GIBSON PRODUCTS CO. v COMMISSIONER
8 TC 654, Code Sec(s) 22, 03/28/1947

Official Tax Court Syllabus
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2. Deduction of expenses of operating airplane while petitioner's president was learning to fly, denied. Expense of airplane operation thereafter allocated between petitioner's business and personal business of its president.

This case involves income and excess profits taxes for years and in amounts as follows:

Calendar year	Income tax	Declared value excess profits tax
1941	$444.76	$242.04
1942	140.10	
1943	349.36	84.45

The questions presented for consideration are: (a) Whether certain expenses in connection with an airplane are deductible as business expense; (b) whether depreciation on the airplane is deductible; (c) whether certain excise taxes paid by the petitioner are deductible when paid by the petitioner in 1943. From admissions and evidence adduced, we make the following findings of fact.

FINDINGS OF FACT.

The petitioner is a corporation, organized under the law of Texas in 1936 and having its principal place of business in Dallas, Texas. Its Federal income tax returns for the taxable years involved were filed with the collector for the second district of Texas, at Dallas, Texas. It keeps its records and makes its returns on an accrual basis. H. R. Gibson has been its president at all times. It is and has been since incorporation engaged in the business, largely wholesale, of drugs, sundries, notions, and school supplies, and in the manufacture of toilet articles and cosmetics, including hair oil.

In the taxable year H. R. Gibson individually owned stores in Texas at Houston, Fort Worth, Abilene, Lubbock, and El Paso, and in Oklahoma at Tulsa, each having the name Gibson Products Co. In addition, he owned, at Dallas, Texas, Dixie Laboratories, and Realshine Co. These stores, with the petitioner and several other stores of the same name, operated by various

relatives of H. R. Gibson, used the same name because it gave them greater buying power, by their buying together.

An airplane was purchased by the petitioner about September 1940, for $2,650. It was sold about January 22, 1942, for $2,195. The rate of depreciation on it was 25 per cent per year. H. R. Gibson received a pilot's license about May 1, 1941, and thereafter made numerous trips in the plane. While he was learning to fly, in 1941 prior to May 1, the petitioner paid for oil, gas, storage, and maintenance of the plane at Love Field, and $20 instruction expense. H. R. Gibson paid personally the expenses of instruction, except the $20. The trips made by the petitioner's president after May 1, 1941, and until the sale of the plane in January 1942, and after purchase of another plane by H. R. Gibson individually, were made both on the business of the petitioner [pg. 656]and in connection with that of the other stores owned by H. R. Gibson personally, with which petitioner transacted business, and which, in a claim for abatement by petitioner, dated February 19, 1942, were referred to as affiliated stores, to which special prices were set by the petitioner. Expenses were paid by the corporation as to the airplane in the amount of $1,318.45 in 1941. In 1942, $475.73 was charged by the petitioner to airplane expense, this being the expense of operating petitioner's airplane until sold, and about one-third of the operating of the other plane which H. R. Gibson then purchased and used partly on petitioner's business. The use of the airplane was necessary in the petitioner's business. Out of 78 days on which airplane trips were taken in 1941 and 1942, 22 flights were to cities where H. R. Gibson's individual stores were located.

In 1936, 1937, and 1938, in connection with its manufacturing, petitioner made excise tax returns and paid excise taxes, monthly, covering manufacture, according to their manufacturing records as to cosmetics and toilet preparations.

The petitioner purchased oil in tank cars and, after coloring matter and perfume had been added, the product was sold and distributed by the petitioner as hair oil. Oil was shipped in an unrefined state to save freight rates. It is, and has been, the petitioner's contention at all times that it was not manufacturing such hair oil, but that it merely bottled, sold, and distributed the product. Therefore, the petitioner did not report or pay the excise taxes upon such hair oil to the extent involved in this case. Under date of February 10, 1942, the collector sent the petitioner a notice to pay additional tax on toilet preparations, amounting with penalty to $10,509.23, and covering the period from September 1, 1936, through December 31, 1938. On February 19, 1942, the petitioner filed with the collector its claim for abatement, contending, so far as here pertinent, that it did not manufacture the hair oil, but that it was delivered to the petitioner in a completed stage; also, that the amount of the assessment was grossly exaggerated and included amounts already paid on oils which were used in the manufacture of toilet preparations. The petitioner filed a proceeding in the District Court of the United States for the Northern District of Texas, asking for injunctive relief against the assessment of tax. On March 4, 1943, the parties to such proceeding stipulated that it might be dismissed, and it was dismissed on that day.

