



Tax Reduction Letter

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William W. Kellet

5 T.C. 608

The Commissioner has determined deficiencies and penalties in income tax against petitioners as follows:

Year	Deficiency	Penalty
1930 _____	\$5,076.16	\$2,583.09
1931 _____	2,737.47	1,408.52

The deficiency for 1930 is due primarily to the following adjustment:

(a) The following items of taxable income have been included in capital gains:

Unreported gain or retirement of B. B. T. Corporation preferred stock _____	\$14,100.00
Unreported gain on common stock of B. B. T. Corporation _____	23,000.00

Total additional taxable income _____	37,100.00

The deficiency for 1931 is due to adjustment (a) as follows:

(a) The taxable compensation received from the Ludington Corporation has been increased as follows:

Cash _____	\$20,000.00
Stock, Central Airport _____	15,000.00

Total _____	35,000.00
Amount reported _____	10,000.00

Increase _____	\$25,000.00

In addition to his determination of the said deficiencies, the Commissioner has also added 50 percent of the deficiencies as a fraud penalty, stating in his deficiency notice as follows:

The 50 percent ad valorem penalty, provided for by section 293 (b) of the Revenue Act of 1928, has been asserted for the reason that the deficiencies in tax shown are due to fraud with intent to evade tax.

Petitioner William W. Kellett will sometimes hereafter be referred to as the petitioner.[pg. 610]

In his pleadings petitioner first pleads the statute of limitations against the assessment and collection of any deficiencies of either of the taxable years; second, denies there was any fraud in either of the taxable years; third, denies there are any deficiencies for either of the taxable years because petitioner claims that the Commissioner erred in making the adjustments to W. W. Kellett's income which are shown in the deficiency notice.

FINDINGS OF FACT.

The petitioners are husband and wife, residing in Philadelphia, Pennsylvania. The returns for the periods here involved were filed with the collector for the first district of Pennsylvania.

Facts as to Taxable Year 1930.

The B. B. T. Corporation of America was incorporated during the year 1923.

During the year 1927 William W. Kellett was vice president and general manager of Scialytic Corporation of America and B. B. T. Corporation of America, from which he received compensation as salary. He performed various business services for Charles Townsend Ludington, which services were in addition to those rendered by him to the B. B. T. Corporation of America and Scialytic Corporation of America.

During the year 1927 Charles Townsend Ludington was associated with the B. B. T. Corporation of America, the Ludington Ferry Flying Service, National Air Transport, Inc., and various other smaller companies. He was the controlling stockholder in the B. B. T. Corporation of America. Ludington in 1926 became ill and had to leave Philadelphia. After he became ill in the latter part of 1926 he was unable to operate any part of his various enterprises.

On December 17, 1927, because of the greater load which William W. Kellett had been carrying and was going to continue to carry due to the illness of Charles Townsend Ludington, Ludington transferred to Kellett the following securities:

	Fair market value (claimed by Ludington)
179 shares of B. B. T. Corporation of America, preferred_	\$16,421.46
47 shares of B. B. T. Corporation of America, common_____	12,558.87
279 shares of Scialytic Corporation of America, common ___	20,330.73
Total_____	49,311.06

Charles Townsend Ludington transferred the aforementioned shares of stock to William W. Kellett for the reason that William W. Kellett was to run the nonaviation part of the B. B. T.

Corporation of America and Charles Townsend Ludington was to run the [pg. 611]aviation part of that business and Ludington, owing to his illness, had been unable to perform his duties and much of his work had fallen on Kellett. The B.B.T. Corporation of America and the Ludington Corporation could not pay William W. Kellett the amount of salary which William W. Kellett should have been paid in view of the work which he had done for Charles Townsend Ludington.

Prior to January 1, 1927, William W. Kellett was the owner of 21 shares of preferred stock of B. B. T. Corporation of America, which had a cost basis to him of \$2,100. He was also the owner of one share of common stock of B. B. T. Corporation. The cost basis of this share is not shown.

