COMMENTS

FARMERS AND THE FEDERAL INCOME TAX

Variations in the operation of the federal income tax may result in unequal tax burdens on different classes of taxpayers. These variations may be explicit or implicit in the structure of the Internal Revenue Code; they may be glossed onto the Code structure by the tax administrators; or they may result from judicial interpretation of a tax law in a manner favorable to a particular group. The federal income tax system contains countless discriminatory features of these types, and the consequent burdens or benefits affect a variety of classes of taxpayers. This comment is confined to a few such facets of the tax structure which are of importance to farmers as a taxpaying group.

While there is no systematic bias in the Internal Revenue Code favoring farmers as a taxpaying class, the Code's definition of taxable income clearly operates to aid the farmer-taxpayer. Although Congress has defined gross income in sweeping terms, the definition is structured around the commercial transaction, and precludes a tax on imputed income. Included within the category of nontaxable imputed income are the use-value of the taxpayer's durable personal goods and the value of his self-service. The exclusion of these items from taxable income is of particular importance to farmers, who are more self-sustaining than other classes of taxpayers.

Section 22(a) of the Internal Revenue Code provides that: "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service ... of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, ... also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

The Treasury Regulations provide that "[a]ll individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as owners or tenants, are designated as farmers. A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer." Treas. Reg. 111 § 29.22(a)-7 (1951).

"Imputed income" may be distinguished from other income in kind, in that it does not arise from the ordinary market process. It may be defined "as a flow of satisfactions from durable goods owned and used by the taxpayer, or from goods and services arising out of the personal exertions of the taxpayer on his own behalf." Marsh, The Taxation of Imputed Income, 58 Pol. Sci. Q. 514 (1943).

Although it might have been argued that imputed income is taxable as "income derived from any source whatever," the emphasis which Section 22(a) places upon the receipt of money or property as a taxable event precluded such a construction. It should also be noted that other sections of the Code impose a tax upon annual increases in the value of property only when income has been realized through a disposition of the property. The requirement that such annual gains be "realized" in order to qualify as taxable income is persuasive evidence that the terms of Section 22(a) do not sanction a tax on any "income" unless a similar prescribed taxable event, such as the receipt of money or property, has taken place. And since consumption has never been regarded as realization, imputed income could not qualify as taxable income under Section 22(a).

The omission of Congress to upset this settled construction of Section 22(a) and substitute the proposition that the use of durable consumer property gives rise to taxable income introduces some serious inequities into the tax system. Critics of the tax immunity now accorded imputed income point to the omission of the rental value of owner-occupied homes from the Code's definition of income. Since persons who do not own homes must use taxable funds to pay rent, home-owners are, in effect, subsidized by the exclusion of the rental value of their homes from taxable income.

This "subsidy" is accentuated by permitting home-owners to deduct part of the cost of owning homes from their gross income. Thus, property taxes and interest charges may be deducted. When the optional standard deduction was

5 Section 111 of the Code provides that: "(a) ... The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis. ... (b) ... The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received." Int. Rev. Code § 111, 26 U.S.C.A. § 111 (1948).

6 A constitutional argument against a tax on imputed income probably would not prevail, although it was thought, at first, that the Sixteenth Amendment required that all taxable income be realized. The Court in Eisner v. Macomber, 252 U.S. 189, 207 (1920), set forth the requirement that income must be "a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital ... and coming in"; see Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509, 519 (1921). Later cases indicate, however, that "the rule [requiring realization of income], founded on administrative convenience, is only one of postponement of the tax to the final event of enjoyment of the income ... and not one of exemption from taxation" Helvering v. Horst, 311 U.S. 112, 116 (1940); cf. Helvering v. Griffiths, 318 U.S. 371 (1943).

7 If Section 22(a) of the Internal Revenue Code were redefined to include imputed income, taxable income would be much closer to the economist's definition of income. Simons, for example, defines income as the "algebraic sum of (1) the market value of rights exercised in consumption, and (2) the change in the value of the store of property rights between the beginning and end of the period in question." Personal Income Taxation 50 (1938). Haig defines income as the "money value of the net accretion to one's economic power between two points of time." The Federal Income Tax 17 (1921). Cf. Magill, Taxable Income 191-97 (1938).

