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Taxation: How to Become Miss America Without Achieving Any "Major Accomplishment" - Some Thoughts on the Income Averaging Provisions of the Internal Revenue Code

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HOW TO BECOME MISS AMERICA WITHOUT ACHIEVING ANY "MAJOR ACCOMPLISHMENT"—

Some Thoughts on the Income Averaging Provisions of the Internal Revenue Code

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It has long been a settled matter of philosophy and tax policy, that the rate of taxation should be directly proportional to the amount of income received by an individual.[1] Neither is it often questioned that those who earn a larger amount within our capitalistic system, should pay for that privilege through increased rates of taxation. Thus, the "wealth is spread" at least to a certain extent, without the use of more overt, and more politically offensive methods.

The progressive system of income taxation does lead to certain inequities. When income is received in "bunches" due to the nature of one's employment, to receipt of a windfall, or to the use of a cash accounting method, the taxpayer consequently pays more tax than his counterpart who received the same number of dollars, but over a longer period. Thus, the attorney who prepares a case over a three-year period on a contingency fee basis, and receives income of $100,000 in one year pays some $18,000 more in tax than the attorney whose salary is $33,333 per annum. Because of the system and its consequential inequitable tax results, authorities have long advocated a system of "income averaging."[2] Although income may be "spread" over a period of years through a variety of methods,[3] the term "income averaging" in general

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[1] For an interesting and informative discussion of both pros and cons of the progressive tax system, *see* C. GALVIN and B. BITTKER, THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE? (1969).

[2] *See, e.g.*, VICKERY, AGENDA FOR PROGRESSIVE TAXATION 172-97, 417-27 (1947).

[3] Other methods available for "spreading" income over a period of time include: the last-in, first-out (LIFO) accounting method (Commissioner approval required); the installment sales method; percentage of completion (available to contractors); capital gains (gain for tax purposes may be taken at the taxpayer's will); and pensions and other deferred compensation. In addition, Section 172 (Net Operating Loss Deduction) provides for the averaging of operating gains and losses over a nine year period. See note 5, *infra.*

refers to a means of spreading income received in one year back over preceding years when income was lower and the tax bracket more favorable. "Income averaging" is a term of art, referring specifically to those sections[4] of the Internal Revenue Code of 1954 (hereinafter referred to as the Code) which outline the method, conditions, and requirements under which one's income may be spread.

Other inequities which are an integral part of the progressive tax system are manifest. Section 441 of the Code requires the income tax to be computed on a *yearly* basis. That is, income is reportable in the year received, and deduction is taken in the year expended. The maximum standard deduction has long been $1000 per annum. For example, if an attorney receives a contingent fee in one taxable year, which he earned over a period of three years, he could take but a single $1000 deduction. However, his counterpart on salary over the same three year period, and receiving the identical total income, would receive three deductions of $1000 each. Tax rates which fluctuate from year to year also result in inequity under a system of progressive taxation. Thus, it is very possible that our attorney working on a contingent fee basis could receive his income in years in which Congress had *increased* the tax rates.

The purpose of this article is to describe the income averaging sections of the 1954 Code, and to point up some of the problem areas which have arisen since the Act was vastly changed in 1964.

I. Policy and Income Averaging

Speaking generally, Sections 1301 through 1305 of the 1954 Code provide for the "spreading" or averaging of income received in the current year over the previous four (base period) years.[5] The Tax

[4] Internal Revenue Code of 1954, §§ 1301-1305 [hereinafter cited as Code].

[5] There is some question as to what effect the operation of other Code sections have upon the income averaging provisions. It would appear that any section which would have an effect on the amount of income reported during previous years, would also affect income averaging. However, sections which affect future years would be of no consequence since income averaging considers the present year and the four previous years.

Perhaps the best example of this effect is presented by the operation of section 172 of the Code, which provides for a carryback of an individual's business-related losses when certain conditions have been met. If an individual were eligible and averaged in 1966 and in 1969 had a loss carryback which disqualified the individual from using the averaging provisions, what is the effect? Although apparently the issue has never arisen in court, an argument could be made that income averaging would not be affected. Rather, since the individual *did* qualify when he elected to average, the loss carryback will not serve to undo what has been done.

