

OPINION NO. 989

DISTRICT OF COLUMBIA TAX COURT

FILED

VIOLET S. THORON,  
Estate of Louise S. Cortesi, Deceased,  
ROGER CORTESI, Executor and Ancillary  
Executor, and SAMUEL SPENCER,

OCT 13 1961

District of Columbia  
Tax Court

Petitioners,

vs.

DOCKET NO. 1734

DISTRICT OF COLUMBIA,

Respondent.

FINDINGS OF FACT AND OPINION

The assessing authority of the District of Columbia assessed three persons, as an unincorporated business, a franchise tax measured by net income for the period from January 1 to August 1, 1958, and represented by a portion of the gain arising from the sale of a large office building which was owned by the petitioners prior to its sale. The petitioners contend that the asset or assets sold were held more than two years; and that the gain is "capital gain", and therefore not taxable within the meaning of Sections 47-1551c(1) and 47-1557a(b)(11), District of Columbia Code, 1951 Edition. On the other hand, the respondent claims that the assets involved were held less than two years; and that the gain is taxable income.

Findings of Fact

1. The petitioner, Violet S. Thoron, is an individual residing in the District of Columbia. The petitioner, Roger Cortesi, is the executor of the estate of Louise S. Cortesi, who died domiciled in New York on August 1, 1958. The petitioner, Samuel Spencer is an individual residing in the District of Columbia, and an attorney at law.

2. On February 1, 1951, the petitioners purchased Lots 825, 826 and 830 in Square 141, City of Washington, D. C., improved by a large office building, known as the "Hurley-Wright Building", and a three story building adjacent thereto, and being premises 1800 H Street and 724 Eighteenth Street, Northwest, respectively.

3. On January 31, 1958, the aforesaid land and two buildings were sold for a price of \$1,456,156.91; and the gain to the petitioners from the sale was \$721,486.28.

4. Within two years of the aforesaid sale, that is to say, between February 1, 1956 and January 31, 1958, permanent improvements were made to the Hurley-Wright Building as follows:

(a) Building Improvements Made in 1956: (i) Partitioning installed in certain portions of the building to divide office space to suit tenants, (ii) Some new electrical installations, particularly additional duplex outlets, connections for air conditioning units and the like, and (iii) Material and labor to substantially modernize offices on two floors, by substituting venetian blinds for roll-up shades, installation of a new asphalt tile, new pipe and radiation for plumbing and heating. The cost of the improvements was \$64,790.95. On January 31, 1958 (date of sale) the depreciated or net value was \$57,192.01.

(b) Building Improvements Made in 1957: Those improvements consisted of, or involved the remodeling of two elevators. The two elevators were continued in the same shaft as before, the same rails and much of the old machinery was utilized. Certain control machinery was changed, the cabs were replaced and superficial trim at the landings was changed. The cost of the improvements was \$55,650.00. On January 31, 1958, the depreciated value or net value was \$51,828.70.

(c) Air Conditioning Equipment Bought in 1956: Certain air conditioning equipment consisting of space or window type conditioners, and a small duct leading from one

of them were bought and installed in Hurley-Wright Building in 1956. The total cost was \$4,347.50. The depreciated value on January 31, 1958, was \$3,659.14.

5(a) The total cost of the Hurley-Wright Building, with the improvements made in the years 1956 and 1957, detailed in Finding No. 4, was \$887,124.03. During the years of ownership depreciation was taken in the amount of \$156,779.72, so that for the purposes of determining gain for taxation purposes (both Federal and District) the basis, or depreciated value, but not real value, was \$730,344.31 on January 31, 1958.

(b) The total cost and the depreciated value, but not the real value necessarily, of the improvements on January 31, 1958, was as follows:

	<u>Cost</u>	<u>Depreciated Value</u>
Improvements Made in 1956	\$ 64,790.95	\$ 57,192.01
Improvements Made in 1957	55,650.00	51,828.70
Air Conditioning Equipment Bought in 1956	<u>4,347.50</u>	<u>3,659.14</u>
	<u>\$124,788.45</u>	<u>\$112,679.85</u>

6. The cost of the Hurley-Wright Building to the petitioners, without the improvements made in 1956 and 1957 was \$762,335.58. The Court is unable to find the value of the Hurley-Wright Building either with or without the improvements made in 1956 and 1957, because there is no evidence as to such values, nor is it able to determine with any degree of accuracy or reality the value of the improvements, or to what extent the improvements increased the value of the building.