8 See, for example, Marsh, op. cit. supra note 3; Vickrey, Agenda for Progressive Taxation 18-35 (1947).

9 Int. Rev. Code § 23(b), (c), 26 U.S.C.A. § 23(b), (c) (1948).
made part of the Code in 1944, this additional home-owner subsidy was weakened to the extent that a great majority of taxpayers claim a blanket deduction of ten per cent of adjusted gross income (limited to a maximum of $1,000) instead of the normally allowable expense deductions specified in the Code. If, for example, a taxpayer who rents his home and a taxpayer who owns his home both claim the optional standard deduction in lieu of deducting the aggregates of their otherwise allowable expense deductions, the home-owner will have lost his pre-1944 tax advantage which was due to the deductibility of property taxes and interest charges under Section 23 of the Code.

However, the more basic discrimination arising from the nontaxability of the rental value of owner-occupied homes remains in the tax structure; and the discrimination is of particular importance to farmers as a taxpaying class, for a higher percentage of farm residences are owner-occupied than are nonfarm residences.

The omission from taxable income of the value of home-produced food consumed by the taxpayer is also significant to farmers, who comprise the only group of taxpayers materially affected by this omission. However, the discrimination resulting from the failure to tax the value of food consumption is not accentuated by permitting expense deductions, as is the case in the home-owner situation, for the farmer is not permitted to deduct from gross income the cost of raising food which he consumes. Farmers are required to reduce yearly expense deductions by an amount equal to the cost of raising food for each member of the family. The value of the food will generally far exceed that amount, and this excess is the tax-free benefit.

Although the omission from taxable income of the value of home-produced food consumed by the taxpayer and the rental value of the taxpayer's home offers most tax savings per dollar's worth of food and "rent" to farmers in the upper income brackets, the omission is also important to farmers at the bottom

11 The 1940 census reports indicate that 53.4% of farm residences are owned wholly or partially by their occupants, while 47.1% of nonfarm residences are owner-occupied. The difference between farm and nonfarm residences in this respect is diminishing; in 1890, 65.6% of farm homes were owner-occupied, as compared to 36.9% of nonfarm homes. Bureau of Census (16th Census of U.S.), 2 Housing: General Characteristics (1948).
12 "If products of a farm consumed thereon are income to the producer, it would seem to follow that the rental value of the farmer's home, the gratuitous services of his wife and children, and the value of the power derived from draft animals owned by the farmer and used without cost should also be so considered. It is obvious that such items are comparable to the rental value of a private residence, which has never been regarded as income." Morris v. Comm'r, 9 B.T.A. 1273, 1278 (1928).
14 Many rural tax agents require that $55.00 be deducted for each adult member of the farmer's family, and $35.00 for each child. Morris, Getting the Maximum Tax Savings for Farmers, 69 J. Account. 490, 494 (1950).
of the income scale, who would otherwise be required to use a large share of income for purchasing food and housing. Even though this tax immunity aids less wealthy farmers, however, it should be noted that most nonfarmers in a comparable financial position must use taxable funds to purchase their food and housing.

As a result of the omission of a tax on imputed income, all taxpayers enjoy some amount of tax-free goods and services, but the farm group in particular is in a position to obtain larger amounts of tax-free food and housing than other groups of taxpayers.

II

When a farmer consumes goods which he has produced, he engages in an activity which has the same effect upon his economic position as the receipt of income, for he has “saved” that part of his money income he would otherwise have had to spend for the goods. And in another sense, farm products bear a resemblance to other forms of “income,” as distinguished from income-producing property, if the farm is thought of as the underlying property which produces such things as crops and livestock. And so the Commissioner has forcefully argued that “[t]he products of a farm are, from the beginning, in the nature of income.” The argument has cropped up in a variety of situations involving dissimilar tax doctrines, but its implications are perhaps most significant in the area of tax law concerned with attempts to transfer tax incidence through gifts of income.

