

***Moore v. Commissioner, 71 T. C. 533, 1979 U. S. Tax Ct. LEXIS 198 (1979)***

Capital is a material income-producing factor in a retail grocery business, limiting the amount of income that qualifies for the 50% maximum tax rate on earned income to 30% of net profits.

**Summary**

In *Moore v. Commissioner*, the U. S. Tax Court determined whether capital was a material income-producing factor in a retail grocery store operated by the Moores as a partnership. The Moores argued their personal services were the primary income source, while the Commissioner claimed capital, evidenced by inventory and equipment investments, was material. The court held that capital was indeed material, citing the substantial investment in inventory and depreciable assets. Consequently, only 30% of the net profits from the grocery store qualified for the 50% maximum tax rate on earned income under Section 1348 of the Internal Revenue Code. This decision underscores the importance of capital in retail businesses when applying tax regulations.

**Facts**

Robert G. and W. Yvonne Moore operated a retail grocery store as a partnership in Willard, Ohio, under an I. G. A. franchise. They reported substantial income from the store in 1974 and 1975, claiming it as earned income qualifying for the maximum tax rate on earned income under Section 1348. The store's operation involved significant inventory and fixed assets, with book values ranging from \$60,554. 47 to \$91,186. 72 for inventory and over \$60,000 for depreciable assets. The Moores managed the store efficiently, minimizing inventory and labor costs, and maximizing profitability compared to similar stores.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the Moores' federal income tax for 1974 and 1975, leading the Moores to petition the U. S. Tax Court. The court heard arguments on whether capital was a material income-producing factor in their grocery business, ultimately deciding in favor of the Commissioner.

**Issue(s)**

1. Whether, for purposes of Section 1348 of the Internal Revenue Code, capital was a material income-producing factor in the Moores' retail grocery business?

**Holding**

1. Yes, because the court found that a substantial portion of the gross income of the business was attributable to the employment of capital, as evidenced by substantial

investments in inventory, plant, machinery, and other equipment.

### **Court's Reasoning**

The court applied the legal test from Section 1. 1348-3(a)(3)(ii) of the Income Tax Regulations, which states that capital is a material income-producing factor if a substantial portion of the gross income is attributable to capital employment. The court emphasized that the Moores' grocery business, like all retail grocery businesses, inherently required significant capital investment in inventory and equipment. Despite the Moores' efficient operations and minimization of capital use, the court rejected their expert's argument that capital was not material, finding it legally unfounded. The court noted that all income from the business came from the sale of groceries, not from fees or commissions for personal services, further supporting the materiality of capital. The court dismissed the Moores' argument that their personal services were the primary income source, stating that personal services were inseparable from the capital employed in the inventory sold to customers.

### **Practical Implications**

This decision impacts how retail businesses are analyzed for tax purposes under Section 1348. It clarifies that capital is a material income-producing factor in retail grocery operations, limiting the portion of net profits that can qualify for the 50% maximum tax rate on earned income to 30%. Legal practitioners should consider this when advising clients in similar industries, as it affects tax planning and the classification of income. The ruling may also influence business practices by emphasizing the importance of capital investments in retail operations. Subsequent cases, such as *Bruno v. Commissioner*, have reinforced this principle, ensuring consistent application across various retail sectors.