Moller v. United States

1 Cl. Ct. 25 (Cl. Ct. 1982)

WHITE, Judge.

This case is related to the considerable number of cases in which courts, through the years, have dealt with the problem of whether taxpayers, in determining their income tax liabilities, may properly deduct from gross income expenses incurred by the taxpayers in connection with the management of their investments.

[*26] A common question in such cases is whether the activities of a taxpayer with respect to his investments constitute the [**1072] carrying on of a "trade or business," as the pertinent provision of the Internal Revenue Code (now contained in *26 U.S.C. § 162(a)*) states in part that "* * * * there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * * *." In this case, because of its unusual facts, the question just stated must be answered in the affirmative.

In the present case, Joseph A. and Dorothy D. Moller (plaintiffs) are husband and wife, and they are residents of Scottsdale, Arizona. During 1976 and 1977, the plaintiffs actively managed four separate portfolios of stocks and other securities, and, in doing so, they incurred expenses totaling $22,659.91 in 1976 and $29,561.69 in 1977.

The 1976 expenses included $5,832.88 as the cost of maintaining an office in the plaintiffs' principal residence at Scottsdale and $1,606.77 as the cost of maintaining a second office in the plaintiffs' summertime residence at Santa Barbara, California. The 1977 expenses included $5,350.55 as the cost of maintaining the office in Scottsdale and $1,896.66 as the cost of maintaining the office in Santa Barbara.

In preparing and filing their joint income tax returns for 1976 and 1977, the plaintiffs deducted from gross income the respective amounts which they had expended during 1976 and 1977 in connection with the management of the four portfolios.

On audit, the Internal Revenue Service (IRS) disallowed the portions of the plaintiffs' deductions based on the costs involved in maintaining the Scottsdale and Santa Barbara offices; and the IRS assessed deficiencies in income taxes, plus interest thereon, for 1976 and 1977.

The plaintiffs paid the deficiencies and interest, sought refunds from the IRS, and, having failed to secure administrative relief, filed the present action.

The Government has conceded that the office expenses with which the court is concerned in the present case were "ordinary and necessary expenses," but the Government disputes the plaintiffs' contention that they were carrying on a "trade or business" during the years in question.

The answer to the question of whether a taxpayer was carrying on a "trade or business" during a taxable period must be determined on the facts of the particular case. *Higgins v. Commissioner, 312 U.S. 212, 217, 85 L. Ed. 783, 61 S. Ct. 475 (1941)*; *Chang Hsiao Liang v. Commissioner, 23 T.C. 1040, 1045 (1957)*. Consequently, in resolving the issue that is before the court in the present action, it is necessary to set out in considerable detail the facts concerning the plaintiffs' investment activities.

It has been mentioned earlier in the opinion that, during 1976 and 1977, the plaintiffs were actively engaged in the management of four portfolios of stocks and other securities. The same four portfolios were managed by the plaintiffs before 1976, and the plaintiffs have continued to manage them since 1977. One of these portfolios consists of securities held by the plaintiff Joseph A. Moller (Mr. Moller) individually, a second consists of securities held by the plaintiff Dorothy D. Moller (Mrs. Moller) individually, a third consists of securities held by Northern Trust No. 1-29551 (Northern Trust), and the fourth consists of securities held by the First Interstate Bank Trust No. 50-50-0224 (First Interstate Trust).

In 1976, the total value of all four portfolios was approximately $13,500,000. In 1977, the total value of the four portfolios was approximately $14,500,000.

The First Northern Trust originated through stock put in trust for Mrs. Moller by her former husband. She is entitled to receive the income from this trust during her lifetime; and, upon her death, the corpus will pass to the other heirs of her former husband.

The First Interstate Trust originated through stock put in trust by Mr. Moller's first wife (now deceased). Mr. Moller receives the income from this trust during his lifetime; and, upon his death, the corpus [*27] will pass to the children of his first marriage.

[**1073] The Northern Trust Company is the trustee of the Northern Trust. Mr. Moller is the trustee of the First Interstate Trust. However, Mr. and Mrs. Moller make all the investment decisions in regard to both of the trusts, as well as with respect to the two portfolios held by them individually.

During 1976 and 1977, the plaintiffs devoted their full time to their investment activities; and each regularly spent between 40 and 42 hours per week in conducting such activities. The plaintiffs kept regular office hours and, on a daily basis, monitored the stock market and their four portfolios. This included studying the performance of the securities held in the four portfolios, and also the performance of securities that were regarded as prospects for purchase and inclusion in the portfolios.

With respect to the stocks that were considered as candidates for purchase, the plaintiffs maintained the following records on a current basis:

(1) A watch list, listing all stocks on the New York Stock Exchange that were considered to be candidates for possible purchase. This list was updated at least once or twice per week.

(2) A book of product research notes, containing information concerning the product of the industry in which any company under study was engaged. These notes contained definitions and information concerning product uses, manner of use, and supply and sales market data for the product.

(3) A portfolio information book, containing information on stocks promoted from the watch list but not yet purchased. These were stocks which were more actively and closely followed than those on the watch list. They were highly eligible for purchase and, depending on the circumstances, would probably be purchased.

Before a decision was made by the plaintiffs to purchase a stock, it was generally watched by the plaintiffs for a period of between 2 to 6 months; and often a stock was watched as long as 1 year.