In *Helvering v. Horst,* the taxpayer clipped some negotiable coupons from his bonds and gave them to his son. The interest paid to the son later that year when the coupons matured was held to be includible within the income of the father, and not the son. The Court viewed the assignment of the coupons as a gift of income, rather than of income-producing property, and since “[t]he dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid,” the assignment could not operate to transfer tax incidence from father to son.

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Marsh states that “compared to imputed residential rent, the other items of taxable imputed income are almost insignificant.” Marsh, op. cit. supra note 3, at 523. See also Vickrey, op. cit. supra note 8, at 18.

16 It should also be noted that the availability of tax-free food and housing probably enables many farmers to purchase the services of laborers at lower rates than those which they would otherwise pay.


18 In I.T. 3815, 1946-2 Cum. Bull. 30, for example, the Commissioner argued that farm products are in the nature of income because he wished to allocate part of the proceeds from the sale of a citrus grove to the immature fruit, and classify this part of the proceeds as ordinary income, rather than capital gain. See text at note 54 infra.

19 311 U.S. 112 (1940).

20 Ibid., at 119.
to son. Although a donor of bond coupons does not receive the interest payments, said the Court:

[He] has nevertheless, by his act, procured payment of the interest as a valuable gift to a member of his family. Such a use of his economic gain, the right to receive income, to procure a satisfaction which can be obtained only by the expenditure of money or property, would seem to be the enjoyment of income whether the satisfaction is the purchase of goods at the corner grocery, the payment of his debt there, or such non-material satisfactions as may result from the payment of a campaign or community chest contribution, or a gift to his favorite son.21

The Commissioner in 1948 used the Horst decision as the basis for two of his rulings, wherein he decided (1) that a farmer who contributes agricultural products to charitable organizations must include the fair market value of the products in his gross income for the year of the contribution,22 and (2) that a farmer who gives feeder cattle to his son must include the fair market value of the cattle in his gross income for the year in which the gift is made.23

The Commissioner's rulings presupposed that farm products are in the nature of income; that a cow, for example, is more like the coupon on a bond than it is like the bond itself. Even if it is granted that a cow is properly categorized as income rather than as income-producing property, however, the Commissioner was applying a rule which was unlike the one prescribed in the Horst case.

The Commissioner decided that a farmer realizes income at the time he gives feeder cattle to his son or at the time he contributes crops to charity. In the Horst case, the Court did not have to decide when the realization of income took place, for the donor had given the bond coupons to the donee in the same year as the donee collected the interest. There is some language in the Horst opinion which lends support to the Commissioner's view; the opinion states, for example, that "[t]he power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment, and hence the realization, of income by him who exercises it."24 Elsewhere in the opinion, however, the Court states that:

21 Ibid., at 117.
23 I.T. 3932, 1948-2 Cum. Bull. 7. For a critical analysis of these rulings see Miller, Gifts of Income and of Property: What the Horst Case Decides, 5 Tax L. Rev. 1 (1950). In the case with which the breeder cattle ruling was concerned, the fair market value of the cattle at the time of the gift from father to son was $1500. The son later sold the cattle for $2100. The Commissioner held that the father's basis was $0, since he had consistently deducted the cost of raising the animal. The son's basis, according to the Commissioner, was $1500, or the value of the cattle at the time of the gift. Miller points out that Section 113(a)(2) of the Internal Revenue Code provides that "If the property was acquired by gift... the basis shall be the same as it would be in the hands of the donor or the last preceding owner." Accordingly, Miller contends (viewing this as a gift of property), the donor's basis should be $0 and the donee's basis should be $2100.
It is the statute which taxes the income to the donor although paid to his donee.... When, by the gift of the coupons, [the donor] has separated his right to interest payments from his investment and procured the payment of the interest to his donee, he has enjoyed the economic benefits of the income. ...\(^{25}\)

The Commissioner's interpretation of the Horst opinion was rejected by the Tax Court in Farrier v. Comm'r.\(^{26}\) In that case, the taxpayer had given some heifers and calves to her daughter; the Commissioner insisted that their value should be taxable to the donor in the year in which the gift was made, even though the animals had never been sold by the daughter. The Court refused to extend the Horst case in this manner, stating that "[n]o income is involved. ... The income, if there was ever to be any, had to await the sale of the cattle."\(^{27}\)