7(a) On January 10, 1961, the assessing authority of the District of Columbia assessed the petitioners a deficiency in "unincorporated business franchise tax" in the amount of \$5,642.67. The tax was computed as follows:

UNINCORPORATED BUSINESS FRANCHISE TAX

Taxable Period January 1, 1958 to August 1, 1958

Net Income, per Form D-30	\$ 3,440.89
Add: Additional Income & Unallowable Deductions: Gain attributed to sale of asset held for less than two years *	112,853.44
Revised Net Income	\$116,294.33
Less: Exemption	2,904.11
Net Taxable Income	\$113,390.22
Tax @ 5%	\$ 5,669.51
Less: Tax previously paid	26.84
Deficiency	<u>\$ 5,642.67</u>

EXPLANATION

\* Gain attributed to sale of Assets \$112,853.44 - Computed as follows:

$$\frac{\$114,239.04}{\$730,344.31} ** \times \$721,486.28 **** = \$112,853.44*$$

\*\* Cost of improvements held less than two years (Net Value), January 31, 1958:

Building improvements made in 1956	\$ 57,192.01
Building improvements made in 1957	21,221.20
Building improvements made in 1957	30,607.50
Air Conditioning Equipment bought in 1956	6,032.00
Air Conditioning Equipment bought in 1957	141.40
Total **	<u>\$114,239.04</u>

\*\*\*Total Net Value of Assets Sold:

Cost	\$887,124.03
Less: Depreciation taken in prior years	156,779.72
Total Net Value ***	<u>\$730,344.31</u>

\*\*\*\* Gain on Sale - Reported Gain as shown, per Schedule attached to return.

\* All gains from sale or exchange of properties other than capital assets are taxable in full for District of Columbia income tax purposes. Capital Assets are defined under the provisions of the District of Columbia Income and Franchise Tax Act of 1947, as amended, as any property held for more than two years."

(b) On January 25, 1961, the petitioners paid the aforesaid "unincorporated business franchise tax" together with interest in the amount of \$620.69, or a total of \$6,263.36.

8. This case was filed on March 20, 1961.

Opinion

This case involves the assessment of a deficiency in franchise tax against three owners in common of a large office building in Washington, D. C., known as the "Hurley-Wright Building", and a three story building adjacent thereto. The deficiency in franchise tax was assessed against the petitioners as an unincorporated business under the provisions of the District of Columbia Income and Franchise Tax Act of 1947,<sup>(1)</sup> which imposes a franchise tax upon unincorporated businesses in the same manner as franchise taxes are levied on corporations.

At the outset it should be stated that the Court is presented with a unique situation which has given the Court trouble in determining how it should be met. The exposition of the matter requires elaboration.

The record discloses that the petitioner, Samuel Spencer is a practicing attorney at law. The record does not indicate that he or the other petitioners ever owned any property other than that involved herein, or were ever engaged in any commercial activity.<sup>(2)</sup>

The stipulation of the evidence shows that on February 1, 1951, the petitioners Violet Thoron and Samuel Spencer and Louise Cortesi, now deceased,<sup>(3)</sup> acquired Lots 825, 826 and 830 in Square 141, City of Washington, D. C., improved by the Hurley-Wright Building, and a three story building adjacent thereto. On January 31, 1958, they sold the land and buildings as a single unit for \$1,456,156.91, and realized a gain from the sale of \$721,486.28.

During 1956 and 1957, permanent improvements were made to the Hurley-Wright Building which remained therein until the building was sold.

Other pertinent facts are the following: On January 15, 1961, the assessing authority of the District assessed the petitioners

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- (1) Chapter 15, Title 47, D. C. Code, 1951 Edition.  
(2) Unless it can be assumed that they operated the Hurley-Wright Building.  
(3) Her executor, Roger Cortesi, is a petitioner herein.

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a franchise tax as an unincorporated business, calling it an "unincorporated business franchise tax", in the amount of \$5,642.67, which was an excise tax measured by net income resulting from the sale of that portion of the Hurley-Wright Building consisting of permanent improvements made to the building within two years prior to the sale, that is to say, during the period from February 1, 1956 to January 31, 1958. The petitioners paid the tax on January 25, 1961, plus interest of \$620.69, or a total of \$6,263.36.