Under date of April 15, 1943, the petitioner's claim for abatement of the $10,509.23 tax was adjusted and allowed to the extent of $9,162.92 but rejected in the amount of $1,346.31. Demand for the payment thereof was made by the collector under date of April 27, 1943. Petitioner paid the $1,346.31, together with interest, amounting in all to $1,445.41, on May 1, 1943, and on June 23, 1943, filed its claim for refund of that amount, still contending that it had not manufactured the oil involved.

On or about December 31, 1943, petitioner filed suit for refund in the District Court of the United States for the Northern District of Texas, seeking a recovery of the $1,445.41 paid. On May 8, 1944, the court rendered judgment against the petitioner, holding that it was not entitled to recover. The petitioner deducted in its income tax return for 1943 the $1,346.31, and in the deficiency notice the respondent disallowed such deduction "for the reason that they were properly accruable and deductible in prior years."

H. R. Gibson was in 1931 convicted in the United States District Court of the crime of shipping illegal goods by express and served about five months in the penitentiary at Leavenworth, Kansas, the charges being then dismissed. He has never been charged with any other offense.

OPINION.

Disney, Judge:

The first question to be answered in this matter is whether the petitioner may deduct in 1943 excise taxes paid in that year but assessed on the ground of manufacture of hair oil in 1936, 1937, and 1938. The respondent contends, in accord with the deficiency notice, that the deductions should have been taken in 1936, 1937, and 1938, being amounts accruable for those years, the petitioner being upon an accrual basis of accounting. The petitioner's argument is based in effect upon Dixie Pine Products Co. v. Commissioner, 320 U. S. 516, the argument being made, as in that case, that the taxes had not been paid in the former years, but were contested and therefore not properly accruable in those years, so were properly deductible in the later year when paid. The respondent seeks to distinguish the Dixie Pine Products case under the argument that here the petitioner during 1936, 1937, and 1938 possessed all facts with respect to quantities manufactured and amount of tax due, and deliberately undertook to avoid the payment of the manufacturer's excise tax and deliberately failed to pay such tax, and that since all events fixing the amount of the tax and liability therefor occurred prior to 1943, the petitioner may not in 1943 deduct the amount paid in that year.

Evidence was presented before us by both petitioner and respondent as to whether there had in fact been manufacture of hair oil in 1936, 1937, and 1938. The evidence of each party was flatly and completely contradictory of the other, except that the petitioner's president testified as to the entire period, whereas the witness for the respondent, a manufacturing chemist, was employed by the petitioner only from March 1938 to April 1939. The point of difference between the parties was as to whether the petitioner's employees, or the employees of [pg. 658]petitioner's vendors of oil, placed and mixed coloring matter or perfume, or both, into such oil, and the testimony of petitioner's president, covering the entire period, was positive and emphatic that there had been no such mixing by its employees, but that it had purchased a completed product, whereas the manufacturing chemist testified that petitioner's employees had done the mixing. The petitioner's president had been convicted of a felony and served a short sentence in the Federal penitentiary at Leavenworth, as was proved in order to discredit his testimony; whereas the manufacturing chemist, as testified by the petitioner's president, had been discharged by him because of alleged irregularities in the handling of petitioner's alcohol and other products. The conviction of the petitioner's president was not upon such grounds as to cause us to feel that his credibility was altogether impugned. Considering the fact that the question of whether there was manufacture had been tried and found against the petitioner in the United States District Court for the Northern District of Texas in the suit for recovery of taxes, together with the evidence of the chemist necessarily considered only as to the period of his employment, and the evidence of

petitioner's president, we feel that the fact as to whether there was or was not, manufacture of hair oil is not established in this case, and, since it seems to us that it is immaterial, no finding has been made. We have found as fact the petitioner's contention at all times that it was not manufacturing hair oil.