The court thus not only refused to concede that the giving of an item of income could in itself qualify as a taxable event, but also refused to hold that it was dealing with a gift whose subject matter was "in the nature of income." The court felt that the donor "simply made a gift of the property itself."\(^{28}\) The Farrier decision therefore indicates not only that the doctrine of the Horst case is to be kept within carefully proscribed limits insofar as the realization requirement is concerned,\(^{29}\) but also that the Commissioner is going to face rough judicial battles whenever he contends that "[t]he products of a farm are, from the beginning, in the nature of income."\(^{30}\)

The Internal Revenue Code provides that net income shall be computed "in accordance with the method of accounting regularly employed in keeping the books" of the taxpayer.\(^{31}\) Such method must, however, "clearly reflect the

\(^{25}\) Ibid., at 119, 120 (italics added).
\(^{26}\) 15 T.C. 277 (1950).
\(^{27}\) Ibid., at 284.
\(^{28}\) Ibid.
\(^{29}\) Cf. Griswold, Charitable Gifts of Income and the Internal Revenue Code, 65 Harv. L. Rev. 84 (1952). Griswold argues that the Commissioner reaches a sound result in including the fair market value of a charitable contribution in the donor's gross income when the contribution is made, since such a course precludes what is, in effect, a "double deduction"—a deduction of the cost of producing the thing given, plus a deduction for a charitable contribution under Section 23(o) or 23(q) of the Code. As Griswold demonstrates, however, the "double deduction" could as easily be prevented by disallowing a charitable contribution deduction when "the gift is of property which would be included in the taxpayer's inventory or is otherwise of property the proceeds of which would be fully included in gross income." Ibid., at 92.

\(^{30}\) I.T. 3910, 1948-1 Cum. Bull. 16. If the Commissioner were to shift his argument, conceding that intra-family gifts of farm products are gifts of property rather than of income, he might argue that the rule of Helvering v. Clifford, 309 U.S. 331 (1940), should be applicable: that the donor-father, for example, retains "enough" rights in the subject matter of the gift to the donee-son so that the attempted transfer of tax incidence is ineffective. The Commissioner has been unsuccessful in pursuing this line of argument, however. See Visintainer v. Comm'r, 187 F. 2d 519 (C.A. 10th, 1951); Alexander v. Comm'r, 190 F. 2d 753, 755 (C.A. 5th, 1951), wherein the court warned that "[t]here is a distinction between managerial control over income producing property with the consent of the actual owner, and the absolute right of control over both the property and the income derived therefrom."

income,” and within this limitation, all taxpayers are permitted to elect between the cash and accrual methods of determining revenue and expenses during the tax period. However, the Code provides that the Commissioner may require that inventories be considered in computing taxes whenever he decides that they are necessary “in order clearly to determine the income.” The Commissioner has so decided in certain instances, and has provided that:

In order to reflect the net income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor.

Where inventories are so required, the Commissioner also requires that the accrual method of accounting be used, at least with regard to purchases and sales, and to this extent the accrual method is mandatory for nonfarmers.

The purpose of the accrual method is to give a more accurate description of annual income by a matching of revenue items with appropriate items of expense. The cost of producing revenue during a tax period can thereby be determined with a degree of accuracy which is much higher than that obtained through the simpler cash method of accounting.

Despite this consideration, the Commissioner has permitted all farmers to operate on either the cash or accrual (inventory) method. In so doing, the Commissioner has yielded to the bookkeeping practices of the preponderant majority of farmers. Before the federal Revenue Acts were passed, many farmers kept no books at all; today, most farmers use the cash method of accounting, and over ninety per cent use the cash method for federal income tax purposes.

The Commissioner’s Regulations provide that:

A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of livestock and produce . . . (2) the profits from the sale of livestock or other items which were purchased, and (3) gross income from all other sources.