This argument loses its thrust when the requirements of the Code and the realities of the situation are considered. We will assume an individual's income for 1966 was $40,000. Since he qualified to average, he paid taxes of $10,000. Now assume a net loss carryback occurred in 1969 of $20,000 reducing his 1966 income to $20,000. Section 172 requires a new 1966 tax return be filed. We will also assume that the "new" income for 1966 ($20,000) would not qualify the individual for averaging. However, because his gross income has been so

Reform Act of 1969[6] reduced the requirement that the income received in the current year exceed the average income of the previous four years by 133 1/3 percent to 120 percent. Thus, if one receives one-fifth more income in the year in issue than the amount he has averaged over the last four years, he may enjoy the tax benefits of these provisions.[7] Because of certain exceptions in the statute pertaining to capital gains and the necessity of computing "averagable income," the tax return[8] computation is a breeding ground for arithmetical as well as substantive errors and should be double-checked upon completion.[9]

Though much relief was afforded by the 1964 amendment[10] to the 1954 Code, income averaging is a less than ideal solution to a complex problem. Because the progressive system of taxation is established in steps, and not along a continuum, it is possible that one's income increase substantially, and yet no relief will be granted under the income averaging sections.[11] No tax saving is possible unless some portion of a taxpayer's averagable income would have been taxed at a marginal rate (the highest rate applicable to any portion of a taxpayer's income) greater than the highest marginal rate applicable to 6/5 his average base period income. In other words, a tax savings is conditioned upon some portion of averagable income falling into a higher marginal tax bracket. Thus, it is clear that at least to some degree the policy of affording tax relief to those with widely fluctuating incomes has not been achieved.

drastically reduced in that year, his tax bill would now be only $4,000. Thus, our hypothetical taxpayer would file a claim for refund for $6,000.

One other hypothetical situation should complete the picture by illustrating that both the loss carryback as well as income averaging may be employed if each falls within the ambit of its respective Code provision. Assume that our taxpayer's 1966 income were $40,000. Assume further that he was eligible for averaging had his income been but $35,000 (133 1/3 percent of his base period income). In 1969, he acquires a loss carryback of $3,000. When applied to his 1966 income of $40,000, his net income for that year is $37,000, so that when he recomputes his 1966 tax, he may still average his income.

For those who are involved with computation of tax returns, enormously complicated problems involving section 172 loss carrybacks and income averaging result when an individual has filed both joint and separate returns, merges or consolidates with another business, or incorporates during the years in question.

[6] Act of December 30, 1969, Pub. L. No. 91-172, 83 Stat. 487.

[7] Section 1301 also requires a minimum income of $3,000 in the computation year.

[8] Form 1040, Schedule G.

[9] For examples, as well as step by step procedure, see Treas. Reg. § 1.1304-5. Although this regulation has not yet been updated to reflect the reduction in percentage increase required to average (from 133 1/3% to 120%), it is otherwise accurate. However, due to the recent changes concerning includibility of capital gains and wagering income, it would be advisable to consult the latest Treasury pamphlet detailing averaging computations. Other excellent practical assistance may be found in Frome, *Income Averaging Provisions of the 1964 Revenue Act*, 32 BROOKLYN L. REV. 120 (1965) and in M. SCHLUSSEL, 100-2d TAX MANAGEMENT PORTFOLIOS-INCOME AVERAGING (1968).

[10] Act of February 26, 1964, Pub. L. No. 88-272, 78 Stat. 105. CODE § 1305.

[11] Sommerfield and Williams, *Does Income Averaging Really Save Taxes? An Analysis of Its Quirks and Weaknesses*, 24 J. TAX. 198 (1966).

