Anders I. Lagreide, Petitioner, v. Commissioner of Internal Revenue, Respondent. Alice Lagreide, Petitioner, v. Commissioner of Internal Revenue, Respondent, 23 T.C. 508 (1954)

When calculating a net operating loss carry-back on a joint return, income from a spouse’s trade or business, including rental income and salary, must be applied to reduce the loss before considering non-business deductions.

Summary

The case concerns the calculation of a net operating loss carry-back for a married couple filing jointly. The husband operated a sole proprietorship that incurred a loss in 1949. The wife earned salary as a teacher and also received rental income from a single property. The Commissioner determined that the wife’s salary and rental income constituted income from a trade or business, which should be applied to reduce the husband’s operating loss before non-business deductions. The Tax Court agreed, holding that the wife’s income from both sources qualified as business income for carry-back purposes, meaning the operating loss was reduced by the income earned by the wife. The decision has practical implications for how married couples should calculate net operating losses when filing jointly.

Facts

Anders Lagreide owned and operated XL Products Company, a sole proprietorship, which incurred a net operating loss in 1949. His wife, Alice Lagreide, was employed as a teacher and earned a salary. She also owned and rented out a single piece of residential property. The Lagreides filed separate income tax returns on a community property basis for 1947 and a joint return for 1949. They initially filed for a tentative carry-back adjustment for 1947 based on the 1949 loss, but the Commissioner of Internal Revenue determined deficiencies, asserting that the wife’s income from her teaching job and the rental property should be applied to offset the husband’s business loss before any non-business deductions.

Procedural History

The Lagreides filed a joint return for 1949 and separate returns for 1947. They filed an application for a tentative carry-back adjustment for 1947 based on the 1949 loss. The Commissioner determined deficiencies in the 1947 tax returns, leading to a petition filed with the United States Tax Court by the Lagreides, seeking to overturn the Commissioner’s decision.

Issue(s)

1. Whether the rental income received by Alice Lagreide from a single piece of property constituted income from the operation of a trade or business regularly carried on by her, for carry-back purposes.

2. Whether the salary earned by Alice Lagreide from teaching school constituted income from the operation of a trade or business regularly carried on by her, for carry-back purposes.

Holding

1. Yes, because the rental of the property was a trade or business regularly carried on by Alice Lagreide, the net rental income must be applied to reduce the husband's operating loss.

2. Yes, because Alice Lagreide's salary as a teacher was income from the operation of a trade or business regularly carried on by her, and that income must also be applied to reduce the husband's operating loss for carry-back purposes.

Court's Reasoning

The court applied regulations that state the net operating loss for a joint return is calculated as if it were the return of a single taxpayer. Income and deductions from both spouses are combined. The court held that rental of a single property and salary from teaching both constitute income from a trade or business regularly carried on. The court cited precedent for both, including cases holding that renting out property is a business and a teacher is engaged in a trade or business. The court looked to the fact that the wife regularly rented the property and was employed as a teacher, so it was considered a business regularly carried on. Under Section 122(d)(5) of the Internal Revenue Code, the business income must be applied against the business loss before considering non-business deductions. The court also rejected arguments from a prior case, stating that any salary income earned was to be included when determining operating loss, particularly for joint returns.

The court stated, "We think that the foregoing regulations are reasonable." It quoted Section 122 (d)(5): "Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall * * * be allowed only to the extent of the amount of the gross income not derived from such trade or business."

Practical Implications

The case provides guidance on the computation of net operating losses for married couples filing jointly. It reinforces that the income from both spouses' trades or businesses is combined to determine the overall business income and loss, especially when calculating a carry-back. Income from both spouses must be considered when calculating the operating loss. It clarifies that income from sources like rentals and teaching are considered business income that must be applied to reduce the operating loss. Taxpayers should carefully document and classify their income sources to ensure accurate computation and avoid potential tax liabilities and penalties, especially when filing jointly. This case remains relevant as an application of how to combine the income and losses of spouses when calculating net operating loss carry-backs and carry-forwards.

Meta Description

The case addresses how to calculate net operating losses for married couples filing jointly, determining what constitutes business income (rentals and teaching salary) and how it must be applied to reduce the loss.

Tags

Lagreide v. Commissioner, Tax Court, 1954, Net Operating Loss, Carry-back, Joint Return, Business Income