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34 Treas. Reg. 111, § 29.22 (c)-1 (1951).
35 Treas. Reg. 111, § 29.41-2 (1951). Congress was slow in recognizing the utility of the accrual method, and it was only after a long legislative struggle that it became firmly entrenched. Consult Reimer, Differences in Net Income for Accounting and Federal Income Taxes (1949) for the legislative history. In approving the use of the accrual method for tax purposes, the United States Supreme Court stated that it would “enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the tax period, the expenses incurred in and properly attributable to the process of earning income during that period.” United States v. Anderson, 269 U.S. 422, 440 (1926).
36 Treas. Reg. 111, § 29.22(c)-6 (1951).
37 Morris, op. cit. supra note 14; Throckmorton, Federal Taxation of the Farmer, 34 Iowa L. Rev. 251 (1949).
38 Treas. Reg. 111, § 29.22(a)-7 (1951).
If, however, the farmer elects to report on the accrual method, the Regulations provide that he must follow the usual methods of accrual accounting. The farmer's accounting formula in that case will parallel the one prescribed for any manufacturer.

If a farmer produces a crop which takes more than a year from planting to harvesting, he may, with the consent of the Commissioner, compute his gross income upon the "crop basis." Under the crop basis, the farmer reports all proceeds from the sale of the crop in the year in which they are realized, but he must also deduct the entire cost of raising the crop in that year.

All farmers may, therefore, elect from among two or three basic accounting techniques, whereas most nonfarmers who are in the business of selling products must adhere to one prescribed basic accounting technique. Since the vast majority of farmers use the cash method of accounting, one segment of the taxpaying population is permitted to compute changes in net worth in a cruder manner than the rest, and in a manner which may lead to tax savings.

A farmer may, by electing to operate on the cash basis, completely disregard his inventories in computing income. It should be noted, however, that a danger which would be present in permitting a manufacturer to operate on the cash basis is absent in the case of the farmer who raises and sells crops. If the manufacturer were permitted to use the cash basis of accounting, he could reduce net income by using current revenue to purchase additional inventories, and he could conceivably have no taxable income at all if he were to expand at the "proper" rate. The farmer who raises and sells crops, on the other hand, cannot stockpile inventories to any great extent, for he is limited by the perishable nature of his produce. This limiting factor is not operative in the case of the farmer who owns a dairy or breeding herd, but the Regulations do not permit ranchers to treat the cost of purchasing additional animals as a current expense deduction. Such purchases are categorized as capital investments and will reduce net income only in the form of increased depreciation deductions. The cash basis farmer thus cannot reduce current taxable income by expanding his farming or ranching operation.

The cash method offers more opportunity to shift items of revenue and expense from one tax period to another than does the accrual method. A cash method taxpayer may postpone recognition of an item of expense by omitting to make payment until a subsequent tax period, and a tax saving will result if the expense can be offset against a large revenue item in the later period. The constructive receipt doctrine, which is now well settled in the tax law, places a

\[39\] Ibid. If a farmer elects to report on the accrual method, "his gross profits are ascertained by adding to the inventory value of livestock and products on hand at the end of the year the amount received from the sale of livestock and products... and deducting from this sum the inventory value of livestock and products on hand at the beginning of the year and the cost of livestock and products purchased during the year." Treas. Reg. 111, § 29.22(a)-7 (1951).

\[40\] Ibid.

\[41\] Treas. Reg. 111, § 29.23(a)-11 (1951).
limit on the ability to postpone receipt of revenue items, however. Apart from this incentive to offset revenue against expense, the progressive nature of the income tax may make it desirable to level income by recognizing an item of revenue in a period other than that in which the taxpayer has an unconditional right to receive it, or by recognizing an item of expense in a period other than that in which the taxpayer incurs an obligation to pay. And the cash method taxpayer has more opportunity to level his income than does the accrual method taxpayer.

Of course, the farmer may in certain years pay a higher tax because he has elected to operate on the cash method. Losses or gains will vary with changing harvests, prices and tax rates; but over a long period of time, the cash method is certain to offer more flexibility than the accrual method. Although the farmer is not permitted to change his accounting method without the consent of the Commissioner, he does have the initial opportunity of selecting the basic accounting technique that is best suited for his particular enterprise, and he does have more of a chance to shift items of revenue and expense than does the accrual method taxpayer. To this extent, the Internal Revenue Code and the Commissioner's Regulations have provided the farm group, along with other groups of taxpayers who have developed specialized approved accounting formulae, with avenues for possible tax savings.