II. The Major Accomplishment Rule

Section 1303 of the Code sets out the criteria which must be met in order for one to be eligible to "average" his income for tax purposes. Prior to the 1964 amendments, the Code provided for the eligibility of a very limited class of persons.[12] Although the Act purported to cover authors and inventors, it did not provide for actors, athletes, architects, attorneys, and others. Moreover, even in the case of authors and inventors, the highly technical requirements[13] of the Act precluded use in many situations where averaging was clearly called for. The 1964 amendment (and, to an even greater extent, the 1969 Tax Reform Act) liberalized the scope of income averaging considerably, both in the *method* used to compute the tax and in *who* would be eligible to benefit from the Act. The primary requisite is that an individual be a citizen of the United States and that he has provided more than 50% of his support during each and every base period year.[14] There are, however, three exceptions to this support requirement. Under the *first,* an individual who has not provided at least half of his support throughout the base period years is still eligible to average if he is *over 25,* and during at least four of the years following his twenty-first birthday, he was *not* a full-time student.[15] Another exception allows averaging if a joint return is filed in the computation year and not more than 25 percent of the total adjusted gross income on that return is attributable to the individual desiring to average.[16] Although these two exceptions are important, they do not give rise to the difficult questions brought about by the third exception, the so-called Major Accomplishment Rule. This exception to the 50 percent support requirement applies if

> (B) more than one-half of the individual's adjusted taxable income for the computation year is attributable to work performed by him in substantial part during 2 or more of the base period years . . .[17]

The Treasury Regulations, promulgated under the authority of Congress,[18] give the rule its name.

> (3) *Major Accomplishment Rule*—(a) an individual may be an eligible individual for a computation year if more than 50 percent of his adjusted taxable income for the compu-

[12] Several commentators have suggested that no real Congressional intent was present when the 1964 amendments to the income averaging provisions were enacted. *See, e.g.,* Klein and Wiegner, *Income Averaging for Tax Purposes—Sources of a Statutory Solution,* 60 Nw. L. Rev. 147 (1965).

[13] Old Section 1302 of the 1954 Code provided only for artists and inventors who received at least 80 percent of their averagable income in the computation year and allowed spread back of their income only over the previous 36 months.

[14] Code, § 1303 (a).

[15] Code, § 1303 (c) (2) (A).

[16] Code, § 1303 (c) (2) (C).

[17] Code, § 1303 (c) (2) (B).

[18] *See* Code, § 1305.

> tation years is attributable to work performed by him in substantial part during two or more of his four base period years. It is not necessary that the individual perform any of the work in his computation year.[19]

A brief examination of the legislative history affords better insight into the intent of these provisions.

The House Ways and Means Committee Report spoke directly to the question of who would be able to average under the Major Accomplishment Rule.

> (One) concern of this provision is that the individual be a member of the labor force both in the computation year and in the 4 base period years. . . .
> (This) exception is provided for the individual who, although not self-supporting in the 4-year base period, nevertheless has income in the current year more than half of which is attributable in substantial part to *work* he has done in two or more of the base period years. This is designed to make sure that those who have performed some work of a substantial nature which occurred over a period of years will be eligible for averaging even though below the 25-year age limit.[20] (emphasis added)

The Senate Finance Committee Report[21] adopts word-for-word the provisions of the House Report set out above.[22] Thus it is apparent that whatever predisposition guided the Congress (the Protestant ethic has been suggested by at least one commentator),[23] the intent was to include only those individuals who, during their base period years, had been "working" in some sense of the word. At the risk of oversimplification, it could be said that the Congressional policy favors those who have been "producers"—that is, contributors to the Gross National Product or to the technological or intellectual wealth of the nation. There is, however, no provision in the statute which does not allow an unemployed individual who, because of some outside source of income, meets the eligibility requirement of support to average his income. For example it would be possible for a settlor-beneficiary of a trust fund to realize an increase in income in the computation year of 120 percent of the average income in the four base period years. Add to this the fact that capital gains (to a certain extent) may now be averaged,[24] and the possibility of such a situation increases even more.

