

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

Tax Division

Robert W. Embry, )  
 )  
 " Petitioner, )  
 )  
 v. )  
 )  
 District of Columbia, )  
 )  
 Respondent. )

Docket No. 2184

**FILED**

JUN 7 1973

Superior Court of the  
District of Columbia  
Tax Division

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Petitioner assails the validity of an unincorporated business franchise tax for the calendar years 1970 and 1971 on the ground that he was not engaged in an unincorporated business within the meaning of the District of Columbia Income and Franchise Tax Act of 1947, <sup>1/</sup> as amended.

Findings of Fact

1. Petitioner is an individual trading as Embry Auto Electrical Services. He was so engaged in the District of Columbia during the calendar years 1970 and 1971, with his place of business at 1218 Mt. Olivet Road, N.E., Washington, D.C.
2. During the years in question petitioner's activity consisted of making electrical repairs to motor vehicles. His gross income from this business derived from two sources, charges for labor and charges for parts. In 1970 petitioner's gross income was \$24,037.38, of which \$20,136.08 was from charges for labor and \$3,901.30 was from charges for parts, which parts cost petitioner \$2,547.09. In 1971 petitioner's gross income was \$25,201.38, of which \$21,380.10 was from charges for labor and \$3,821.28 was from charges for parts, which parts cost petitioner \$2,464.35.

1/ Title 47 § 1574, D.C. Code (Supp. V 1972).

3. Nearly all of the labor charges were for services performed personally by petitioner. The remaining labor charges were for work done by petitioner's only employee, his son, during the latter half of 1970 and 1971. More than 80 percent of the gross income of the business was derived from personal services actually rendered by petitioner.

4. The vast majority of parts purchased by petitioner were ordered specially to fulfill the needs of customers who had engaged petitioner to repair their automobiles. Petitioner kept an average of only \$50 worth of frequently used parts "upon the shelf" for future resale.

5. Capital was not a material income-producing factor in petitioner's business. The primary income-producing factor was petitioner's services, experience, and skill in making electrical repairs to automobiles.

6. On April 14, 1971, petitioner paid respondent an unincorporated business franchise tax in the sum of \$390.00 for the year 1970; on April 10, 1972, petitioner paid respondent an unincorporated business franchise tax in the sum of \$407.00 for the year 1971.

7. On June 20, 1972, petitioner filed claims for refunds for both years. These claims were denied on July 7, 1972. The petition appealing from the denial of the claims for refunds was filed with the Court on July 31, 1972.

#### Conclusions of Law

Article I, Title VIII, § 1, of the Income and Franchise Tax Act of 1947 (Title 47, § 1574 of the D.C. Code (Supp. V 1972); Section 307.4(a)(2) of the D.C. Finance and Revenue Regulations) exempts from the application of the tax on unincorporated businesses ". . . any trade or business in which more than 80 per centum of the gross income is derived from the personal services actually rendered by the individual

or members of the partnership or other entity in the conducting or carrying on of any trade or business and in which capital is not a material income-producing factor."

It is clear to the Court that more than 80 percent of the gross income was derived from personal services actually rendered by petitioner. Therefore, the only issue remaining is whether petitioner fulfilled the second requirement for exemption -- namely, that capital not be a material income-producing factor.

Respondent's contention that capital was a material income-producing factor is based on the fact that petitioner made a substantial profit on parts which he used in his repairs. In 1970 petitioner received \$3,901.30 for parts which cost him \$2,547.09, a profit of \$1,354.21 and a mark-up of 53 percent. In 1971 petitioner received \$3,821.28 for parts which cost him \$2,464.35, a profit of \$1,356.83 and a mark-up of 55 percent. It is clear that the cost to petitioner of these parts constituted "capital." Section 307.4(c) of the D.C. Finance and Revenue Regulations defines "capital" as ". . . the total value of all those assets of the business (whether such assets be of a tangible or intangible nature and irrespective of how acquired) which are essential to and are used in conducting such business . . . ." Petitioner's contention that his capital is limited to the value of those parts purchased by cash instead of on credit is clearly erroneous. However, the use of a substantial amount of capital in petitioner's business will not deprive him of the exemption under Article I, Title VIII, § 1 of the Income and Franchise Tax Act of 1947 unless the capital is a "material income-producing factor."

In Kronstadt v. District of Columbia, [1954-1957 Transfer Binder] D.C. Tax Repts. § 14.076 at 1611, Rept. No. 157 (April 15, 1954), the District of Columbia Tax Court interpreted this statute as allowing the exemption in a case strongly analagous to the one at hand. In

Kronstadt the petitioners owned an advertising agency which purchased advertising space and time in various media on behalf of its clients and then billed the clients for the cost of the advertisements plus a 15 percent commission. The Court held that the Assessor erroneously denied petitioners' claim for an exemption, finding that capital was not a material income-producing factor, but rather that the primary income-producing factor was petitioners' skill, experience, and the advice rendered to their clients. This Court finds the following language of the Tax Court pertinent and persuasive:

The petitioners did not purchase time from broadcasting companies or space from publications or other media for their own account as the ordinary merchant buys merchandise, to be sold at a profit to whomsoever shall wish to purchase it. The advertising services were arranged by them for the benefit of their clients and no obligation in respect thereto was assumed before their client's direction to them with a corresponding liability at the same time on the part of the client. The petitioners did not acquire a commodity and put it "upon the shelf," so to speak, to await some customer who might want it, with their capital tied up or frozen therein in the meanwhile. Supra, at 1614.

Likewise the petitioner in the case at hand did not assume any obligation to pay for parts specially ordered for his customers until the customer assumed a corresponding obligation to pay for them. He only kept an average of \$50 worth of frequently used parts "upon the shelf"; and the Court is convinced that the income produced from this capital is not material.

This case is distinguishable from Rohrbaugh v. District of Columbia, 96 U.S. App. D.C. 207, 225 F.2d 264 (1955), upon which both respondent and petitioner rely. In Rohrbaugh the court applied the two requirements for exemption of Article I, Title VIII, § 1 of the Income and Franchise Tax Act of 1947 to a brokerage and securities firm that derived income from five distinct sources: (1) brokerage commissions, (2) dividends on securities held as firm investments, (3) profit from sales of such securities, (4) income from underwriting, and (5) profits

from dealing in securities as principal. The court held that sources (4) and (5) did not qualify under the first requirement in that they did not constitute income derived from personal services actually rendered by petitioners; that sources (2) and (3) did not qualify under the second requirement, in that they were material income-producing factors; and that only source (1) met both requirements. Sources (4) and (5), income from underwriting and profits from dealing in securities as principal, are similar to petitioner's disputed income from the mark-up of parts in that the securities in question, like the automobile parts, were not purchased until the customer ordered them. However, the court did not determine that these sources of income were material income-producing factors, but only that they were not derived from personal services actually rendered by petitioners. Sources (2) and (3), dividends on securities held as firm investments and profit from sales of such securities, which the court did hold to be material income-producing factors; are not at all similar to the profit that the petitioner in the case at hand derived from the mark-up of specially ordered parts.

For the reasons stated the Court holds that the Finance Officer erred in denying petitioner's claim for a refund, and that petitioner is entitled to a refund of an unincorporated business franchise tax for the calendar year 1970 in the amount of \$390.00, with interest thereon at the rate of 4 percent per annum from April 14, 1971, to the date of the payment of such sum, and for the calendar year of 1971 in the amount of \$407.00, with interest thereon at the rate of 4 percent per annum from April 10, 1972, to the date of the payment of such sum.

Decision will be entered for petitioner.



Paul F. McArdle  
Judge