TAXATION OF IMPUTED INCOME

IMPUTED income, once neatly defined as "a flow of satisfaction" from goods owned and used by the taxpayer or from benefits arising through the exertions of the taxpayer on his own behalf,[1] is generally deemed not within the ambit of the American income taxing provisions.[2] Thus, items which actually represent an increase in economic power, such as farm products consumed by the farmer and his family,[3] domestic services of the housewife, and rental value of owner-occupied property,[4] are not subject to the federal income tax.

To this general rule there is an exception primarily carved out by cases and Treasury rulings involving insurance agents.[5] That is, an insurance agent is taxed on commissions from policies he writes on his own life,[6] although, in effect, he is merely enabled to purchase the insurance at a reduced premium. This exception extends as well to an agent purchasing insurance on members of his family, key employees, and partners,[7] and regardless of whether he is a direct representative of an insurance company or merely a salesman for a general insurance agency.[8]

---

[1] Marsh, *The Taxation of Imputed Income*, 58 POL. SCI. Q. 514 (1943).

[2] For discussions of the imputed income problem, see VICKREY, AGENDA FOR PROGRESSIVE TAXATION 18-35, 44-52 (1947); Marsh, *supra* note 1.

[3] Homer P. Morris, 9 B.T.A. 1273, 1278 (1928) (dictum); INTERNAL REVENUE SERVICE, FARMERS' TAX GUIDE 12 (1958). This rule apparently extends also to rents received from tenants in crop shares, which are not required to be reported until reduced to money or the equivalent of money, whether the farmer is on the cash or accrual basis. U.S. Treas. Reg. § 1.61-4 (1957).

[4] It has been recommended that a tax be imposed on rental values of owner-occupied homes in order to eliminate discrimination between owners and renters. An alternative suggestion is to allow resident tenants a deduction of rental expenses. VICKREY, *op. cit. supra* note 2, at 18-24; Marsh, *supra* note 1, at 530. Rental values of owner-occupied homes are subjected to an income tax in England. For the English practice see NEWPORT, INCOME TAX LAW AND PRACTICE (1943); TOLLEY, INCOME TAX CHART MANUAL (1943).

[5] T.D. 2137, 17 TREAS. DEC. INT. REV. 48 (1915); G.C.M. 10486, XI-1 CUM. BULL. 14 (1932); Rev. Rul. 273, 1955-1 CUM. BULL. 221. And see Ostheimer v. United States, — F.2d — (3d Cir. 1959).

[6] T.D. 2137, 17 TREAS. DEC. INT. REV. 48 (1915); G.C.M. 10486, XI-1 CUM. BULL. 14 (1932).

[7] Ostheimer v. United States, P-H 1959 FED. TAX SERV. (3 AFTR2d 886) ¶ 59-483 (3d Cir. Mar. 9, 1959).

[8] Rev. Rul. 273, 1955-1 CUM. BULL. 221. The Tax Court recently declined to extend this exception to include as taxable income commissions received by an insurance

A pair of cases closely related to the insurance agent rulings, *Toy v. Commissioner*[9] and *Benjamin v. Hoey*,[10] dealing with the taxation of imputed income in the context of profits derived from purchases made through brokerage partnerships, reached results opposite to each other.[11]

The broad question of taxation of imputed income was again before the Tax Court in the recent case of *Kenneth W. Daehler*.[12] The taxpayer, salesman for a real estate broker, wished to purchase for himself for subdivision purposes a tract of land listed at $60,000 with another broker. The taxpayer felt that $52,500 was a fair price for the land and recognized that if he could buy through his employer at this figure he could obtain the property at a net cost of $50,662.50, the difference representing his commissions on the sale. Accordingly, taxpayer made a formal offer of $52,500, which was accepted. This sum was paid by checks to the listing broker, who returned five per cent as commission to the taxpayer's employer. Of this amount, $1,837.50 was repaid the taxpayer and listed on his employer's books as commissions paid. When the taxpayer did not return this amount as income, the Commissioner assessed a deficiency. The Tax Court, five judges dissenting,[13] reversed

broker on policies written on his own life. Sol Minzer, 31 T.C. No. 115 (1959). See note 15, *infra*.

[9] P-H 1942 B.T.A. AND T.C. MEM. DEC. ¶ 42,452.

[10] 139 F.2d 945 (2d Cir. 1944).

[11] In *Toy*, a partner in a real estate brokerage firm purchased several properties listed with the firm, understanding that he would be able to procure them at the listed price less the brokerage commissions. The firm received the commissions, listing them as partnership income. The taxpayer's partner reported as income his entire distributive share of partnership income, including that received in the transactions concerned, while the taxpayer reported only his distributive share less one half the firm's commissions on property which he had purchased through it. The Board of Tax Appeals, in holding that the taxpayer's full distributive share was income, stated that the fact that he had purchased from a partnership of which he was a member did not change his share of the commission on such transactions into a discount on purchase price. In *Benjamin*, a stockbroker was held not to have received income where he ran his personal transactions through the brokerage of which he was a partner, even though the other partners returned as income their full distributive shares, including amounts representiug commissions on these transactions. The court stated that this was money which the taxpayer had paid to himself and that what one pays to one's self cannot be part of one's income. There seems little factual basis for distinguishing these cases.

[12] 31 T.C. No. 73 (1959). The transaction involved took place in 1952, the case arising under INT. REV. CODE OF 1939 § 22(a), which is substantially unchanged in INT. REV. CODE OF 1954, § 61(a).