IV

Section 117(j) of the Internal Revenue Code provides that gains from the sale or exchange of certain real or depreciable property, held for longer than six months, and used in the trade or business, may be treated as capital gains. In order to come within the scope of the Section, the property must not be "of a kind which would properly be includible in the inventory of the taxpayer if on hand at the end of the taxable year," and must not be "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

At the end of each tax period, the taxpayer is permitted to balance his "Section 117(j) gains" with his "117(j) losses." If the gains exceed the losses, the excess is treated as a net long-term capital gain; but if the gains do not exceed the losses, neither gains nor losses are accorded capital asset treatment. Thus,

43 In Hineman v. Brodrick, 99 F. Supp. 582 (D.C. Kans., 1951), for example, a grain elevator association postponed payment for wheat shipments at the farmer's request. Since it was customary to pay for the wheat upon delivery, the court held that the farmer-taxpayer was in constructive receipt of the purchase price and had realized income in the year of delivery.

44 For a discussion of some of the situations in which the liberty of choosing an accounting technique results in tax savings for farmers, see Morris, op. cit. supra note 14; Throckmorton, op. cit. supra note 37; Foster, Farm Income Tax Problems, 36 Ill. Bar. J. 312 (1948); Keaton, Practical Farm Tax Problems, 22 Ind. L.J. 151 (1947).

the Section never imposes upon the taxpayer the risk of paying a larger tax than he would have paid in the absence of the Section. And although the Section prescribes a system of balancing gains against losses, the taxpayer may, by postponing 117(j) losses to another period, manage to get capital gains treatment for all 117(j) gains during the current period. The postponed 117(j) losses will, in turn, be treated as ordinary losses if there are no offsetting gains during the later tax period. Similar tax savings may, of course, be obtained by recognizing 117(j) losses in the current period, and postponing 117(j) gains to a later period.

It is clear that Section 117(j) was not meant to apply to sales of stock in trade, or to normal, recurring business transactions; it was meant to lessen the burden which would be incurred if a normal tax were placed upon gains from abnormal business transactions. The first comment on the measure by the Bureau of Internal Revenue concerned itself with the applicability of the Section to sales of livestock. The Commissioner ruled that livestock which were purchased for draft, breeding, or dairy purposes, and not primarily for sale, comprised property whose eventual sale might bring it under Section 117(j). The Commissioner then stated that "[t]he sale of animals culled from the breeding herd as feeder or slaughter animals in the regular course of business is not to be treated as the sale of a capital asset." So the benefits of the Section were not to be accorded "culls"—the undesirable animals that farmers remove from dairy and breeding herds and sell each year.

The Commissioner realized the impracticality of accurately recording the sales of all such culls from large herds, and in a later ruling provided a prima facie test, which stated that the farmer could not receive capital gains treatment for sales of culls if he maintained his herd at the same size; if, however, he decreased his herd by selling culls, the sales would be treated as dispositions of capital assets. This ruling thus precluded a lower tax on recurrent transactions which did not operate to reduce the size of the taxpayer's business property.

The Commissioner's rulings were contested and overruled in Albright v. United States. Albright had sold some culls from his breeding herd, and re-

45 If, for example, a taxpayer has a 117(j) loss of $10,000 in 1950 and a 117(j) gain of $10,000 in 1950, the two will offset each other and result in neither a net gain or loss. If the taxpayer postpones his 117(j) gain to 1951, however, his 1950 117(j) loss will be treated as an "ordinary loss," and will be fully deductible. His 1951 117(j) gain will be taxed at capital gains rates. The net result of postponing his 117(j) gain is a tax saving of $5,000.

46 It has been said that the purpose of a lower tax on capital gains "is to alleviate the burden which would be incurred by the taxpayer should that gain be classified as ordinary income over a short period when, in fact, it had accrued over a long period of investment." Boomhower v. Comm'r, 74 F. Supp. 997, 1001 (N.D., Iowa, 1947). Consult Miller, The "Capital Asset" Concept: A Critique of Capital Gains Taxation, 59 Yale L.J. 837, 1057 (1950).