In our view, the Dixie Pine Products case does apply. The petitioner from the time that the excise tax on the alleged manufacture of oil was proposed against it continuously and consistently contended that it had not manufactured. All of the evidence leaves us with no doubt that it would have made the same contention during the years 1936, 1937, and 1938. We are not convinced by the record here that the petitioner was in bad faith in trying to escape the excise tax, and in not reporting, so far as concerns the hair oil in question. Though the shipping in of oil and the mixing of coloring matter and perfume with it would, under the records, save considerable freight charges, and if there was no manufacture by the petitioner, it would also escape excise taxes, the question is too close for us to feel convinced that the petitioner did not think it was properly saving both freight and tax. It had a right to do both, under proper circumstances. The question for us is not whether there was, or was not, manufacture, but whether there was such question or contention in that respect as to prevent proper accrual of the excise taxes. The petitioner was, in effect, in the same position as the taxpayer in the Dixie Pine Products case-a position of denying manufacture, and therefore denying excise tax. It could not, therefore, have accrued the amount of such tax during that period under the Dixie Pine Products case, the logic, of course, being that the contention rendered the item so contingent as to be unaccruable. So here we consider that it has been established, irrespective as to whether there was in fact manufacture, a persistent attitude that there was no such manufacture, so that the petitioner would have had no right in 1936-1938 to accrue any possible tax based upon such manufacture. There is a remarkable similarity between the question as to whether there was manufacture of hair oil here and the question in the Dixie Pine Products case whether the petitioner there was using a nontaxable "solvent," or taxable gasoline.

The respondent does not contend that the tax was deductible in 1944 when final judgment was rendered in the petitioner's action to recover the tax paid, and in Chestnut Securities Co. v. United States, 62 Fed. Supp. 574, it was held by the Court of Claims that the taxpayer, on the accrual basis, could deduct taxes paid in 1940, although for the years 1936, 1937, and 1938, and although its suit to recover the taxes paid was not finally determined until 1942. The reason the taxes were not paid until 1940 was that the petitioner thought it was not subject to an intangible personal property tax. We conclude and hold that the petitioner properly deducted the $1,346.31 in 1943.

We next consider the question of deduction of expense of operating an airplane, amounting in 1941 to $1,318.45 and in 1942 to $475.73. As to 1942, the evidence is that the plane was owned by the petitioner's president and only one-third of the expenses charged to petitioner. Nothing indicates, and the respondent does not contend, that such apportionment is unfair, and we therefore accept it and approve the deduction of $475.73. But we think such an apportionment, between the petitioner and its president, has meaning for us in the question as to 1941. The petitioner's president was a businessman with at least three businesses, and a number of stores outside of Dallas, aside from that of the petitioner. He used a plane from May 1, 1941, to fly back and forth between Dallas and these stores, and other points. Though he testified that all trips were solely on the business of the petitioner the other stores were "affiliated" with petitioner, in his words in the claim for abatement dated February 19, 1942. Under all the facts, we may not reasonably conclude that no use of the plane had to do with these other stores; and, since nothing

indicates a different amount of use or different ratio of use in 1941 from that in 1942, between petitioner and its president, we think a ratio accepted by the petitioner as to 1942, when the plane belonged to the president (except about three weeks at the beginning of the year), should be considered on the same point as to 1941 expenses. The two planes were probably used for about the same purposes, by a busy businessman. However, of the flights on 78 days in 1941, only 22 were made to cities where the president's individual stores were operated. The president testified that at such stores he might, on flights, stop "for the corporation business-see about the merchandise and things that the corporation was selling to our own Gibson Products Company stores." We think that under Cohan v. Commissioner, 39 Fed. (2d) 540, some of the airplane expenses should be considered as being those of the petitioner. We conclude and hold that 11/78 of the 1941 expense should be allocated to the petitioner's president, on the theory that on the trips to cities where the president had his stores he attended alike to corporation and individual business. This proportion to the petitioner is less than the 1942 apportionment might indicate. The 11/78, however, applies only to those expenses after May 1, 1941, paid by the petitioner, for prior to that date we do not regard expense of operating the plane, while the petitioner was learning to fly, as expense of the petitioner. There is nothing of record to indicate any business of petitioner transacted by use of the plane during such period. Merely training the president to fly (obviously largely for personal reasons, as indicated by the use of the plane and the apportionment of expense in 1942) is not shown to be a corporation expense. Welch v. Helvering, 290 U. S. 111. Since one-third of the year 1941 had run by May 1, when the president received his pilot's license, we eliminate one-third of the $1,318.45 claimed as deduction; and, as above stated, allow the petitioner deduction for all but 11/78 of the remaining expense for 1941. The expense, so far as above allowed, is held ordinary and necessary expense of business. The respondent does not contend otherwise and argues only as to the proper allocation.

Though depreciation on the airplane owned by the petitioner in 1941 was disallowed in the deficiency notice, at trial the parties agreed that a 25 per cent basis was reasonable, and the respondent does not contest, on brief, the petitioner's arguments on the point. It is therefore considered waived, and deduction of depreciation on that basis approved.