Schmidt v. Commissioner, 10 T.C. 746 (1948)

Income received in 1943 attributable to services performed over multiple years, including 1942, is taxable in 1943 under Section 107 of the Internal Revenue Code, but the Current Tax Payment Act of 1943 does not allow for exclusion of 1942-attributable income from the 1943 tax calculation for forgiveness purposes.

Summary

Arthur T. Schmidt, a lawyer, received fees in 1943 for services rendered over several years, some attributable to 1942. He argued that income attributable to 1942 should be excluded from his 1943 income for the purpose of calculating tax forgiveness under the Current Tax Payment Act of 1943. The Tax Court held that while Section 107 of the Internal Revenue Code allows for income averaging, it does not modify the application of the Current Tax Payment Act. The court determined that the income was taxable in 1943, and the forgiveness provisions applied to the actual 1942 tax liability, not a hypothetical increased liability.

Facts

Petitioner Arthur T. Schmidt, an attorney, received two legal fees in 1943 totaling $27,850 for services rendered over multiple years (1940-1943). A portion of these fees, $8,720.76, was attributable to services performed in 1942 under Section 107 of the Internal Revenue Code. The Current Tax Payment Act of 1943 provided a system for current tax payments and included a "forgiveness" feature for 1942 taxes. Schmidt sought to reduce his 1943 tax liability by excluding the income attributable to 1942 from his 1943 income calculation when applying the forgiveness provisions of the Act.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Schmidt's 1943 income and victory tax. Schmidt petitioned the Tax Court, contesting the Commissioner's determination regarding the application of Section 107 and the Current Tax Payment Act.

Issue(s)

1. Whether, under the Current Tax Payment Act of 1943, income received in 1943 but attributable to services performed in 1942 under Section 107 of the Internal Revenue Code should be excluded from 1943 taxable income for the purpose of calculating the 1942 tax forgiveness.

Holding

1. No, because the Current Tax Payment Act of 1943 does not authorize or justify excluding income taxable in 1943 under Section 107 from the 1943 tax

calculation for the purpose of increasing the 1942 tax forgiveness.

Court's Reasoning

The Tax Court relied on its prior decision in *William F. Knox, 10 T.C. 550 (1948)*, which addressed the same issue. The court emphasized that Section 107 of the Internal Revenue Code is to be applied "without regard to subsections" of the Current Tax Payment Act, as explicitly stated in subsection 6(d)(3) of the Act. The dissenting opinion argued that the majority's interpretation effectively disregarded this provision. Judge Hill, dissenting, stated, "the effect of the majority opinion is that such provision is not binding on this Court and that the language, 'shall be applied without regard to,' etc., shall be totally disregarded." The dissent contended that Section 107 income should be taxed in the year received (1943) and should not retroactively increase the 1942 tax liability for forgiveness purposes. The majority, however, followed the *Knox* precedent, holding that the income was taxable in 1943 and the tax forgiveness applied to the actual 1942 tax liability, not a recalculated, inflated 1942 tax.

Practical Implications

Schmidt v. Commissioner clarifies the interaction between income averaging provisions like Section 107 (regarding compensation for services rendered over multiple years) and tax law changes aimed at current payment, such as the Current Tax Payment Act of 1943. The case reinforces that statutory forgiveness or relief measures are applied to actual tax liabilities of the specified period and are not expanded by income allocation rules. For legal professionals and taxpayers, this case highlights the importance of understanding the specific scope and limitations of tax relief legislation and how it interacts with other provisions of the tax code. It demonstrates that income averaging mechanisms do not retroactively alter prior year tax liabilities for the purpose of maximizing benefits under subsequent tax acts. Later cases would need to consider similar interactions between income-spreading provisions and subsequent tax law changes, always adhering to the principle that tax benefits are construed narrowly and applied as explicitly defined by statute.