48 Ibid., at 272.


50 173 F. 2d 339 (C.A. 8th, 1949).
placed them with healthier animals he had raised. The Commissioner decided that the proceeds of the sale were fully taxable as ordinary income; but Albright contended that under Section 117(j) the proceeds constituted a capital gain. The court found for Albright, holding that all the requirements of Section 117(j) had been met. The Commissioner had based his opposition to the taxpayer on the argument that the livestock were held by the taxpayer “primarily for sale.” The court looked to the intent of the taxpayer in acquiring the livestock, and found that he was in the business of maintaining a breeding herd, rather than selling nonbreeding livestock. Although the taxpayer knew that some of the livestock would recurrently be sold, his primary purpose was to use the animals for breeding purposes, and so he brought himself within the language of Section 117(j).

The Albright rule accorded capital gains treatment to transactions which as a class are recurrent and expected. The farmer usually sells culls from his breeding or dairy herd every year—and his tax is considerably lowered every year—because such sales come under Section 117(j). But customary transactions of this sort, yielding fixed returns, are not usually accorded capital gains treatment. A great deal of difficulty in the Albright situation arises because of the dual nature of the property involved. While the property is held by the taxpayer it is used in his business and is not “held for sale,” but when its period of usefulness has expired, it clearly is “held for sale,” and this was understood from the moment of acquisition. It might have been proper, for the purposes of Section 117(j), to have recognized that a certain part of each herd of breeder cattle is intended to be sold to customers regularly after a fixed holding period, even though this part of the herd may be used as business property during the holding period. By not making such a distinction, the courts have extended to many farmers a sizeable tax advantage not normally open to other classes of taxpayers.

Section 117(j) has been held to be applicable to another class of farm transactions involving gains which bear some resemblance to ordinary income. Owners of citrus groves often sell their entire holdings, including the immature fruit on

51 Albright’s herd of breeding hogs was also in issue in the case. Each year he sold his entire herd of breeding hogs, as is customary in the hog-raising business, and replaced them with a new herd of young hogs. It was held that such sales come within the scope of Section 117(j).

52 Since Albright used the cash method of accounting, the Commissioner did not contend that the livestock were “properly includible” in the farmer’s inventory. In Fawn Lake Ranch Co., 12 T.C. 1139 (1949), wherein the taxpayer involved used the accrual method and inventoried its cattle, the court decided that the inventorying was a “convenience of accounting,” and held that the proceeds from the sale of inventoried cattle came within the scope of Section 117(j). The dissenting judge stated that “I am unable to conclude that Congress did not legislate with regard to existing and established methods of accounting in the various forms of enterprise and that it did not intend to exclude, as property ‘used in the trade or business,’ the breeding herd of a ranching operation.” Ibid., at 1146.

53 For some examples of the application of the Albright rule, see Miller v. United States, 98 F. Supp. 948 (D.C. Neb., 1951); Davis v. United States, 96 F. Supp. 785 (D.C. Iowa, 1951); Bennett v. United States, 89 F. Supp. 106 (D.C. Tex., 1950); Isaac Emerson v. Comm’r, 12 T.C. 875 (1949).
the trees. The Commissioner has contended that the fruits are held primarily for sale to customers, and "regardless of the stage of their development," the part of the gain from the sale of the entire grove allocable to the fruit should be treated as ordinary income.54

The Commissioner's allocation formula was rejected by a District Court in *Irrgang v. Fahs*,55 the court holding that since the taxpayer "sold herself out of business for a lump sum consideration," and since she was in the business of selling "mature fruit as a product separate from the grove," the entire gain on the sale would be accorded the benefit of Section 117(j). A different result was later reached by the Tax Court in *Watson v. Comm'r*.56 In this case too, the taxpayer argued that a sale of immature fruit should not give rise to ordinary income because she was "in the business of producing and selling ripe oranges and not in the business of producing and selling green oranges." In holding for the Commissioner, the court answered:

[The primary purpose and objective of the farmer or fruit grower is the sale of his crop to some customer or customers . . . we are unable to see how the holding of the oranges primarily for sale to customers is changed to a holding primarily for some other purpose because the grower manages to realize his purpose to sell . . . before the oranges are mature, or because as a part of the same transaction the land was also sold.57