The Major Accomplishment Rule excepts persons from the requirement of providing 50 percent of their support during the four base years,

[19] Treas. Reg. § 1.1303-1 (c) (3).
[20] H. R. REP. No. 749, 88th Cong., 1st Sess. 114 (1963).
[21] S. REP. No. 805, 88th Cong., 2d Sess. 144 (1964).
[22] To the same effect is the JOINT COMMITTEE EXPLANATION OF THE HOUSE BILL, 88th Cong., 1st Sess. 110 (1963): "The bill ... intends that the individual in general must have been a member of the labor force in both the computation year and in the 4 base period years."
[23] See Klein and Wiegner, *supra* note 12, at 164.
[24] Act of December 30, 1969, Pub. L. No. 91-172, 83 Stat. 487.

when more than half of their income in the current year is attributable to "work" performed during two of the four base period years. This provision provides relief for persons whose work product was the result of work performed over a long period, and who received "bunched income" as a result. Typical examples include the young[25] artist, inventor, and author. Although it would appear that this rule is insignificant when considering the relatively few persons who could be covered by it, as the cases discussed below indicate, the rule is being tested by certain classes who, although few in number, have rather large dollar amounts at stake.

A. The Miss America Case

The first case involving the 1964 Major Accomplishment Rule was *Wilson v. U.S.* (hereinafter referred to as "The Miss America Case"), an action in Federal District Court for a refund of an alleged overpayment. In 1965, Deborah Bryant (now Deborah Bryant Wilson) entered and won the Miss Kansas City, Kansas Contest, the local level of competition of the Miss America Pageant. After going on to win the Miss Kansas competition, she participated in the Miss America Contest in Atlantic City, New Jersey and was selected and crowned "Miss America 1966."

The experience was not a unique one for Debbie Bryant. Through her teen years, she had participated in several beauty contests. She had been selected Miss Teen America only a few years before being selected Miss America. Most, if not all, of the previous contests were

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[25] Although the Major Accomplishment Rule may apply to older persons, it is likely that persons over 25 would qualify under section 1303 (c) (2) (A) or would have provided more than 50 percent of their support during each base period year.

[26] 322 F. Supp. 830, 27 A.F.T.R. 2d 71-535 (D. Kan. 1971). The case has received national attention from the press. *See, e.g.,* Wall Street Journal, Feb. 10, 1971, at 1, col. 6.

[27] In addition to the income averaging question, the complaint alleged refunds were due on three other counts. First, Miss Bryant had received some $600 during the years in pursuit of the $10,000 in scholarship funds she had been awarded as a result of winning the Miss America title. The entire $10,000 was held by the Miss America Pageant, a non-profit corporation, for withdrawal as school expense receipts were sent to the custodian of the fund. The contract provided the entire remaining amount would be paid in cash upon completion of college. In this case, Miss Bryant received a check for over $7,000 upon her completion of college but not during either of the years in question in the suit. This issue was made part of the Government's motion for partial summary judgment along with the income averaging issue. The Government argued that the "scholarship" was a prize and thus includible under section 74 of the 1954 Code. In the alternative, it was the Government's contention that the money was compensation and thus not excludable under Section 117 which excludes scholarships from taxation.

The Government also claimed that the fair market value of the use of a new Oldsmobile for the year in which Miss Bryant reigned as Miss America should have been included in her gross income. In addition, Miss Bryant had deducted the price of two fur pieces which she had been asked to purchase as result of her being crowned. Neither of these issues were before the court on the motion for summary judgment.

judged strictly on beauty, poise and appearance, but did not include a talent competition. Miss Bryant had taken a modeling course and had performed some modeling before entering the Miss America Contest. She contended that all of these things helped her to win the Miss America title. Moreover, her life's ambition had been to win that title.[28]

After being crowned Miss Kansas and upon her entry in the Miss America Pageant, Debbie signed a contract with the Pageant (a non-profit corporation) which specified her future obligations and responsibilities should she win the title. The agreement called for her to make personal appearances at rates varying from $250 to $1,000 per day *plus* her expenses and those of a chaperone.[29] As a result of winning the title, she was awarded a $10,000 scholarship. During the year following her selection, she traveled extensively making personal appearances, generally on behalf of commercial products and, to a limited extent, on behalf of organizations. During that year Miss Bryant earned approximately $80,000. On her federal tax return she did not include the portion of the scholarship which had been paid to her, claiming it was excluded from income by section 117 of the Code, which relates to *Scholarship and Fellowship Grants.* She also "averaged" her income in accordance with the procedures set out in sections 1301-1305.

