24 T.C. 1117 (1955)

Under the Trading with the Enemy Act, as amended, and related Treasury regulations, income earned by property held by the Alien Property Custodian is taxable to the owner in the years the income was earned, even if the owner did not receive the funds until a later year.

Summary

The petitioners, Richard and Katharina Oswald, were cash-basis taxpayers who received royalty income from the Alien Property Custodian in 1950. This income was earned from foreign films during 1945 and 1946, while the films were held by the Custodian. The Commissioner of Internal Revenue determined that the income should be allocated to the years 1945, 1946, and 1947, based on when it was earned, rather than 1950 when it was received. The Tax Court upheld the Commissioner's determination, citing the Trading with the Enemy Act and related regulations. The court ruled that the Attorney General, acting as Custodian, was required to pay taxes on the income in the years it was earned and that the taxpayers were also required to report the income in those years.

Facts

Richard and Katharina Oswald, husband and wife, were cash-basis taxpayers. In 1950, they received $2,918.17 from the Alien Property Custodian as royalty income from foreign films. The Custodian had held the rights to these films during 1945 and 1946, during which the films generated the income. The Oswalds did not know of the royalty income during 1945 and 1946. The Commissioner determined deficiencies in the Oswalds' income tax for 1945 and 1946, arguing the income should be allocated to those years, not 1950. The Oswalds reported the income on their 1950 tax return, which was consistent with the actual year of receipt. The Alien Property Custodian was acting under the Trading with the Enemy Act and related regulations.

Procedural History

The Commissioner determined deficiencies in the Oswalds' income tax for 1945 and 1946, disallowing the reporting of the income in 1950. The Oswalds contested the Commissioner's decision, arguing they correctly reported the income in the year of receipt, 1950. The case was brought before the United States Tax Court.

Issue(s)

1. Whether the royalty income received in 1950 from the Alien Property Custodian should be taxed in the years 1945 and 1946, when earned, or in 1950 when received by the taxpayers?

Holding

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1. Yes, because under the Trading with the Enemy Act, as amended, and related regulations, the income was properly allocable to the years 1945 and 1946 when earned.

Court's Reasoning

The court relied on the Trading with the Enemy Act and related Treasury regulations, particularly Section 36 of Public Law 671. This law and the regulations established that the Attorney General, as Custodian, was primarily liable for the income taxes on the vested property's income in the years the income was earned. The regulations specified that the vesting of property did not affect ownership and that the Custodian's actions were considered the owner's actions. The regulations provided that the income taxes should be computed for each taxable year, or period, during which the property was vested. The court cited the case of *Adele Kahle*, which established a similar rule regarding the taxation of income from property held by the Alien Property Custodian during World War I. The court reasoned that the 1946 amendments to the Trading with the Enemy Act did not change the rule of *Kahle* and that it was the intent of Congress that the owner should be liable for taxes on income for the year in which such income arose.

Practical Implications

This case clarifies that income generated by property held by the Alien Property Custodian is taxable to the owner in the years the income is earned, even if the owner does not receive the income until later. This is true whether the property is subsequently returned to the owner or not. This ruling affects cash-basis taxpayers who may receive income from property vested with the Custodian. Taxpayers must report income in the year the income was earned and the Custodian held it, irrespective of when the funds were actually received. This case highlights the importance of understanding the specific tax implications of property held by the Custodian under the Trading with the Enemy Act. It influences how similar cases are analyzed by mandating that the income be allocated to the years when it was earned, not just when it was received by the owner. It underscores that tax liability generally follows the earning of income, even when the income is held by a third party.

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