In the Revenue Act of 1951, all the farmer's judicial contests under Section 117(j) were finally resolved in his favor. First, the Albright rule was written into the Code. Section 117(j) was amended to apply to sales of "livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for twelve months or more from the date of acquisition."58 Sales of poultry, for some unexpressed reason, are specifically excluded from the coverage of the Section. Second, Section 117(j) was amended to insure that the gain from the sale of a farm or grove allocable to immature crops or fruit be accorded capital gains treatment. The new subsection of 117(j) provides that:

In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged . . . at the same time and to the same person, the crop shall be considered as "property used in the trade or business."59

58 Int. Rev. § 117(j), 26 U.S.C.A. § 117(j) (Cum. Supp., 1951). In 1951, before the Congressional action, the Commissioner partially acquiesced to the Albright rule, and agreed that animals culled from the dairy and breeding herds would be considered property "used in the trade or business," and within the scope of Section 117(j), provided that the animals were held for their "full period of usefulness," and that they were sold as a "consistent practice" by the taxpayer. Income Tax Information Release No. 3 (April 18, 1951).
59 Int. Rev. Code § 117(j)(3), 26 U.S.C.A. § 117(j)(3) (Cum. Supp., 1951). Section 24(f) was also added to the Internal Revenue Code in 1951. It provides that: "Where an unharvested crop sold by the taxpayer is considered under the provisions of Section 117(j)(3) as 'property.
The farmer now has legislative assurance that the generous provisions of Section 117(j) will be applied to two broad classes of farm transactions.

Some of the provisions of the Internal Revenue Code, some of the Commissioner's Regulations, and some court decisions have, at one time or another, served to benefit farmers as a taxpaying class. The same or similar Code provisions, Regulations, and court decisions have undoubtedly benefited many other classes of taxpayers in a like fashion. An appraisal of the economic consequences of this variety of benefits in the tax system would be difficult, if not impossible; and perhaps the very difficulty of such an appraisal is a forceful argument against Code provisions, Regulations, and court decisions which accord special treatment to a chosen class of taxpayers.

LIVING EXPENSES WHILE "AWAY FROM HOME": BUSINESS OR PERSONAL?

Section 23 (a)(1)(A) of the Internal Revenue Code provides that when an expenditure is incurred in the pursuit of a business venture, as distinguished from personal gratification, it is deductible from gross income. Before 1921 it was held by the Bureau of Internal Revenue and the courts that although transportation expenses incurred on business trips were deductible, expenditures made for meals and lodgings during such trips were not. In 1920 a regulation of the Bureau made deductible expenses for meals and lodging in excess of what the taxpayer would ordinarily pay for these personal needs when at his established residence. In 1921 an amendment to a statute comparable to Section 23 (a)(1)(A) explicitly provided for the deduction of meals and lodging expenses by enlarging the business expense category so as to encompass all "traveling expenses (including the entire amount expended for meals and lodg-

used in the trade or business," in computing net income no deduction . . . attributable to the production of such crop shall be allowed." For a survey of the problems which may arise under §§ 117(j)(3) and 24(f), see Halstead, Capital Gains of Farmers, 25 So. Calif. L. Rev. 36, 47 et seq. (1951).


2 The section provides that in computing net income there shall be allowed as deductions: "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." Ibid. In contrast, Section 24 (a)(1) states that no deduction shall be allowed for "[p]ersonal, living or family expenses. . . ." Int. Rev. Code § 24 (a)(1), 26 U.S.C.A. § 24 (a)(1) (1948).


4 T.D. No. 3101, 3 Cum. Bull. 191 (1920). This ruling amended Treas. Reg. 45, Art. 293 (1920) which had stated that expenses for meals and lodging on business trips were not fully deductible. Accord: 10 B.T.A. 386, 389 (1928); Mim. 2688, 4 Cum. Bull. 209 (1921). A person claiming a traveling expense deduction was required to attach to his return a statement setting forth the cost of personal expenses had he lived at his residence. All business traveling expenses in excess of that amount were deductible.