As slightly bearing on the matter immediately under consideration, it should be stated that in the computation of the franchise tax due in the auditors report of deficiency in "unincorporated business franchise tax", there appeared by way of a credit, the following:

"Less: Tax previously paid \$26.84"

The record is silent as to the kind of tax that was paid by the petitioners. It is, however, assumed in this discussion that the tax previously paid by the petitioners was a franchise tax. If it was, there is nothing in the record to show why or for what activity it was paid. It might be assumed, purely for purpose affording the circumstances or situation most favorable to the District, that the petitioners operated the Hurley-Wright Building while they owned it. If they did operate it, they were, of course, while operating it an unincorporated business, but they ceased to be such when they sold it. Ownership, joint or in common, is not an activity amounting to an unincorporated business, except, of course, where the parties are engaged in the business of buying and selling real or personal property in regular course of activity. CP. Stone v. District of Columbia, 91 U.S. App. D.C., 198 F.2d 601, 80 W.L.R. 1285. That is not the situation here. This Court had occasion to deal with this question in Ben Lar Associates, et al. v. District of Columbia, D.C.T.C., Docket No. 1599, where the parties during ownership of

(4) There is no evidence that they operated the building.

real property where an unincorporated business, but where this Court held that upon sale that capacity or status ended, and that the proceeds of sale were received by the owners individually and as tenants in common. Upon appeal to the United States Court of Appeals for the District of Columbia Circuit the decision of this Court was affirmed, Per Curiam. District of Columbia v. Ben Lar Associates, et al., 104 U.S. App. D.C. 275, 261 F.2d 376, 86 W.L.R. 1038. Of particular and pertinent application is the excerpt from this Court's opinion in that case following:

"If the conduct of an individual did not measure up to an unincorporated business, it did not become so by being done by a partnership or any other entity (other than a corporation, of course). If an individual should buy an apartment building, he would not in that transaction or at that point be carrying on an unincorporated business. If he should lease the building to some person and take no part in its operation, he still would not be carrying on an unincorporated business. District of Columbia v. Pickford, 86 U.S. App. D.C. 17, 179 F.2d 271; Zonne v. Minneapolis, supra. If, however, he should decide to operate the building with the supplying of services, etc., either by himself or through an agent he would be engaged in an unincorporated business. District of Columbia v. Pickford, supra, CF Flint v. Stone Tracy Co., 220 U.S. 107, 31 S.Ct. 342, 55 L.Ed. 389, Ann. Cas. 1912 B, 1312; Littlehales v. District of Columbia, 75 U.S. App. D.C. 368, 130 F.2d 402. If after holding the property for some time he should sell the same, the unincorporated business in the case last mentioned would end. The sale transaction would not be an unincorporated business. It would be merely an individual selling property, who would be required to report and pay an income tax upon any taxable gain. The fact that he was engaged as an unincorporated business during his ownership of the apartment building would not legally subject him to an unincorporated business franchise tax measured by the gain from the sale."

The Court is convinced that the assessment of a deficiency in franchise tax against the petitioners was erroneous. If they were subject to any tax it was an income tax, except that the executor of the estate of Louise S. Cortesi, deceased, would not be liable for any tax since the decedent was apparently domiciled and residing in New York.

Two difficulties present themselves to this Court at this point. The first relates to the power or authority of the Court to consider and decide the question of the validity of the franchise taxes in view of the fact that the petitioners have not raised the question of their status as an unincorporated business or as to the propriety assessing a franchise tax on that basis.

Rule 7(a)(B)(4) of this Court, as does Rule 7(a)(B)4 of the Tax Court of the United States, provides that the petition contain "Clear and concise assignments of each and every error which the petitioner alleges to have been committed by the assessing authority". The Tax Court of the United States has repeatedly ruled that issues not raised by the pleadings cannot be considered by that Court, the latest case involving that principle being Peter Licavoli, Memo. Op. Aug. 15, 1956, Doc. 58056, 15 T.C.H. 998. See also Hamell's, Practice and Evidence before the U. S. Board of Tax Appeals, Section 65, pp. 89 and 90. It has been the practice of this Court to follow the rulings of the Tax Court of the United States where, as here, the rules are identical.

