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Internal Revenue - Effect of Erroneous Returns - Statutes of Limitation on Assessing Deficiencies on Income Taxes

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In the controversy over strict versus liberal determination of access rights as applied to particular facts is ever-present the conflict between the public safety and convenience, and the rights of abutting owners. It is up to the courts to balance these two forces in an attempt to produce overall justice without causing undue hardship to either the public or the individual.[17] The courts must recognize that the right of access has its origin in policy and that modern policy may require extensive regulation and limitation for the public good.

WILLIAM F. HODNY.

INTERNAL REVENUE — EFFECT OF ERRONEOUS RETURNS — STATUTES OF LIMITATION ON ASSESSING DEFICIENCIES ON INCOME TAXES. — Taxpayer had sold certain lots for residential purposes and had overstated the "basis" of such lots by erroneously including in their cost certain unallowable items of development expense. Action was commenced more than three but less than five years after the return was filed. There was no claim that the returns were fraudulent. The government claimed a special five-year statute of limitations[1] applied as taxpayer's miscalculation of profits exceeded 25% of gross income. The Supreme Court of the United States *held,* two justices dissenting, that the tax assessments were barred by the general three-year statute of limitations.[2] *Colony, Inc. v. Commissioner,* 357 U.S. 28 (1958).

Section 275 (c) of the 1939 Code has been the subject of a considerable amount of litigation. The difficulty arises in the interpretation of the words "omits from gross income" which is the deciding factor of the Commissioner's right to maintain suit for tax deficiencies after the three-year statute has run.

The Tax Court consistently upheld the Commissioner's interpretation of section 275 (c) that an overstatement of deductions constitutes an omission from gross income.[3] The decisions of the Circuit Courts were irreconcilable.[4]

A taxpayer in his return stated his total income correctly but overstated deductions. His *gross* income was increased by an amount in excess of 25% resulting from disallowance of deductions from *gross* income claimed. The court held that this constituted an omission from gross income and the five-year statute applied.[5]

In contrast, a taxpayer stated his gross income correctly but claimed total

17. See Petition of Burnquist, 220 Minn. 48, 19 N.W.2d 394, 405 (1945), "Instances may arise where the acquisition of such a right might completely eliminate the value of the dominant estate."

1. Int. Rev. Code of 1939, § 275 (c), 53 Stat. 86. "Omission from gross income. If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed."

2. Int. Rev. Code of 1939, § 275 (a), 53 Stat. 86. "General rule. The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period."

3. For example, see the Tax Court opinion on the instant case. 26 T.C. 30 (1956) *citing* Estate of J. W. Gibbs, Sr., 21 T.C. 443 (1954).

4. Reis v. Commissioner, 142 F.2d 900 (6th Cir. 1944); Ketcham v. Commissioner, 142 F.2d 996 (2d Cir. 1944); supporting the Commissioner. But, Uptegrove Lumber Co. v. Commissioner, 204 F.2d 570 (3d Cir. 1953); Davis v. Hightower, 230 F.2d 549 (5th Cir. 1956); rejected the view of the Commissioner.

5. Corrigan v. Commissioner, 155 F.2d 164 (6th Cir. 1946).

exemption from income taxes. His exemption was disallowed but the court in holding that the three-year statute applied stated, "We are of the view that if there are any omissions they were not on the part of the taxpayer but of those who handled the returns after they were filed."[6]

The Supreme Court in the instant case adopted the latter view. The purpose of the five-year statute was to enable the Commissioner to investigate returns where he was working under a disadvantage due to a taxpayer's failure to include an item in his return. When the Commissioner has all the items before him there is no such disadvantage.[7]

Section 6501 (e) (1) (A) of the 1954 Code has "resolved the problem for the future".[8] The Code provision is not new, but is a clarification of section 275 (c) of the 1939 Code. The instant case would make the result under both provisions essentially the same. Thus, under both Codes the Commissioner has only three years to assess a tax deficiency where gross income has been accurately reported and where no fraud is involved.[9]

WILLIAM J. MCMENAMY.

LABOR RELATIONS — UNFAIR PRACTICES OF LABOR ORGANIZATIONS — "HOT CARGO" CLAUSE NOT A DEFENSE TO ALLEGED VIOLATION OF SECONDARY BOYCOTT PROVISIONS OF TAFT-HARTLEY ACT. — Labor union and contractor were parties to a collective bargaining agreement which provided: "Workmen shall not be required to handle non-union material." This type of provision is known as a "hot cargo" clause. Sand Door Company filed a complaint with the National Labor Relations Board alleging union violation of the provision of the Labor-Management Relations Act of 1947,[1] which forbids unions to induce employees to refuse to handle goods for their employer

6. Slaff v. Commissioner, 220 F.2d 65 (9th Cir. 1955). "We . . . find no occasion to further torture the meaning of the word 'omit'." The court had previously held *contra*, O'Bryan v. Commissioner, 148 F.2d 456 (9th Cir. 1945).

7. The Court in the instant case stated: ". . . Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage. And this would seem to be so whether the error be one affecting 'gross income' or one, such as overstated deductions, affecting other parts of the return."

8. Subsection (ii) provides: "In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item." Thus the burden is on the government to show that the error was not ascertainable from the face of the return.

9. Where the Commissioner can prove fraud there is, of course, no time limit. Int. Rev. Code of 1954, § 6501 (c). Int. Rev. Code of 1939, § 275 (a), 53 Stat. 87.

1. Labor-Management Relations Act of 1947 (Taft-Hartley Act), 61 Stat. 141 (1947), 29 U.S.C. § 158 (b) (4) (A) (1952): "It shall be an unfair labor practice for a labor organization or its agents, *** to engage in or to induce or encourage the employees of any employer to engage in, a strike or concerted refusal in the course of their employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services where an object thereof is forcing or requiring any employer or self-employed person to join any labor or employer organization or any employer or other person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person."