The monitoring and study of stocks held in the four portfolios included the assembly and maintenance of information regarding the corporations invested in, their products, and their performance. The following records on such stocks were maintained by the plaintiffs on a current basis:

(1) A stock note data book which contained an alphabetical list of the stocks held and included the earning percentage of each company's product in its market and the company's profit percentage in that market, as well as other information which would affect the value of the stock.

(2) A stock record book for each portfolio, listing all stocks currently held, in which entries were made whenever a stock was purchased.

(3) A current stock purchase book, containing a sheet for each stock, prepared on the date of purchase, recording the number of shares purchased, the date of purchase, and the cost. A master sheet was made up of these purchases, to indicate the stock-of-record dates so that the plaintiffs could determine whether dividends would be paid on the current purchases. The sheet made up for each stock was placed in the stock record book only when the stock certificate was received. On receipt of the stock certificate, the certificate number and the date were recorded on the stock purchase sheet and inserted in the stock record book.

(4) Current capital gains records, which provided a detailed record of gains and losses.

(5) Dividend record books, indicating the number of shares held in each stock, the dividend for each, and the total dividend, as well as the information from Forms 1099 at the end of each year to check those totals against the dividend record books' totals.

The plaintiffs kept the following records on a current basis both for stocks held and for stocks that were being considered for purchase:

(1) Stock purchase worksheets, which were projections for stocks based on study and the daily quotations. These sheets contained projections for possible use in examining [*28] options of purchasing one stock as opposed to another, the likely stocks to be [**1074] sold if cash were to be needed, and the relative desirability of various stocks. The stocks to be purchased were drawn from this list.

(2) Market information on all securities held in the portfolios and on some securities that were being watched for possible purchase, including certain securities which might have been held in the past and were regarded as candidates for repurchase. The weekly price for each stock as of the close of the market on Friday night was entered, as well as the type of stock, its rating, symbol, and range of prices, and an indication of the last purchase.

The plaintiffs made all of their investment decisions "on their own." They did not employ an investment advisor, and they did not seek investment advice from their stockbroker.

In order to assist them in their investment studies and decisions, the plaintiffs subscribed to and regularly studied a number of publications and services. Three of these (including the Wall Street Journal) were received on a daily basis, 10 were received on a weekly basis, three were received on a monthly basis, and five were received on a quarterly basis. In addition, the plaintiffs also received and studied the annual reports of companies in which they were interested. Mr. Moller studied these materials between 8 and 10 hours a week, and Mrs. Moller studied them between 7 and 8 hours per week. The cost of the publications and services to which the plaintiffs subscribed was approximately $1,800 in 1976 and $2,400 in 1977.

The plaintiffs engaged in 83 security purchase transactions in 1976 and in 76 such transactions in 1977. The total dollar amounts of these transactions were $1,844,669 in 1976 and $958,073 in 1977. [1]

1 Eight of the security purchase transactions in 1976 and nine in 1977 consisted of deposits to secure shares in interest-bearing common trust accounts at Northern Trust Company; three transactions in 1976 and 23 in 1977 consisted of invasions by Mrs. Moller of the corpus of the Great Northern Trust (she could invade the corpus annually to the extent of 5 percent); and 14 transactions in 1976 and nine in 1977 consisted of stocks acquired through splits and stock dividends.

The plaintiffs invested in Treasury Bills any funds which were not currently committed to stocks, in order to maintain the liquidity of those funds, while still producing revenue. The 1976 and 1977 transactions in Treasury Bills, including roll-overs of Treasury Bills that matured during those years, involved total dollar volumes of $2,561,739 in 1976 and $1,500,042 in 1977. The plaintiffs maintained a sheet on which the Treasury Bills were recorded, together with the amounts and the dates on which they would become due, and also a Treasury Bills transaction summary, indicating purchases, sales, and dates of sale and purchase, as well as the amounts involved.

In 1976, the plaintiffs engaged in 41 transactions involving sales of securities. [2] The total dollar amount of these transactions in 1976 was $1,679,813. In 1977, the plaintiffs engaged in 30 transactions involving sales of securities. [3] The dollar amount involved in the 1977 sale transactions was $821,028. The stocks sold in 1976 and 1977 had been held for an average of more than 3-1/2 years and 8 years, respectively.

2 This figure includes 22 withdrawals from common trust funds.

3 This figure includes seven withdrawals from common trust funds.

During 1976 and 1977, the portfolios included stocks that were neither purchased nor sold during those years, but were retained during the period. A decision to retain a stock was a continuing one, and involved a study (1) of the administration of the corporation, (2) of the corporation's outlook, plans, and spending levels for development, (3) of the acceptance of the corporation's product in the market place, *i.e.*, whether such product was growing or lessening in importance, and (4) of the price-earning ratio of the stock. As the plaintiffs were attempting to minimize risk and maximize long-term growth, the decision to hold [*29] a stock was equally as important as a decision to buy or sell a stock.

[**1075] The plaintiffs maintained telephone contact with their broker at E.F. Hutton & Company every other day, on the average. On days of active trading, 10 or 15 calls per day could be placed to the broker, and, on less active days, one or two calls a day could be placed. The plaintiffs' account with E.F. Hutton & Company was the largest account of that firm's local office, being larger than the accounts which any of the local banks had with the firm.

