Riley v. Commissioner, 66 T. C. 141, 1976 U. S. Tax Ct. LEXIS 120 (1976)

Income averaging provisions cannot be used to calculate the minimum tax on tax preference items.

Summary

In Riley v. Commissioner, the U. S. Tax Court ruled that the income averaging provisions under sections 1301 through 1305 of the Internal Revenue Code cannot be applied to compute the minimum tax on tax preference items as outlined in section 56. The Rileys, who sold Levi Strauss & Co. stock for a significant gain in 1971, attempted to use income averaging to avoid the minimum tax on their capital gains, which were classified as tax preference income. The court held that the minimum tax is a separate, self-contained provision, and income averaging is not applicable to it, emphasizing Congress's intent to ensure some minimum taxation of tax preference items.

Facts

Norman O. and Louise Riley sold 3,900 shares of Levi Strauss & Co. stock in 1971, which they had held for over six months, resulting in long-term capital gains of $163,437. These gains created tax preference income of $81,718 under section 57(a)(9)(A). The Rileys had no other tax preference income in 1971 or the preceding four years. On their 1971 tax return, they elected to use income averaging under sections 1301 through 1305 to compute their section 1 tax, and believed they could also average their tax preference income to avoid the minimum tax under section 56. The IRS challenged this approach, asserting a deficiency of $2,056.

Procedural History

The Rileys filed a petition in the U. S. Tax Court challenging the IRS's determination of a $2,056 deficiency due to the application of the minimum tax on their tax preference income. The case was submitted under Rule 122 of the Tax Court Rules of Practice and Procedure, and all facts were stipulated by the parties.

Issue(s)

1. Whether the income averaging provisions of sections 1301 through 1305 of the Internal Revenue Code can be utilized in determining the liability for the minimum tax on tax preference items imposed by section 56.

Holding

1. No, because the minimum tax imposed by section 56 is a separate and self-contained provision, and the income averaging provisions do not apply to its computation.

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Court's Reasoning

The court reasoned that the minimum tax under section 56 is intended to ensure some level of taxation on certain items of investment income, including capital gains, which had previously escaped taxation. The court noted that section 56 is a distinct provision, designed to function independently from the regular tax imposed under section 1. The court emphasized that the language of sections 1301 through 1305 specifically applies to the tax imposed by section 1, not the minimum tax under section 56. The court further stated that if Congress had intended to allow income averaging for the minimum tax, it would have explicitly provided for it. The court concluded that allowing income averaging for the minimum tax would undermine the purpose of section 56, which is to subject tax preference items to at least a minimum level of taxation.

Practical Implications

This decision clarifies that taxpayers cannot use income averaging to reduce or eliminate their liability for the minimum tax on tax preference items. Practitioners must advise clients that capital gains and other tax preference income must be considered separately when calculating the minimum tax, without the benefit of income averaging. This ruling upholds the integrity of the minimum tax regime established by the Tax Reform Act of 1969, ensuring that tax preference items are subject to some level of taxation. Subsequent cases have consistently applied this principle, reinforcing the separation between the regular tax and the minimum tax on tax preferences.

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