William W. Kellett did not include in his gross income as reported by him on his income tax return for the year 1927 the fair market value of the shares of stock which he received in that year from Charles Townsend Ludington in remuneration for his services in carrying on the work of Ludington while he was ill and unable to perform his duties. Kellett did not report these shares of stock as income because he regarded them as gifts from Ludington.

On March 31, 1928, William W. Kellett received from Charles T. Ludington for services rendered 25 shares of common stock of B. B. T. Corporation of America, which shares cost Charles Townsend Ludington \$25,000. The total number of shares of common stock of B. B. T. Corporation of America owned by William W. Kellett on May 31, 1928, was 73 shares. William W. Kellett did not report as taxable income on his individual income tax return for the calendar year 1928 the fair market value of the 25 shares of common stock of B. B. T. Corporation of America received by him from Charles Townsend Ludington on March 31, 1928, as compensation for services rendered. His failure to so report them was due to the fact that he regarded them as gifts from Ludington.

The owners, namely, William W. Kellett and Charles Townsend Ludington, of the 150 shares of common stock of B. B. T. Corporation of America, representing all the outstanding stock of that company, offered to sell them to American Gas Accumulator Co. on the following basis:

Purchaser to pay \$21,000.00 in cash or 200 shares of American Gas Accumulator 8% Convertible Cumulative "A" Preferred Stock, valued at \$21,000.00.

Purchaser to pay an additional amount of \$46,325.85, which sum was to be paid at the rate of 50% of the profits of the combined American Gas Accumulator Company and B. B. T. Corporation of America business per year, but in any event such payments were not to be less than \$8,000.00 per year until the entire amount had been paid.

Upon acceptance by the board of directors of the American Gas Accumulator Co. of this agreement, the 150 shares of common stock were to be placed in the hands of a trustee mutually agreed upon, with [pg. 612]the understanding that if payments were not made as provided in the agreement the stock was to be returned to the seller.

On June 18, 1930, the offer to sell the 150 shares of common stock of B. B. T. Corporation of America, as referred to above, was accepted by the executive committee of the board of directors of the American Gas Accumulator Co.

On June 24, 1930, William W. Kellett and Charles Townsend Ludington and the American Gas Accumulator Co. executed a declaration of trust and named therein the Union County Trust Co., Elizabeth, New Jersey, as trustee. In accordance with the provisions of that trust there were deposited with the trustee the total outstanding 150 shares of common stock of the B. B. T. Corporation of America. The said trust agreement provided in part:

The sum of \$46,325.85 was to be paid by American Gas Accumulator Company to Kellett and Ludington, one-half each, payments to be made at the rate of 50% of the profits of the combined

American Gas Accumulator Company and B. B. T. Corporation of America businesses for that year, but in any event such payments not to be less than \$8,000.00 per year from the date of the agreement until the entire amount has been paid.

Upon final payment of the full amount of \$46,325.85 at any time within the period the trustee was to deliver the 150 shares of common stock of B. B. T. Corporation of America to American Gas Accumulator Company, of Elizabeth, New Jersey.

William W. Kellett devoted a large portion of his time to the affairs of Charles Townsend Ludington and was responsible for the sale in 1930 of the business of the B. B. T. Corporation of America to the American Gas Accumulator Co.

On June 25, 1930, there were delivered to William W. Kellett 100 shares of preferred stock of American Gas Accumulator Co. pursuant to agreement dated June 24, 1930. The fair market value on June 25, 1930, of the 100 shares of preferred stock of American Gas Accumulator Co. received by William W. Kellett pursuant to agreement dated June 24, 1930, was \$10,000. William W. Kellett did not report as taxable income on his income tax return for the year 1930 the said sum of \$10,000 representing the fair market value of 100 shares of American Gas Accumulator Co. preferred stock received by him in that year from American Gas Accumulator Co.