Ever since 1965, the plaintiffs have relied almost wholly on their income from investments for their livelihood. Their only other sources of income have been two small pensions and social security.

The plaintiffs' income from dividends and interest *(i.e.*, from investments) has steadily increased through the years. In 1976, their income from dividends and interest amounted to $543,265, and their federal income tax amounted to $297,745. In 1977, the plaintiffs' income from dividends and interest amounted to $590,762, and their federal income tax amounted to $316,721.

The plaintiffs maintained five separate bank accounts in connection with their investment activities. One of these bank accounts was for the payment of expenses incurred in the conduct of such activities.

During the 1976-77 period (as well as before and after that period), the plaintiffs conducted their investment activities (except during the summertime) in a well-equipped office which they maintained in Scottsdale. They were assisted in such activities by a secretary/bookkeeper, who worked approximately 22 hours per week and whose work related almost wholly to the plaintiffs' investment activities. The office consisted of two rooms, and contained a desk for Mr. Moller, a desk for Mrs. Moller, a desk for the secretary/bookkeeper, calculating and reproduction machines, filing cabinets, a typewriter, a checkwriter, a postage meter, and a 2-drawer filing cabinet for current files. All of the books, records, documents, publications, and services previously described were stored in this office.

At all times pertinent to this case, the plaintiffs also maintained a similarly equipped office in Santa Barbara, California, except that their permanent files remained in Scottsdale. The plaintiffs spent (and they still spend) their summers in Santa Barbara. They performed the same sort of investment activities in their Santa Barbara office that they performed in their Scottsdale office.

The plaintiffs' Scottsdale and Santa Barbara offices were used exclusively for their investment activities. As stated earlier in the opinion, each of the plaintiffs devoted between 40 and 42 hours per week to such activities. (The plaintiffs' offices will be mentioned again at a later point in the opinion.)

The facts, as previously summarized, indicate that the plaintiffs would not qualify as traders in the securities market. A trading account has been defined as one in which "securities are bought and sold with reasonable frequency in an endeavor to catch the swings in the daily market movements and profit thereby on a short-term basis." *Chang Hsiao Liang v. Commissioner, supra, 23 T.C. at 1043*. The plaintiffs in this case were investors rather than traders, as they were primarily interested in long-term growth and the payment of dividends by the companies in which they invested.

In dealing with the deductibility of expenses incurred by investors in the management of their investments, the decided cases have tended to distinguish "between a passive investor and one whose activities place him in the category of those carrying on business * * * *." *Kales v. Commissioner, 101 F.2d 35, 38 (6th Cir. 1939).*

The facts clearly show that the plaintiffs were anything but "passive" investors. On the contrary, their investment activities were regular, extensive, and continuous, and they involved the active and constant exercise of managerial and decision-making functions.

The plaintiffs in this case have made a substantially better showing in support of [*30] their contention that they were carrying on a business during the period in question [**1076] than did the taxpayer in the *Kales* case, previously cited. In that case, the taxpayer was a woman of considerable means who had inherited from her father valuable real estate and stocks in 46 corporations. She had an arrangement with a law firm whereby her books were kept by the firm's bookkeeping staff, and she paid $3,000 a year for this service. The firm set aside an office where the taxpayer could confer with the head bookkeeper, and she visited the office three or four times a week for this purpose. She made all the decisions effecting either the purchase or the sale of her securities. During a 14-year period, the taxpayer purchased bonds in the aggregate amount of more than $11,665,000, bonds were sold or matured in the aggregate amount of over $3,000,000, and stocks were purchased in the aggregate amount of approximately $500,000.

In successfully suing to recover income taxes which she was required to pay pursuant to deficiency assessments, Mrs. Kales expended a considerable sum for attorney fees and other expenses. The Court of Appeals held that such expenses were deductible for income tax purposes, stating (*101 F.2d at 39*):

> Concluding that there are cases where the activities of taxpayers are such that though they invest but their own capital they are none the less carrying on a business, we think that Mrs. Kales' activities bring her deductions within the permissible scope of the statute. * * * *

The court also said *(id. at 39*) in this connection that it was "sufficient to say that * * * * [the taxpayer's activities] were extensive, varied, continuous and regular * * * *."

The plaintiffs' offices were well-equipped and personally maintained by the plaintiffs, and not borrowed office space such as that used by Mrs. Kales; the plaintiffs kept regular office hours each working day and devoted from 40 to 42 hours per week to their investment activities, instead of merely visiting the office three or four times a week as Mrs. Kales did; the plaintiffs devoted their full time to their investment activities and each day carefully monitored the stock market and their four portfolios of stocks, which Mrs. Kales apparently did not do; the plaintiffs subscribed to and carefully studied numerous publications and services in order to keep abreast of developments in the stockmarket, which apparently Mrs. Kales did not do; and the plaintiffs kept elaborate, up-to-date records on the performance of the stocks in which they had invested, and also of stocks which they regarded as possible candidates for purchase, which Mrs. Kales apparently did not do. Accordingly, the plaintiffs' investment activities were certainly more "extensive, varied, continuous and regular" than were the investment activities of Mrs. Kales, who was allowed to deduct her investment expenses.