On the other side of the coin is a case, which when analyzed, requires the Court to consider and decide the question which presents itself, even though not presented by the petitioners. In Trustees of St. Paul M.E. Church v. District of Columbia, 94 U.S. App. D.C. 75, 212 F.2d 214, 82 U.L.R. 813, there were involved real estate taxes for two years on church property, which the District contended was not used for church purposes, but to obtain revenue, and consequently taxable. The sole question or issue presented in this Court by the petition was the use of the property during the two years, and no other issue was raised, briefed or argued in the United States Court of Appeals on appeal from a decision of this Court holding that the property was not being used for religious purposes and was, therefore, taxable. (5) The United States Court of Appeals affirmed the decision of this Court as to the second taxable year, but reversed the decision as to the first year on the ground that, since the correct procedure for restoring the property to the rent rolls and for assessment had not been complied with, the

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(5) The use and other circumstances of occupancy were the same for both years.

tax was invalid and should be cancelled. The decision of this Court, apparently, was reversed, because it should have decided the question of the propriety of the procedure and held the tax invalid, notwithstanding the issue was not raised in this Court. The Court does not believe that it should make the same mistake or commit the same error in this case; and that it should consider and decide the question sua sponte. Two cases, while somewhat out of line, do support the position which the Court believes it should take. Henry F. Cochrane, 23 B.T.A. 202, in which a reduction in petitioner's gross income was ordered although the question was not raised and no request for the reduction was made; and W. H. Langley & Co., 23 B.T.A. 1297, in which certain deductions from income were allowed, although not claimed in the petition.

The Court believes that it should decide the question presented; and that the ruling should be that the franchise tax assessed against the petitioners as an unincorporated business was invalidly assessed and should be cancelled.

While the income tax on individuals and the franchise tax on corporations and unincorporated businesses are levied by the same act, the taxes are different, Flint v. Stone Tracy Co., 220 U.S. 107, 55 L.Ed. 339, 31 S.Ct. 342. This Court "may affirm, cancel, reduce or increase" an assessment, but it cannot assess a tax or a deficiency, and, therefore, cannot assess an income tax on the gain from the sale against the two resident (6) petitioners to take the place of the franchise tax. (7) While it was held in Hosmer v. District of Columbia, 77 U.S. App. D.C. 295, 135 F.2d 654, 71 W.L.R. 932; and Hamilton National Bank v. District of Columbia, 85 U.S. App. D.C. 109, 176 F.2d 624, 77 W.L.R. 1102, that the then Board of Tax Appeals, was "a constituent member of the assessing authority", Congress in

(6) Violet S. Thoron and Samuel Spencer.

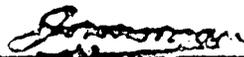
(7) It so happens that the rate of tax would be the same, namely, 5%.

(8)  
the Act of July 10, 1952, making the Board the Tax Court, took away that administrative function by declaring that "The said District of Columbia Tax Court shall not be deemed or held to be a constituent member of the assessing or the taxing authority of the District of Columbia \* \* \*" This case is quite different from District of Columbia v. Gallant, Incorporated, \_\_\_ U.S. App. D.C. \_\_\_, 290 F.2d 745, where it was held that this Court should not be precluded from determining the validity or amount of a franchise tax, notwithstanding the lack of a proper formula for the apportionment of net income of a multi-state business. The Court in that case was not called upon to assess a tax, but actually to "reduce or increase" a tax already assessed by the assessing authority of the District. A different tax was not involved.

In view of the ruling that the assessment of a franchise tax against the petitioners as an unincorporated business was illegal, it would not be proper for the Court to decide the two issues raised by the petition, namely, whether the gain from the sale of that portion of the Hurley-Wright Building consisting of permanent improvements was taxable, as a gain from the sale of non-capital assets; and whether the method of apportioning the gain between the parts of the building was proper.

For the reasons stated the Court holds that a franchise tax for the calendar year 1958 in the amount of \$5,642.67, plus interest in the amount of \$620.69, or a total of \$6,263.36, was erroneously assessed against and collected from the petitioners, and should be cancelled; and that the petitioners are entitled to a refund thereof, with interest thereon at the rate of 4 per centum per annum from January 25, 1961, to date of payment of refund.

Decision will be entered for petitioners.



Jo. V. Morgan, Judge.

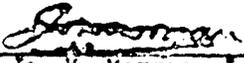
(8) See third paragraph in Section 47-2402, D. C. Code, 1951 Edition, Supplement VIII.

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