On June 27, 1930, William W. Kellett received the sum of \$15,000 in liquidation of 200 shares of preferred stock of B. B. T. Corporation of America owned by him and which he had acquired in prior years as detailed in these findings. On October 13, 1930, William W. Kellett received the sum of \$1,000 in liquidation of the 200 shares of preferred stock of B. B. T. Corporation of America owned by him. On December 31, 1930, William W. Kellett also received in the liquidation of shares of [pg. 613]preferred stock of B. B. T. Corporation of America owned by him shares of stock in the Aero Co. which had a value of \$200.

William W. Kellett did not report as taxable income on his tax return for 1930 any gain realized from the liquidation of his 200 shares of preferred stock in B. B. T. Corporation. His reason for not reporting any gain from the liquidation of said shares was because he considered that he had received 179 of such shares as a gift from Charles Townsend Ludington and that he was entitled to use the cost basis of such shares to Ludington, which petitioner believed to be as great as or greater than the price which he received for such shares in liquidation. He knew that he had a cost basis of \$2,100 for the 21 shares which he owned prior to the receipt of the 179 shares from Ludington and believed that the aggregate amount which he received in liquidation of his 200 shares of preferred stock did not exceed their cost basis to him. He did not include any amount in the gross income shown on his 1930 return from the sale of 73 shares of the common stock in B. B. T. Corporation to American Gas Accumulator Co., in which sale or exchange he received 100 shares of American Gas Accumulator preferred stock and a contract under the terms of which he was to receive in the future \$23,162.93. Petitioner did not report any income on this sale or exchange of his common stock in B. B. T. Corporation because he believed, on the advice of his tax representatives, that he had not realized any taxable gain thereon in the year 1930. Petitioner in 1931 reported as taxable income the cash which he received in that year in the amount of \$4,000 under the contract which had been entered into with American Gas Accumulator Co.

Petitioner's income tax return filed for the year 1930 was not false or fraudulent with intent to evade tax and the statute of limitations has barred the deficiency and any penalty based thereon for the year 1930.

Facts as to Year 1931.

Nicholas S. Ludington is the brother of Charles Townsend Ludington, and during the years 1930 and 1931 he was president of the Ludington Corporation and various other enterprises which he and his brother owned.

In 1930 William W. Kellett was elected vice president of the Ludington Corporation and was reelected to that position in 1931.

On May 19, 1931, the Ludington Corporation paid \$10,000 to William W. Kellett as compensation for services rendered by him during that year. This amount he reported as income received on his income tax return for 1931.

On September 29, 1931, a special meeting of the board of directors of the Ludington Corporation was held, at which it was voted to sell [pg. 614] certain securities belonging to that corporation for the purpose of raising cash to "make a first salary payment to Mr. William W. Kellett of \$10,000.00." On October 7, 1931, the Ludington Corporation paid William W. Kellett the sum of \$5,000 for services rendered by him during that year. On October 22, 1931, the Ludington Corporation paid William W. Kellett the sum of \$5,000 for services rendered by him during that year. The said payments of \$5,000 each made on October 7, 1931, and October 22, 1931, or a total of \$10,000 by the Ludington Corporation to William W. Kellett for services rendered, were paid pursuant to an agreement or understanding which Nicholas S. Ludington made as president of the Ludington Corporation with William W. Kellett. William W. Kellett was to be the executive vice president of the corporation. William W. Kellett on his income tax return filed by him for the calendar year 1931 did not report as taxable income the sum of \$5,000 received by him on October 7, 1931, and the sum of \$5,000 received by him on October 22, 1931, from the Ludington Corporation as compensation for services rendered.