It must be noted that the Supreme Court once said that "investing is not a trade or business." *Whipple v. Commissioner, 373 U.S. 193, 202, 10 L. Ed. 2d 288, 83 S. Ct. 1168 (1963)*. This statement, however, should be considered in context. The *Whipple* case did not involve expenses incurred in the management of a portfolio of securities. The taxpayer in that case organized, owned the controlling interest in, and managed a bottling company (among other companies). He sold equipment on credit to the bottling company; the indebtedness became worthless; and he deducted it as a business bad debt in computing taxable income. In holding that the deduction was improper, the Court stated in part as follows (*373 U.S. at 202*):

> Devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. When the only [*31] return is that of an investor, the taxpayer has not satisfied his burden of [**1077] demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation. Even if the taxpayer demonstrates an independent trade or business of his own, care must be taken to distinguish bad debt losses arising from his own

> business and those actually arising from activities peculiar to an investor concerned with, and participating in, the conduct of the corporate business.

Consideration should also be given to the Supreme Court's decision in *Higgins v. Commissioner, 312 U.S. 212, 85 L. Ed. 783, 61 S. Ct. 475 (1941)*. In that case, the taxpayer lived in Paris, France, but he had extensive investments (real estate and securities) in this country. To assist him in the management of his financial affairs, the taxpayer maintained an office in New York City, staffed by four employees, and an office in Paris, staffed by the taxpayer's secretary. The activities of the New York City office related principally to the taxpayer's real estate holdings, particularly the rental of buildings, but they also related to the taxpayer's securities. There was no controversy before the Court about the deductibility of the office expenses insofar as they were allocable to the management of the plaintiff's real estate. The controversy related to the portion of the office expenses allocable to the management of the taxpayer's securities.

Through correspondence, the taxpayer in the *Higgins* case kept a watchful eye over his securities. However, as his portfolio consisted mostly of permanent investments, there were only limited shiftings in his portfolio. The activities in connection with the securities were performed by the taxpayer's New York City office, which kept records, received the relatively few securities that were purchased pursuant to the taxpayer's instructions, received dividend and interest checks, made deposits, and forwarded weekly and annual reports to the taxpayer.

In holding that the taxpayer's office expenses in the *Higgins* case were not deductible for income tax purposes insofar as the expenses were allocable to the management of the taxpayer's securities, the Court stated in part as follows (*312 U.S. at 218*):

> * * * * The Commissioner [of Internal Revenue] and the Board [of Tax Appeals] appraised the evidence here as insufficient to establish petitioner's activities as those of carrying on a business. The petitioner merely kept records and collected interest and dividends from his securities, through managerial attention for his investments. No matter how large the estate or how continuous or extended the work required may be, such facts are not sufficient as a matter of law to permit the courts to reverse the decision of the Board. * * * *

The activities of the taxpayer and his employees in the *Higgins* case, insofar as the management of the taxpayer's securities was concerned (they "merely kept records and collected interest and dividends from his securities"), were not at all comparable to the regular, extensive, and continuous activities of the plaintiffs in this case with respect to the four portfolios of securities which they managed. Consequently, the facts of the *Higgins* case are readily distinguishable from the facts of the present case.

Other cases in which investors received unfavorable court decisions can also be distinguished from the present case. For example, in *Snyder v. Commissioner, 295 U.S. 134, 79 L. Ed. 1351, 55 S. Ct. 737 (1935)*, the taxpayer did not devote a substantial part of his business day to his stock transactions. In *Deputy v. Du Pont, 308 U.S. 488, 84 L. Ed. 416, 60 S. Ct. 363 (1940)*, the taxpayer's expenses were not "ordinary and necessary expenses." In *Wilson v. United States, 179 Ct. Cl. 725, 376 F.2d 280 (1967)*, one taxpayer devoted an average of only 2 or 3 hours a day, and another taxpayer devoted an average of only 3 or 4 hours per week, to the [*32] management of their securities portfolio. In *Kane v. Commissioner, 100 F.2d 382 (2nd* [**1078] *Cir. 1938)*, the evidence did not show to what extent there was activity in buying or selling securities. In *Miller v. Commissioner, 102 F.2d 476 (9th Cir. 1939)*, there was no evidence relating either to the number or to the extent of the taxpayer's dealings in securities. In *Purvis v. Commissioner, 530 F.2d 1332 (9th Cir. 1976)*, the taxpayer did not maintain a separate bank account, or office, or personnel in connection with his transactions in securities; his study of the stock market consisted of visiting brokers' offices three or four times a week to observe the market; and his income tax returns consistently indicated that his occupation was that of an attorney.

On the basis of the unusual facts in this case, it is concluded, and found as a fact, that the plaintiffs' office expenses were ordinary and necessary expenses incurred in carrying on a business.

As mentioned earlier in the opinion, the plaintiffs' expenses with which the court is concerned in this case were expenses incurred in connection with the maintenance of offices in the plaintiffs' residences at Scottsdale and Santa Barbara. Accordingly, it is necessary to refer to *26 U.S.C. § 280A*, which provides in part as follows:

> (a) General rule. -- Except as otherwise provided in this section, in the case of a taxpayer who is an individual * * * *, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.
>
> (c) Exceptions for certain business or rental use * * * *. --
>
> (1) Certain business use. -- Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis --
>
> (A) The principal place of business for any trade or business of the taxpayer.

