fourth Circuit's suggested rationale based on the right of a prisoner to access to the courts is not a strong one. *See* note 32 *supra.* The Supreme Court case cited by the Fourth Circuit on this issue required prisons to provide legal assistance or law libraries to prisoners in order to ensure that prisoners have access to the courts. *See* 571 F.2d at 1307 n. 2. *See* Bounds v. Smith, 430 U.S. 817 (1977). This case, as did other Supreme Court cases which dealt with prisoner's right of access to the courts, involved a continuing practice in the prison which inhibited prisoners' access to the courts. *See, e.g.,* Procunier v. Martinez, 416 U.S. 396 (1974) (invalidated a statute excluding law students and legal paraprofessionals from prisons); Younger v. Gilmore, 404 U.S. 15 (1971), *aff'g per curiam* Gilmore v. Lynch, 319 F. Supp. 105 (N.D. Cal. 1970) (invalidated a statute limiting prison law libraries to a few codes and references); Johnson v. Avery, 393 U.S. 483 (1969) (invalidated regulations prohibiting jailhouse lawyers from assisting fellow prisoners). On the other hand, Curry did not show that Leavenworth Penitentiary, in which he was confined, had been repeatedly depriving prisoners of access to the Tax Court by its mail handling practices. Furthermore, there was no evidence that Curry's problem was not merely an unfortunate error which could have also occurred in a nonprison context.

[50] The trend to relax the requirements for obtaining Tax Court jurisdiction under § 7502 is best exemplified by the cases dealing with petitions received by the Tax Court without a postmark. In the earlier cases the Tax Court refused to accept jurisdiction, considering a timely postmark a sine qua non for jurisdiction. *See* Rappaport v. Commissioner, 55 T.C. 709 (1971), *aff'd,* 456 F.2d 1335 (2d Cir. 1972); C. Louis Wood, 41 T.C. 593 (1964), *aff'd,* 338 F.2d 602 (9th Cir. 1964); Nathaniel A. Denman, 35 T.C. 1140 (1961); Luther A. Madison, 28 T.C. 1301 (1957). More recently, however, the Tax Court has reversed itself and agreed to accept jurisdiction where the taxpayer can show that his petition was mailed early enough so that it should have received a timely postmark. *See* Sylvan v. Commissioner, 65 T.C. 548 (1975). *See also* Thompson v. Commissioner, 66 T.C. 737 (1976) (Tax Court accepted jurisdiction of petition where postmarked cover had been discarded by IRS, where taxpayer could show that petition was mailed in time to receive timely postmark); Perry Segura & Assoc. v. Commissioner, 34 T.C.M. (CCH) 406 (1975) (Tax Court accepted jurisdiction of petition where postmarked cover destroyed in postal handling, where taxpayer could show that petition was mailed in time to receive timely postmark).

[51] *See* text accompanying note 44 *supra.*

[52] *See* note 44 *supra.*