During the year 1931 the Ludington Corporation made the following purchases of shares of stock of the Central Airport, Inc.:

Date purchased	Shares	Price per share
Jan. 8, 1931 _____	3,100	\$2.00
Jan. 5, 1931 _____	27,300	2.00
Sept. 21, 1931 _____	200	4.00
Sept. 23, 1931 _____	500	4.00

On May 12, 1931, Rollin S. Saltus, secretary of the Ludington Corporation, transferred 5,000 shares of Central Airport, Inc., stock to William W. Kellett. The journal entry relating thereto states:

	Debit	Credit
Deferred Management Expense _____	10,000.00	
Investment Affiliated Companies _____		\$10,000.00

 (Explanation: 5,000 shares Central Airport, Inc., stock transferred to Mr. William W. Kellett for services as vice-president)

The fair market value of each share of stock of Central Airport, Inc., received on May 12, 1931, by William W. Kellett from Ludington Corporation for services rendered was \$2 per share. The total value of the 5,000 shares received by him on May 12, 1931, was \$10,000 at the time the shares were received by him. William W. Kellett failed to report as taxable income on his income tax return for the calendar year 1931 the sum of \$10,000 representing the fair market value of 5,000 shares of Central Airport, Inc., stock received by him on May 12, 1931, from the Ludington Corporation for services rendered.

The Ludington Corporation did not take as a deduction on its income tax return filed for the year 1931 the two payments of \$5,000 each [pg. 615] which it made to Kellett in October 1931, nor did it take as a deduction the fair market value of the 5,000 shares which it transferred to William W. Kellett on May 12, 1931. For the year 1931 the Ludington Corporation sustained a net operating loss of \$308,214.90, as shown by its income tax return filed for that year.

The income tax return as filed by petitioner W. W. Kellett for the calendar year 1931 was false and fraudulent, with intent to evade tax, and a part of the deficiency is due to fraud with intent to evade tax. Accordingly, there is no period of limitation upon assessment and collection of the proposed deficiency in income tax and penalty as determined against petitioner W. W. Kellett for the year 1931.

Facts as to Whether 1930 and 1931 Returns Were Joint Returns.

The return for the year 1930 was filed February 14, 1931. It bears the caption "William W. Kellett, 535 West Allen Lane, Mt. Airy, Philadelphia, Pennsylvania." In answer to the question printed on the return: "Is this a joint return of husband and wife?" the answer is "Yes." The return was executed by "W. W. Kellett" and nowhere on the return does the name of Virginia Kellett appear. None of the income reported on the return was that of Virginia Kellett. The return in question was not the joint return of William W. Kellett and Virginia Kellett, but was the individual return of William W. Kellett.

The return for the year 1931 was filed March 11, 1932. It bears the caption "W. W. Kellett, 535 W. Allen Lane, Phila., Penna." In answer to the question printed on the return: "Is this a joint return of husband and wife?" the answer is "Yes." The return was executed by "W. W. Kellett" and nowhere on the return does the name of Virginia Kellett appear. None of the income reported on the return was that of Virginia Kellett. The return in question was not the joint return of William W. Kellett and Virginia Kellett, but was the individual return of William W. Kellett.

OPINION.

Black, Judge:

The first issue which we have to decide in this proceeding is whether the statute of limitations has barred the deficiencies and penalties which the Commissioner has determined.

In his answer respondent denied that the statute of limitations had run, but at the hearing and in his brief he concedes that the statute of limitations has run unless petitioner's tax returns for each of the taxable years were false or fraudulent with intent to evade tax. Respondent recognizes that the statute places upon him the burden of proof to establish fraud and at the hearing he assumed this burden to go forward with his evidence, after conceding that the statute of limitations [pg. 616] had run unless he was successful in establishing fraud. The applicable statutes are in the margin. 1

What constitutes fraud is a question of fact which frequently requires a nicely balanced judgment to answer. To be considered are all of the facts and circumstances surrounding the conduct of the taxpayer's business and all the facts incident to the preparation of the alleged fraudulent return. The conclusion must be reached not on isolated bits of testimony, but on the whole record. See discussion of "What Constitutes Fraud," Merten's Law of Federal Income Taxation, sec. 55.11, vol. 10. The same author says in section 55.19, vol. 10, that:

The Code contains a provision that in any proceeding involving the issue "whether the petitioner has been guilty of fraud with intent to evade tax" the burden of proof in respect of such issue shall be upon the Commissioner. This burden is a difficult one to sustain.