It has already been determined that the plaintiffs were carrying on a business during the taxable period involved in this case. The facts show that the offices in their Scottsdale and Santa Barbara homes were the plaintiffs' principal place of business, as virtually all of their investment activities were conducted in the respective offices, depending on the seasons of the year.

Also, the facts show that the two offices were used exclusively for business purposes. The plaintiffs did not entertain there, and guests did not go there. Other parts of the respective residences were used for such purposes.

In addition, the facts show that the offices were used regularly for business purposes. The plaintiffs kept regular office hours there each working day, and each devoted from 40 to 42 hours per week to their investment activities.

Accordingly, the plaintiffs' use of offices in their Scottsdale and Santa Barbara residences came within the exception previously quoted from *26 U.S.C. § 280A(c)(1)(A)*, and the expenses incurred in maintaining the offices are deductible for income tax purposes.

It necessarily follows that the plaintiffs are entitled to recover. The determination of the amount of the recovery will be determined in subsequent proceedings under Rule 42(c).

CONCLUSION OF LAW

On the facts, as found by the court, the court concludes as a matter of law and decides that the plaintiffs are entitled to recover, together with interest computed in accordance with *section 6611 of the Internal Revenue Code of 1954*. The determination of the amount of the plaintiffs' recovery is reserved for further proceedings under Rule 42(c), after which a final judgment will be entered.

[*none] [EDITOR'S NOTE: The following court-provided text does not appear at this cite in *1 Cl. Ct. 25.]*

1. (a) The plaintiffs, Joseph A. and Dorothy D. Moller, are husband and wife, they are citizens of the United States, and they reside in Scottsdale, Arizona.

(b) The plaintiffs were married in 1965.

2. This is an action for the recovery of income taxes, and interest thereon, assessed against and collected from the plaintiffs, plus interest according to law on the amounts thus assessed and collected.

3. (a) On or before April 15, 1977, the plaintiffs filed with the Western Region Service Center, Ogden, Utah, a joint United States income tax return for the calendar year 1976. The return reflected a taxable income of $466,902.87 and a tax liability of $297,501.31.

(b) The tax liability, as calculated by the plaintiffs, was timely paid by them through estimated tax payments and a remittance that was submitted with the return.

4. (a) On or about March 10, 1980, the defendant assessed against the plaintiffs a deficiency in income taxes of $5,029, plus an assessment for interest in the amount of $911.04, with respect to the plaintiffs' 1976 income tax return. The deficiency was based on the disallowance of office expenses claimed by the plaintiffs as a deduction.

(b) On or about March 17, 1980, the plaintiffs paid to the defendant the sum of $5,940.04, which was the full amount of the deficiency, plus interest, assessed against the plaintiffs for 1976.

5. (a) On or about June 24, 1980, the plaintiffs filed an amended joint income tax return for 1976 with the Western Region Service Center, Ogden, Utah, seeking a refund of the tax and interest assessed, as indicated in finding 4, plus interest on the total amount paid from the date of payment.

(b) A period of more than 6 months has elapsed since the filing of the plaintiffs' amended joint income tax return for 1976, and the refund sought in such return has neither been allowed nor disallowed by the defendant, and no part of the amount claimed has been repaid by the defendant to the plaintiffs.

6. (a) On or before April 15, 1978, the plaintiffs filed with the Western Region Service Center, Ogden, Utah, a joint income tax return for the calendar year 1977. The return reflected a taxable income in the amount of $499,623.03 and a tax liability of $316,288.95.

(b) The tax liability, as calculated by the plaintiffs, was timely paid through estimated tax payments and a remittance that was submitted with the return.

7. (a) On or about March 15, 1980, the defendant assessed against the plaintiffs a deficiency in income taxes of $5,073, plus an assessment for interest in the amount of $574.36, with respect to the plaintiffs' 1977 joint United States income tax return. The deficiency was based on the disallowance of office expenses claimed by the plaintiffs as a deduction.

(b) On or about April 21, 1980, the plaintiffs paid to the defendant the sum of $5,647.36, which was the full amount of the deficiency, plus interest, assessed against the plaintiffs for 1977.

8. (a) On or about June 24, 1980, the plaintiffs filed an amended joint income tax return with the Western Region Service Center, Ogden, Utah, seeking a refund of the taxes and interest

assessed against the plaintiffs for 1977, as indicated in finding 7, plus interest on the total amount paid from the date of payment.

(b) A period of more than 6 months has elapsed since the filing of the plaintiffs' amended income tax return for 1977, and the refund sought in the return has neither been allowed nor disallowed by the defendant, and no part of the amount claimed has been repaid by the defendant to the plaintiffs.

9. The claims for refund submitted by the plaintiffs, as indicated in findings 5 and 8, were based upon the same grounds as are asserted in the present action.

10. During 1976 and 1977, as well as before and after the 1976-77 period, the plaintiffs administered four separate portfolios of stocks and other securities.

11. Those portfolios consisted of stocks and securities held: (a) by Joseph Moller individually; (b) by Dorothy Moller individually; (c) by the Northern Trust No. 1-29551 ("Northern Trust"); and (d) by the First Interstate Bank Trust No. 50-50-0224 ("First Interestate Trust").

12. (a) Joseph Moller is the trustee of the First Interstate Trust.

