17 T.C. 64 (1951)

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Under California community property law, income from a business acquired after marriage is community income and must be equally divided between spouses for federal income tax purposes; additionally, if a taxpayer omits more than 25% of their gross income, a 5-year statute of limitations for assessing deficiencies applies, regardless of whether the omission was intentional.

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Summary

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Leslie and Marjorie Sutor, a married couple operating a charter launch business, filed separate income tax returns. The Commissioner of Internal Revenue assessed deficiencies, arguing that Marjorie omitted over 25% of her gross income by not reporting half of the business's gross receipts, which constituted community income under California law. The Tax Court addressed whether the 5-year statute of limitations applied due to the omitted income, whether certain deductions were properly disallowed, whether negligence penalties were warranted, and whether the Commissioner improperly inspected their books. The Court upheld the deficiency assessments and negligence penalties.

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Facts

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Leslie and Marjorie Sutor, husband and wife, operated a charter launch business on San Francisco Bay. They filed separate income tax returns for 1943, 1944, and 1945. Marjorie had previously worked outside the home but contributed no services to the launch business. The income from the business was reported on a cash basis. The Sutors did not keep formal books or records. The gross receipts from the launch business were not equally divided on their returns. The IRS determined that the gross receipts of the business were understated on Leslie's returns and that Marjorie's salary was understated on her 1943 return.

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Procedural History

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The Commissioner issued separate notices of deficiency to Leslie and Marjorie. Leslie initially contested the deficiency for 1943 but the IRS conceded the assessment was time-barred under the 3-year statute of limitations. Leslie signed a waiver extending the statute of limitations for his 1944 return. Marjorie challenged the deficiencies, arguing the 3-year statute of limitations barred assessment. The Tax Court reviewed the Commissioner's determinations regarding the statute of limitations, disallowed deductions, negligence penalties, and alleged improper inspections of books and records.

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Issue(s)

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1. Whether Marjorie's income tax returns for 1943 and 1944, otherwise barred by the 3-year limitation period under section 275 (a) of the Internal Revenue Code, are subject to assessment under the 5-year limitation of section 275 (c) of the Code.

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2. Whether the Commissioner erred in disallowing deductions for certain expenditures and depreciation claimed by petitioners.

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3. Whether the Commissioner erred in determining negligence penalties against each petitioner for each taxable period.

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4. Whether the Commissioner's original determinations were barred due to alleged violations of section 3631 of the Code.

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Holding

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1. Yes, because Marjorie omitted from her gross income an amount exceeding 25% of the gross income stated in her returns, triggering the 5-year statute of limitations

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under section 275(c) of the Code.

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2. No, because the Sutors failed to provide sufficient evidence to support the deductions claimed.

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3. No, because the Sutors' failure to keep adequate books and records, coupled with their business experience, demonstrated negligence.

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4. No, because the Sutors failed to prove that the Commissioner conducted multiple inspections without proper notice, and any such protection was waived by failing to object.

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Court's Reasoning

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The Tax Court reasoned that under California community property law, income from the launch business, acquired after the marriage, was community income divisible equally between the spouses. Marjorie's failure to include her half of the gross receipts resulted in an omission exceeding 25% of her reported gross income, triggering the extended statute of limitations under <span normalizedcite="26 U.S.C. 275 (c)

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