*** The Commissioner does not have to establish his determination of fraud beyond a reasonable doubt, but fraud must be established by more than a mere preponderance of the evidence; the evidence must be clear and convincing.

We think the foregoing statements are well supported by the authorities, and we shall endeavor to apply them in the instant case. Applying these rules, we will now consider separately the two respective taxable years which we have before us. Each year has its own respective facts.

1930.

It seems clear to us that the Commissioner has failed to meet his burden of proof as to this year. Respondent has introduced a great deal of evidence, oral and documentary, in his effort to show that petitioner's return for the year 1930 was false and fraudulent, with intent to evade the tax. The upshot of this evidence is that in 1927 petitioner W. W. Kellett received from Charles Townsend Ludington certain preferred and common shares of B. B. T. Corporation which he did not report in his income tax return for that year; also that he received 25 shares common stock of B. B. T. Corporation in 1928 under similar circumstances, which he did not report as income in his 1928 return; that petitioner's preferred shares were liquidated in 1930 and his common shares were sold or exchanged in that year to [pg. 617]American Gas Accumulator Co.; and that no gain was reported by petitioner from either transaction. It is not disputed by petitioner that his preferred shares in B. B. T. Corporation were completely liquidated in 1930 and that he received in such liquidation the amounts which respondent has determined, but he contends these amounts did not exceed his basis. Petitioner contends that his basis of cost for the 200 shares of preferred stock which he owned in B. B. T. was greater than the price which he received, and hence he had no gain from the liquidation of said stock which he should have reported. Petitioner contends, and the respondent concedes, that petitioner had a cost basis for 21 of his preferred shares of \$2,100. The balance of his preferred shares, 179, petitioner contends he received as a gift in 1927 from Charles Townsend Ludington, and that these shares had a cost basis of \$100 per share to Ludington, and that under the applicable statute petitioner is entitled to use his donor's basis of cost. Petitioner also contends that even if he is wrong in his belief that the 179 shares of preferred stock which he received in 1927 from Ludington were a gift and that the value of these shares was taxable to him as compensation in 1927, that, nevertheless, respondent can not make out of these facts fraud in failing to report any gain from the liquidation of the shares in 1930. On this point petitioner says in his brief, as follows:

*** If it was received as a gift, the basis to petitioner would be the basis in the hands of the donor and if it were received as compensation, its basis would be the value at date of receipt, as

is evidenced by the affirmation of the decision of this Court in *McKee vs. Commissioner*, by the Circuit Court of Appeals for the Sixth Circuit, 116 F. (2d) 949 (1941) and the case of *Hawke v. Commissioner*, 109 F. (2d) 946 (1940). If only the question of tax liability were involved, the respondent might be in a position to plead estoppel. Certainly he is not in a position to plead estoppel where fraud is involved. And fraud is never presumed; *Griffiths v. Commissioner*, 50 F. (2d) 782.

In discussing whether the Commissioner has established fraud for 1930, it should be remembered that we are not called upon to decide whether petitioner was guilty of fraud in 1927 because of his failure to report in his income tax return for that year the fair market value of such stock. We do not have that year before us. But while we do not have 1927 before us, we think petitioner has given an excuse of some plausibility for not reporting it as income in that year—certainly seemingly enough to exculpate him from the charge of fraud. The shares of stock were not paid to him by the corporation by whom he was employed, but were paid to him by Charles Townsend Ludington, as an individual. Ludington was the president of the corporation, but was ill throughout the year 1927 and was unable to perform his duties as president of the corporation. Petitioner stepped into the breach and performed them for him. In consideration of this [pg. 618]fact, Ludington transferred the shares in question to him. Charles T. Ludington testified at the hearing as a witness for the Commissioner and attested to the truth of the foregoing facts.