(b) The Northern Trust Company is the trustee of the Northern Trust, and Dorothy Moller is the investment director of that trust.

(c) The plaintiffs make all investment decisions in regard to both trusts.

13. In 1976, the Northern Trust portfolio contained 26 stocks, the First Interstate Trust 14, Joseph Moller's individual portfolio 33, and Dorothy Moller's individual portfolio 116.

14. In 1977, the Northern Trust portfolio contained 20 stocks, the First Interstate Trust 15, Joseph Moller's individual portfolio 30, and Dorothy Moller's individual portfolio 131.

15. (a) In 1976, the total value of all four portfolios was approximately $13.5 million.

(b) In 1977, the total value of all four portfolios was approximately $14.5 million.

16. (a) The Northern Trust originated through stock put in trust for Dorothy Moller by her former husband. Dorothy Moller is entitled to receive the income from the Northern Trust during her lifetime. Upon her death, the corpus will pass to the other heirs of her former husband.

(b) During the years in question, and before and after those years, Dorothy Moller had the power annually to invade 5 percent of the corpus of the Northern Trust pursuant to the trust instrument, and had full power to direct the trust's investments.

(c) The plaintiffs placed the orders for Northern Trust transactions, and those orders would then be executed by the plaintiffs' broker.

17. The First Interstate Trust originated through stock put in trust by Joseph Moller's first wife, now deceased. Joseph Moller receives the income from that trust during his lifetime, after which the corpus will pass to the children of his former marriage.

18. Since 1965, the plaintiffs have relied almost wholly on their investment income for their livelihood. Their only other sources of income have been two small pensions and social security.

19. From 1971 to 1975, the plaintiffs' taxable income was as follows:

1971	$ 334,976
1972	372,902
1973	414,494

1974	473,707
1975	491,632

20. During the 1971-75 period, the plaintiffs' federal income taxes were as follows:

1971	$ 150,665.00
1972	188,036.00
1973	211,726.00
1974	256,986.00
1975	269,165.37

21. In 1976 and 1977 the plaintiffs' total taxable income was $551,044.66 and $594,680.11, respectively, 98 percent of which came from their investments. Their federal income taxes for those 2 years were $297,744.80 and $316,721.12, respectively.

22. In 1978, the plaintiffs' taxable income was $673,474, and their federal income taxes were $360,726.10.

23. In 1980, the plaintiffs' taxable income was approximately $895,000; and for 1981, Joseph Moller estimates that it will be approximately $1,042,000.

24. During the 1971-1978 period, the plaintiffs' gross income, income from interest and dividends, and income from the sale of securities were as follows:

	Gross Income	Interest & Dividends	Securities
1971	$345,965	$342,435	
1972	386,595	380,637	$ 4,356
1973	429,375	426,400	(2,611)
1974	491,536	487,417	
1975	510,816	506,095	283
1976	551,244	543,265	612
1977	594,880	590,762	(223)
1978	673,675	664,400	(11,302.67)

25. (a) During the years 1971-1978, the plaintiffs were involved in the following number of transactions involving purchases of securities:

	Plaintiffs' Own Stock	Northern Trust	[1] Trust Invasion	Splits/ Dividends	[2] Common Trust	Total Dollar Amount
1971	63	19	4	2	1	$1,102,057.27
1972	52	20	13	2	8	1,372,086.40
1973	69	12	8	13	8	1,735,491.08
1974	24	6	7	3	12	1,010,946.52
1975	22		8	7	13	1,243,733.90
1976	32	26	3	14	8	1,844,669.29
1977	32	3	23	9	9	959,073.37
1978	73		2	12	9	1,870,859.28

1 All of these transactions involved stocks which plaintiffs had previously counted as purchases when made by the Northern Trust.

2 These transactions consisted of deposits to interest-bearing accounts at Northern Trust Company. These accounts paid a fixed rate of interest and there were no restrictions as to withdrawal.

(b) Of the 83 purchase transactions consummated in 1976, some were attributable to invasions of the corpus of the Northern Trust. These invasions of the Northern Trust corpus were treated as purchases by the plaintiffs, as the corpus was taken in the form of stock in lieu of cash, thus avoiding two brokerages which would be entailed by liquidating the stock in the trust, receiving the cash as the invasion, and in turn using that cash to purchase additional stock.

26. (a) The plaintiffs invested in Treasury Bills any funds which were not currently committed to stocks, in order to maintain the liquidity of those funds, while still producing revenue.

(b) In 1976 and 1977, the plaintiffs had 27 and 19 transactions, respectively, in Treasury Bills. However, some of these transactions consisted of the roll-over of Treasury Bills that matured during those years. The 1976 and 1977 transactions in Treasury Bills, including roll-overs, involved a total dollar volume of $2,561,738.77 in 1976 and a total dollar volume of $1,500,041.74 in 1977.

27. The plaintiffs did not purchase securities for speculative purposes. Instead, the plaintiffs were primarily interested in long-term growth potential and the payment of dividends.

28. (a) During the years 1971-1978, the plaintiffs were involved in the following number of transactions involving sales of securities:

	Plaintiffs' own Stock	Common Trust [3] Fund	Northern Trust	Number of days in which plaintiff's Own stock was sold
1971			10	
1972	4	6	2	3
1973	21	10	1	13
1974		8	2	
1975	17	13	2	5
1976	10	22	9	3
1977	23	7		10
1978	34	11	1	11

3 These transactions involved withdrawals from the accounts at Northern Trust Company in which deposits had previously been made. See fn. 2.