[13] The dissenters stated: "The $1,837.50 which petitioner received from [his employer] was an employee's commission paid to him for personal services rendered by him to such employer. It was computed at a 70 per cent rate, by taking into consideration

the Commissioner, stating that the arrangement was merely a means of purchasing property at a reduced price and that, as a result, taxpayer realized no income on the transaction.

No attempt was made by the Tax Court to reconcile the *Daehler* decision with rulings relating to the taxation of insurance commissions, although these rulings appear to be more nearly analogous than any other existing precedent. Both situations involve a purchase by a salesman, from or through his employer, of the very commodity or item which the salesman was employed to sell, and a reduction in price actually accruing to the employee by virtue of his employment contract.[14]

In addition to the fact that many imputed income situations involve relatively trifling amounts, it seems clear that the general rule of non-taxation of imputed income reflects awareness of the extremely difficult administrative problems which would arise in assessing the tax. As an example, what wage value should be assigned to the laborings of a housewife, and for how many hours a day? In this regard, of course, the amount of income to be imputed from the agent's purchase of insurance on his own life is not difficult to measure, and this factor might logically be thought to attract a tax. But this factor will not serve to distinguish the typical insurance commission situation from the *Daehler*

the *volume of business* transacted by petitioner under his employee arrangement with said employer; and it was at the same rate as that which would have been paid to him in the case of any other sales brought about by him." The dissent further points out that ". . . the compensation paid by his employer in no way entered into the price negotiations between petitioner and Hicks, the owner of the real estate." 31 T.C. No. 73, 6 (1959).

[14] In Ostheimer v. United States, P-H 1959 FED. TAX SERV. (3 AFTR2d 886, 889) ¶ 59-483 (3d Cir. Mar. 9, 1959), the court discussed the problem of rebates in the insurance commission cases, stating that "The insurance companies were required by Pennsylvania statute to sell insurance to the public at fixed or uniform rates and taxpayer as a licensed insurance agent was likewise required by statute and by contract to sell at the fixed rates and not to rebate his commission. . . . Had taxpayer not been the agent who placed the policies he would not, and could not, have received the commissions on the premiums. It was only in his capacity as agent that he was paid these commissions." See PA. STAT. ANN. tit. 40, § 275 (1954).

For statutes prohibiting rebates of insurance premiums, see N.Y. INS. LAW. §§ 188, 209 (1950); N.C. GEN. STAT. § 58-44.5 (Supp. 1957); VA. CODE ANN. § 38.1-52(8) (1953 repl. vol.). Each of these, however, excludes commissions on policies written on the agent's own life from the general proscription of rebates. The North Carolina provision applies only to fire and casualty insurance.

The rebate laws might, at first glance, seem to indicate a ground of distinction between the insurance commission cases and the *Daehler* case on the theory that there can be no "cheap purchase" if no rebate is allowed. It is submitted, however, that the real effect is the same whether or not the transaction can technically be labelled a "cheap purchase."

case, where the amount of income realized was equally easy to measure.

There is, however, a plausible ground for distinguishing the *Daehler* case. In that case, as well as many others involving cheap purchases, it may not be necessary to tax the transaction which produced the imputed income in order to obtain a tax revenue from the benefit actually received. Any reduction in the purchase price of real estate or other property will be reflected in a lower cash basis. Thus, upon subsequent resale, a tax will be imposed upon the entire gain realized, albeit often at a capital gains rate. Moreover, there would seem to be a certain equity in this treatment, since the resale would clearly establish the amount of the income and also would place cash in the hands of the taxpayer with which to pay his tax. Under this rationalization, the cases are distinguishable, in as much as insurance policies are neither customarily acquired for resale nor readily marketable, while the realty involved in the *Daehler* case, having been acquired for subdivision, was probably intended for resale.

Under the foregoing analysis, then, the *Daehler* case can be squared with existing precedent, which would have seemed to indicate a contrary result, only by assuming that probability of resale is a significant determining factor. If this be true, however, a clearer articulation and broader application of this factor would seem to be in order. Otherwise, insurance agents are illogically singled out under the Tax Court's current treatment of imputed income.[15]

[15] In Ostheimer v. United States, *supra* note 14, at 889, involving an insurance agent, the court stated: "Taxpayer has called our attention to Kenneth W. Daehler, ... There it was held . . . that the amount refunded to a real estate salesman by his employer as salesman's share of commission on a house the salesman himself bought constitutes a reduction of the price paid for the house rather than taxable income. With respect to this case we need but say that we do not subscribe to its holding."

As this issue went to press, the Tax Court, seven judges dissenting, held that commissions on life insurance policies written by an insurance broker on his own life were not taxable income, but merely represented a reduction in the cost of such insurance. The court, referring to the word "commissions" as a "verbal trap" when applied to a reduction in cost of a broker's own insurance, stated that TD 2137, *supra* note 6, is specifically limited to cases where an employer-employee relationship exists between company and agent, and that it is explicit therein that a contrary result obtains in the absence of such relationship. Since the case involved a broker who was not an employee, the commissions were not and were not intended to be compensatory in nature. Sol Minzer, 31 T.C. No. 115 (1959). Thus, the Tax Court, while perhaps achieving a desirable result in eliminating discrimination against insurance brokers where imputed income is involved, has by the use of a somewhat dubious distinction perpetuated that same discrimination against the insurance agent.