We think from the evidence given by Ludington there is some plausibility in petitioner contending that the shares of stock were received in 1927 as a gift from Ludington and not as taxable compensation, but we do not have to decide that question, for the year 1927 is not before us. Even if we assume that the shares of stock were not received as a gift by petitioner in 1927, but were received as taxable compensation for services to Ludington, his failure to report them as such in 1927 would not deprive him, in the absence of estoppel, of the right to a cost basis of such shares of stock when they were liquidated in 1930.

Respondent has not pleaded estoppel and the facts do not seem to sustain it, even if he had pleaded it. He simply contends, in substance, that as a matter of law, because petitioner did not receive the stock as a gift from Ludington in 1927, but received it as compensation and did not report such compensation in his income tax return for 1927, then he has no basis of cost in 1930 which he can use when the stock is liquidated. This position of respondent does not appear to be correct as a matter of law. See *Countway v. Commissioner*, 127 Fed. (2d) 69.

At any rate, the determination of a cost basis of stock which a taxpayer has acquired in some prior year, other than by purchase for cash, is frequently one of some considerable complications under the statute, and an innocent mistake by a taxpayer in the determination of such cost basis, when the stock is sold, can not be made the occasion of a determination of fraud against the taxpayer, even though he has been negligent in the determination of such basis. "Fraud," within statute providing for unlimited period for assessment in case of false or fraudulent return and statute providing for penalty of 50 percent additional because of "fraud" in tax return with intent to evade tax, means actual, intentional wrongdoing, and the intent required is the specific purpose to evade a tax believed to be owing, and mere negligence, whether slight or great, is not enough. See *Mitchell v. Commissioner*, 118 Fed. (2d) 308.

For the foregoing reasons we hold that the Commissioner has not proved fraud against petitioner because petitioner omitted from his income tax return for the year 1930 the alleged gain resulting from the liquidation of his shares of preferred stock in B. B. T. What we have said with respect to the alleged profit of petitioner from the liquidation of his preferred stock in the B. B. T. Corporation applies with equal force to the sale or exchange in 1930 of his 73 shares of common stock in B. B. T. Corporation to the American Gas Accumulator [pg. 619]Co. Petitioner received

all but one of the 73 shares of common stock which he owned in B. B. T. Corporation from Charles T. Ludington in the same manner that he received 179 shares of his preferred stock in B. B. T. Forty-seven of these shares were received from Ludington in 1927 and 25 of them were received from Ludington in 1928. Petitioner received in exchange in 1930 for his 73 shares of B. B. T. common stock from American Gas Accumulator Co. 100 shares of preferred stock of American Gas Accumulator Co. having a fair market value of \$10,000, and a contract executed by American Gas Accumulator Co. to pay him approximately \$23,000 in years following the taxable years.

Petitioner reported no gain from the receipt of the 100 shares of the American Gas Accumulator Co. stock because he regarded its fair market value of \$10,000 as being less than the cost basis which he was entitled to use because of having received 72 shares of common stock in B. B. T. Corporation stock as a gift from C. T. Ludington. The record shows that these 72 shares did have a cost basis in the hands of Ludington much greater than \$10,000 and we do not understand that the Commissioner contends otherwise. He contends that petitioner's 73 shares of common stock in B. B. T. Corporation had no cost basis to him because he did not receive it as a gift from Ludington, but received it as compensation for his services. His argument in that respect is the same as he used with reference to petitioner's 179 shares of preferred stock in B. B. T. For reasons we have already stated we reject respondent's argument in this respect.