(b) The stock sold by plaintiffs during the years 1971-1978 had been held by them for the following periods of time:

	*6*Years 0-1	1-2	2-3	3-4	4-5	over 5
1971	0	0	0	0	0	0
1972	3	0	0	0	0	1
1973	0	2	4	0	5	10
1974	0	0	0	0	0	0
1975	0	1	4	1	0	11
1976	0	2	1	5	0	2
1977	2	3	2	0	1	15
1978	3	5	8	1	0	17

(c) The stock owned by plaintiffs which they sold during 1976 and 1977 had been held for an average of over 3-1/2 and 8 years, respectively.

(d) The total dollar amounts involved in the 1976 and 1977 sale transactions were, respectively, $1,679,813.35 and $821,028.50.

29. The plaintiffs maintained five bank accounts in connection with their investments, one each for their dividends, one each for their purchases and sales of Treasury Bills, and one for office expenses.

30. (a) The plaintiffs subscribed to and studied the following publications and services in connection with their investments:

DAILY

Wall Street Journal

Standard & Poors

Listed Stock Reports (2-3 times/week)

WEEKLY

Barron's

Wall Street Transcript

Indicator Digest

Reporting on Governments

Kiplinger Newsletter

Kiplinger Taxletter

U.S. News Washington Letter

Silver & Gold Report

Daily News Digest

Commerce Clearing House Federal Tax Reports

MONTHLY

Stock Guide

Tax Angles

Standard & Poors Earnings Forecaster (bimonthly)

QUARTERLY

Facts on the Funds

Three-Trend Cycligraphs

Taxing and Spending

Stock Quarterly Financial Reports

Information Accompanying Quarterly Reports

ANNUALLY

Annual Stock Reports

(b) Joseph Moller studied these publications between 8 and 10 hours per week, and Dorothy Moller studied them between 7 and 8 hours per week.

(c) The cost of the publications and services to which the plaintiffs subscribed was approximately $1,800 in 1976 and $2,400 in 1977.

31. The plaintiffs monitored the stock market and their portfolios daily, and made all of their investment decisions "on their own." They did not employ an investment advisor, nor did they seek investment advice from their stockbroker.

32. The plaintiffs' purchases of stocks were typically in a block of 1,000 shares of a particular stock, with the result that the plaintiffs paid a discounted commission on such purchases, which was much less than the commission would have been on smaller purchases. The total volume of the plaintiffs' purchases also made possible a negotiated discount of 50 percent on brokerage fees from those given smaller purchasers.

33. A purchase order for 1,000 shares usually was not filled in on purchase at the desired price, with the result that an additional determination was required as to whether to purchase at a different price the remaining shares necessary to complete the block. This purchase decision was also affected by the fact that the commission would be higher if the full block of 1,000 shares could not be purchases the same day.

34. (a) The plaintiffs' investment activities included monitoring and studying the stocks held and stocks eligible for purchase, as well as the corporations invested in, their products, and their performance.

(b) The plaintiffs did not visit the corporations in which they invested; and during 1976 and 1977 they attended only three or four stockholders' meetings, which were held in the Phoenix area.

35. The plaintiffs devoted their full time to their investment activities, and each regularly spent between 40 and 42 hours per week in conducting these activities during 1976 and 1977.

36. Before a decision is made to purchase a stock, it is generally watched by the plaintiffs between 2 and 6 months, but often a stock is watched as long as 1 year.

37. The decision to retain a stock is a continuing one, and involves a study (a) of the administration of the corporation, (b) of its outlook, plans, and spending levels for development, (c) of the acceptance of the corporation's product in the marketplace, i.e., whether that product is of growing or lessening importance, and (d) of the price-earnings ratio of the stock.

38. For an investor who is attempting to minimize risk and maximize long-term growth, a decision to hold a stock is equally as important as a decision to buy or sell a stock.

39. Telephone contact with the plaintiffs' broker at E.F. Hutton & Company was maintained on the average of every other day. On days of active trading, 10 or 15 calls per day could be placed to the broker, and, on less active days, one or two calls per day.

40. The plaintiffs' account with E.F. Hutton & Company was the largest account of that firm's local office. The plaintiffs' account was larger than the accounts local banks had with E.F. Hutton & Company.

41. All of the investment decisions, investigations, functions, and records are kept or performed by the plaintiffs for each portfolio.

42. The measure of the performance of an investor is the net total return, and an investor who is successful in acquiring a stock at the bottom and selling at the top could hold a stock between

6 and 7 years. An investor ordinarily does not seek short-term gain, but holds for appreciation and does not sell a stock unless his position is substantially improved.

43. Even though a stock has grown considerably, its continuing positive performance might dictate its being held for several years. This could result from the fact that the investor is satisfied with the performance of the stock, or that the stock had been inherited with a low tax base and the risk involved in not selling it would be minimal compared with the tax penalty, or that the investor is not concerned with short-term fluctuations but buys and holds securities primarily for their investment value.

44. The plaintiffs' activities in studying the market and managing their various portfolios were similar to the activities provided by a professional investment advisor to his clients.

