***14 T.C. 8 (1950)***

In community property states like Washington, income from a separately owned farm is community income to the extent it's attributable to the personal efforts of the owner and their spouse.

**Summary**

The Tax Court addressed whether income from a farm inherited by a Washington resident was entirely separate income, as argued by the IRS, or community income, as claimed by the taxpayer and his wife. The taxpayer had operated the farm with his wife for years before inheriting it. The court held that the portion of the farm income attributable to the couple's personal labor was community income, while the remaining portion, representing the rental value of the land, remained separate income. The court also determined the fair market value of farm improvements for depreciation purposes.

**Facts**

C. Clifford Minnick and his wife, Blanche, resided in Washington, a community property state. From 1909, they operated a farm owned by Minnick's brother, sharing the crop proceeds. Minnick inherited the farm in 1939 and continued farming it with his wife. They also purchased an adjacent tract in 1941. All income was treated as community income and deposited into joint accounts. The IRS determined that all income from the inherited farm was Minnick's separate income, resulting in a tax deficiency.

**Procedural History**

The Commissioner of Internal Revenue assessed deficiencies in Minnick's income tax for 1942-1945. Minnick petitioned the Tax Court for a redetermination, contesting the IRS's classification of the farm income as entirely separate and the disallowed depreciation deductions.

**Issue(s)**

1. Whether income from a farm inherited by a taxpayer in a community property state is entirely separate income, or whether the portion attributable to the personal efforts of the taxpayer and their spouse is community income.

2. What is the correct depreciable basis for farm improvements acquired by inheritance?

**Holding**

1. No, not entirely. Because a portion of the farm income was attributable to the personal efforts of the taxpayer and his wife, that portion constitutes community

 

income.

2. The depreciable basis is the fair market value of the improvements at the time of inheritance.

### Court's Reasoning

The court relied on Washington state law, which defines separate property as that acquired before marriage or by gift, bequest, devise, or descent, along with its rents, issues, and profits. Community property is all other property acquired after marriage. The court cited Poe v. Seaborn, <span normalizedcite="282 U.S. 101“>282 U.S. 101 for the principle that state law determines the character of property for federal tax purposes.

The court distinguished Hester v. Stine, supra and Seeber v. Randall, supra, cases cited by the IRS, noting that those cases did not involve significant personal labor contributing to the income. Instead, the court applied the principle from In re Witte's Estate, 21 Wash. (2d) 112; 150 Pac. (2d) 595 that earnings from separate property due to personal effort are community property. It determined that a fair allocation was to treat one-third of the crops as rental value (separate income) and two-thirds as resulting from personal efforts (community income), aligning with the historical rental arrangement.

Regarding depreciation, the court valued the buildings and fences as of August 1939. The dwelling house, being for personal use, was not depreciable for tax purposes.

Opper, J., dissented, arguing that the income should be taxed entirely to the husband due to his control over the property and a long-standing administrative practice.

### Practical Implications

This case clarifies the treatment of income from separate property in community property states when personal labor contributes significantly to that income. Attorneys must consider the allocation between the inherent return on the separate property and the value added by community labor. The case emphasizes that even in situations where the underlying asset is separate property, the income stream may be bifurcated for tax purposes. This ruling impacts tax planning for individuals in community property states who actively manage inherited or separately owned businesses or farms. It also highlights the importance of documenting the extent of personal labor involved in generating income from separate property. Subsequent cases would need to assess the factual contribution of personal services to determine the appropriate allocation, potentially requiring expert testimony on valuation.