Petitioner failed to return as income anything from the receipt of the contract with American Gas Accumulator Co. to pay him \$23,000 in future years because he regarded the contract as having no fair market value. He did return as income the \$4,000 which he received from this contract in 1931. No point is made of his having done so and we have no issue in this proceeding to decide as to the correctness of petitioner's return of this \$4,000 in 1931.

On the whole record we think respondent has failed to show that petitioner's income tax return for the year 1930 was false or fraudulent with intent to evade tax. Therefore, the statute of limitations has barred the assessment and collection of the deficiency and penalty which the Commissioner has determined for the year 1930 against W. W. Kellett and his wife, Virginia Kellett. Therefore, there is no deficiency and penalty for 1930 due by either of them.

1931.

The facts connected with petitioner's income tax return for the year 1931 are considerably less complicated than the facts concerning the year 1930. The Commissioner has added to petitioner's income [pg. 620]for the year 1931, two sums of \$5,000 each which petitioner received in October 1931 from the Ludington Corporation and 5,000 shares of Central Airport stock which petitioner received from Ludington Corporation May 12, 1931. Petitioner's contention as to why he failed to report in his income tax return for the year 1931 the receipt of these amounts as income is that he regarded them as gifts from the Ludington Corporation. His contention in that respect is much less plausible and convincing than it was as to the shares of stock which he received from Charles T. Ludington in 1927 and 1928, the facts of which we have already discussed under the heading of the year 1930.

In 1931 petitioner was executive vice president of the Ludington Corporation and it seems rather plain to us that what he received from that corporation in 1931, including the above described items, was taxable compensation. Petitioner reported in his 1931 income tax return the receipt of \$10,000 from Ludington Corporation as income, but he did not report nor make any mention on his return of the two sums of \$5,000 each which he received from Ludington Corporation in October 1931, nor did he report or make mention on his return of the 5,000 shares of Central Airport stock which he received from Ludington Corporation May 12, 1931.

Nicholas S. Ludington testified at the hearing as a witness for respondent. He testified that in 1931 he was president of the Ludington Corporation. The following questions and answers occur in his testimony:

Q Do you know what compensation he [Kellett] was to receive for services rendered by him to the Ludington Corporation in 1931?

A He was paid in 1931, in May, \$10,000; in May again 5,000 shares of Central Airport stock, \$2 a share; in October he received \$5,000 in cash; and again in October \$5,000 in cash.

Q And the sums received by him were for services rendered to the corporation, is that right, sir?

A I would say they were services either rendered or to be rendered to the corporation.

Q Now, that relates not only to the cash received by him but to the 5,000 shares of Central Airport stock, is that correct?

A That is correct.

On cross-examination by petitioner's attorney, the following testimony of the witness, Nicholas S. Ludington, occurs:

Q With respect to the payments made to Mr. Kellett following your becoming inactive in the company in 1931, can you say of your own knowledge that the amounts paid to him were for compensation for services?

A I will just reiterate my other statement, that the payments made to Mr Kellett were for services either rendered or to be rendered.

Q And you are satisfied in your own mind that that is so?

A Yes, sir.

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Q How do you know that?

A Because I was president of the corporation and that was the understanding that I made with Mr. Kellett.

Q That you made with Mr. Kellett?

A Before I left, that is correct.

Q Do you remember any of the details of that?

A Not very clearly. I remember that I had to leave and we wanted Mr. Kellett to be the executive vice-president of the corporation, and that was the arrangement which was made with him.

Although Nicholas S. Ludington was called as a witness by respondent, there was not the slightest indication that he was unfriendly to petitioner. It seems safe to assume, we think, that Nicholas S. Ludington and petitioner are on friendly terms. Therefore, on the strength of Ludington's testimony and other evidence in the record, we conclude that petitioner knew that the two payments of \$5,000 each paid to him in October 1931 and the 5,000 shares of Central Airport stock which were transferred to him May 12, 1931, were paid to him as compensation for his services as executive vice president of the Ludington Corporation. We see little support in the

record for petitioner's claim that these shares and this \$10,000 in cash were gifts to him by the Ludington Corporation.