45. In connection with their investment activities, the plaintiffs maintained the following books, records, notes, and research aids:

(a) A watch list which lists all stocks on the New York Stock Exchange which are candidates for purchase and study. This list is updated at least once or twice per week as to the stocks desired for purchase.

(b) A book of product research notes which contains information regarding the product of an industry under study, the stock of which is a candidate for purchase. These notes contain definitions, product uses, manner of use, and supply and sales market data for the product.

(c) A stock note data book, which is an alphabetical list of stocks held, and includes the earning percentage of each company's product in its market, and the company's profit percentage in that market, as well as other information which would affect the value of the stock.

(d) Stock purchase worksheets, which are projections of stocks based on study and the daily quotations. These sheets contain projections examining options of purchasing one stock as opposed to another, the likely stocks to be sold if cash is needed, and the relative desirability of various stocks. Stocks to be purchased are drawn from this list.

(e) Market information on current portfolios, which lists all securities held, as well as some which are being watched, including some which have been held in the past and now are candidates for repurchase. The weekly price as of the close of the market on Friday night is entered, as well as the type of stock, its rating, symbol, and range of prices, and an indication of the last purchase.

(f) A portfolio information book, which contains stocks promoted from the watch list. These stocks are more actively and closely followed, and are highly eligible for purchase, and, depending on the circumstances, will probably be purchased.

(g) A stock record book for each portfolio, listing all stocks currently held, in which entries were made whenever a stock was purchased.

(h) A current stock purchase book, containing a sheet for each stock, prepared on the date of purchase, recording the number of shares purchased, the date of purchase, and the cost. A master sheet is made up of these purchases to indicate the stock-of-record dates, which determined whether dividends would be paid on the current purchases. The sheet made up for each stock is placed in the stock record book only when the stock certificate is received. On receipt of the stock certificate, the certificate number and date are recorded on the stock purchase sheet and inserted in the stock record book.

(i) Current capital gains records, which maintain a detailed record of gains and losses.

(j) Dividend record books, indicating the number of shares held in each stock, the dividend for each, and the total dividend, as well as the information from Forms 1099 at the end of each year to check those totals against the dividend record books' totals.

(k) A sheet to record Treasury Bills, and the amount and date at which they come due.

(1) A Treasury Bill transaction summary, indicating purchases, sales, and dates of sale and purchase, as well as amounts.

46. In 1976, the plaintiffs' investment expense, including the expense of their offices, was $22,659.91. In 1977, it was $29,561.69.

47. (a) The expenses of the residential office space were $7,439.65 in 1976, of which $5,832.88 related to the Scottsdale residence and $1,606.77 related to the Santa Barbara residence. In 1977, the total was $7,247.21, with $5,350.55 relating to Scottsdale and $1,896.66 relating to Santa Barbara.

(b) The plaintiffs reported their investment expenses as itemized expenses deductible under *section 212 of the Internal Revenue Code*. The only expenses in issue are those relating to residential offices, as the others were allowed as claimed.

48. The plaintiffs decided not to rent an office for their investment activities because of the cost of an outside office, and their need to have a convenient location to work at night.

49. During the period in question, virtually all of the plaintiffs' investment activities (except during the summertime) were conducted in their home office at Scottsdale.

50. All of the books, records, documents, publications, and services described in previous findings are stored in the plaintiffs' home office at Scottsdale.

51. The home office in Scottsdale consists of two rooms, and contains a desk for Joseph Moller, a desk for Dorothy Moller, and a desk for their secretary, who has been employed by the plaintiffs since May 1976 and who works as a secretary/bookkeeper approximately 22 hours per week. In 1980, the plaintiffs purchased an Apple Computer with a special New York Stock Exchange program which allows them to follow the price of their stocks on an instantaneous basis.

52. Virginia Fronabarger, the plaintiffs' secretary-bookkeeper, spends 99 percent of her time on the plaintiffs' investment activities. Any personal work she does for the plaintiffs takes no more than 1 percent of her time.

53. Contained in the plaintiffs' Scottsdale office are calculating and reproduction machines, filing cabinets, a typewriter, a check writer, a postage meter, and a two-drawer file cabinet for current files, as well as a cable television terminal which conveys stock prices.

54. The plaintiffs keep regular office hours each working day, and use the office exclusively for investment activities. The plaintiffs do not entertain there, and guests do not visit there; other parts of the house are used for such activities.

55. The plaintiffs maintain a similarly equipped office in a home that they own in Santa Barbara, California, and occupy in the summertime. Although the plaintiffs' permanent files remain in Scottsdale, whenever they visit Santa Barbara, they perform the same investing activities on an exclusive and regular basis in their Santa Barbara office.

56. The IRS twice conceded that the plaintiffs' home offices were necessary for their investment activities.

57. The plaintiffs were regularly, continuously, and actively engaged in their investment activities during 1976 and 1977.

58. The plaintiffs conducted their investment activities in their offices, which were regularly, continuously, and exclusively used for such purpose.

59. The plaintiffs' investment activities during 1976 and 1977 were extensive, continuous, and regular.

60. The expenses involved in the present action were incurred by the plaintiffs in carrying on a business.

61. The plaintiffs' use of their offices in their homes was exclusive and on a regular basis as their principal place of business.

62. The plaintiffs' office expenses were ordinary and necessary expenses incurred in carrying on a business.