We have, therefore, made a finding of fact, based on the whole record, that the income tax return which petitioner filed for the calendar year 1931 was false and fraudulent, with intent to evade tax, and a part of the deficiency for that year was due to fraud with intent to evade tax. Having made that finding, it is of course clear that the statute of limitations does not bar the assessment and the collection of the deficiency which has been determined by the Commissioner.

We now take up the question of petitioner's tax liability for the year 1931. He concedes that he received the two payments of \$5,000 each in October 1931 from Ludington Corporation. His only defense against including these payments in his taxable income is that he received the payments as gifts from the Ludington Corporation. We having held against petitioner on this question in our determination of the fraud issue, it naturally follows that our holding is the same on the income tax question. We, therefore, sustain the Commissioner in his action in including these two \$5,000 payments in petitioner's taxable income for the year 1931.

As to the 5,000 shares of Central Airport stock which petitioner received from Ludington Corporation May 12, 1931, he contends that if our Court should decide that the fair market value of these shares is includible in his taxable income for 1931, then their fair market value was no greater than \$2 per share. Petitioner's only defense against including the fair market value of these shares in his taxable income for 1931 is that they were received by him as a gift from Ludington [pg. 622]Corporation. We having held against petitioner on that issue, it naturally follows that the fair market value, if any, of these shares at the time they were received by petitioner in 1931 should be included in petitioner's taxable income for that year. Petitioner does not contend that the shares had no fair market value at the time they were received in 1931. He contends the fair market value was not greater than \$2 per share. We think the evidence supports petitioner in this contention and we have found that the fair market value of the 5,000 shares received by petitioner in 1931 was \$2 per share at the time they were received. It may well be that these shares were worth \$3 per share before the end of the taxable year 1931, but this appreciation in value would not be taxable to petitioner until such shares were sold or otherwise disposed of. What is to be taxed to him in 1931 is the fair market value of such shares at the time they were received in 1931, which was \$2 per share.

For reasons already stated, the Commissioner's imposition of the 50 percent fraud penalty against William W. Kellett for the year 1931 is sustained. The amount, however, of this penalty will be recomputed under Rule 50.

Tax Liability of Virginia Kellett.

Respondent, in his determination of the deficiency and fraud penalty for 1931, has included the name of Virginia Kellett along with her husband William W. Kellett. He has done this on the theory that the income tax return which William W. Kellett filed for the year 1931 was a joint return filed for himself and his wife, Virginia Kellett. He still insists in his brief that his determination in this respect is correct. However, we think the facts are against him. It is true that on the income tax return filed by W. W. Kellett for 1931 the question, "Is this a joint return of husband and wife?" is answered "Yes." This, of course, is a circumstance to be considered in determining whether or not the return filed was a joint return. But it is only a circumstance. Other facts in the record are to be considered and they seem to show clearly that it was not a joint return. These facts are: The return was made out in the name of W. W. Kellett alone, it was signed by him alone. Nowhere on the return does the name of Virginia Kellett appear. None of her income is included in the return. In fact there is nothing in the record which shows that she

had any income for the taxable year. All the income upon which the Commissioner has determined the deficiency and the fraud penalty was the income of William W. Kellett. Therefore, we have found as a fact that the return filed in 1931 in the name of W. W. Kellett was not a joint return of himself and his wife, Virginia Kellett.[pg. 623]

On these facts we reverse the Commissioner's determination of a deficiency and fraud penalty against petitioner Virginia Kellett for the year 1931. See John Kehoe, 34 B. T. A. 59; affd., 309 U. S. 277.

Decision will be entered under Rule 50.

1 Revenue Act of 1928-

SEC. 276. SAME-EXCEPTIONS.

(a) False return or no return.-In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such a tax may be begun without assessment, at any time.

*** SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

*** (b) Fraud.-If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.