Miss Bryant had not provided more than 50 percent of her support during the four years prior to her winning the Miss America Pageant and thus could only be eligible to average if she could bring herself within one of the three exceptions.[30] She attempted to qualify under the Major Accomplishment Rule. The Commissioner determined a deficiency, claiming she was not eligible under that provision. Miss Bryant paid the tax and filed a claim for refund which was denied. She then filed for a refund in Federal District Court for the District of Kansas. The United States moved for partial summary judgment[31] on the income averaging and the scholarship issues. The merits of both issues were presented to the Court who took the matter under advisement.

The Government's position was based primarily on the language of the committee reports and other legislative history surrounding the 1964 amendments. It was acknowledged that the plaintiff had entered

[28] An interesting account of all the events leading to Miss Bryant's winning of the title, beginning with her early years and culminating with her crowning, may be found in Goodrich, *Discovery of Miss America,* SATURDAY EVENING POST, November 6, 1965 at 36.

[29] Miss Bryant was chaperoned by her mother throughout her year's reign as Miss America.

[30] See notes 15-17, *supra* and accompanying text.

[31] The Government's reason for moving for summary judgment was tactical as well as procedural. If the income averaging issue were to go to trial, there was the distinct possibility that the jury would in reality decide the issue. Because of the nuances of the question (and coincidentally the charm of the plaintiff which would, of course, be quite impressive on the witness stand), counsel for the Government felt the question could only be decided as a question of law by a judge.

and won other beauty contests, that she had attended modeling school (and done a limited amount of modeling), and that she had participated in dramatic events. In fact, the Government did not question that her subjective intention was to capture the title and that she had had this intention and had accomplished some degree of preparation through at least two of the four years directly preceding the year in which she won the title. The government contended, however, that her income was not directly attributable to work performed during two or more of the four base period years.

The Government hoped to convince the court that what Miss Bryant had done was to *prepare* for a contest, not to perform *work* which would culminate in the realization of income. Perhaps the strongest argument by the Government was that what was actually being paid[33] for was not Miss Bryant's preparation, but rather for her actual appearances and testimonials during the year following her selection. She actually performed the work for which she received compensation in the same year compensation was received. Thus, the Government argued, as a matter of law she was not eligible to take advantage of the income averaging provisions.

Plaintiff argued that the definition of "work" included any form of physical or mental exertion and thus included "working toward the goal of becoming Miss America."

The plaintiff went on to argue that although she was not being paid for *preparation,* neither is the novelist. What he *is* paid for is a book—for prints and reprints. In essence, then, the plaintiff argued that the legislative intent could not possibly have been to limit the scope of the exception to those who labored over some physical work product, while denying it to those whose work resulted in an intangible achieve-achievement—in this case, the *title* of Miss America.

> [T]his Title of Miss America . . . produced the income. Regardless of the girl who wins each year, it is the title and the demand for the titleholder which produces the income.[34]

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[32] H. REP. No. 749, 88th Cong., 1st Sess. 114 (1963) (emphasis added).

[33] It should be noted that the $10,000 "scholarship" awarded Miss Bryant was not in question on the averaging issue. This award had been omitted from her tax return on the basis that it was excludable gross income based on section 117 relating to scholarships and fellowship grants. See note 27, *supra.* Had the scholarship been included, there is little doubt that the amount could be averaged if the recipient meets the eligibility requirements. In Robertson v. United States, 343 U.S. 711 (1952), the taxpayer was successful in attempting to average a $25,000 prize won in a music contest. *See also* Rev. Rul. 68-457, 1968-2 CUM BULL. 341. *But cf.,* Rev. Rul. 69-110, 1969-1 CUM BULL. 203. Since the enactment of the 1969 Tax Reform Act which allows the averaging even of wagering income, the legislative policy would seem to clearly favor averaging of such income.

[34] Brief for Plaintiff in Defense of Defendant's Motion for Partial Summary Judgment at 3, Wilson v. United States, Civil No. KC-2968 (D. Kan., filed October 14, 1970).

The decision of the court was that Miss Bryant did not qualify for averaging under the Major Accomplishment Rule.[35] Judge Stanley recited the general rule that when a statute provides an exception to the general rules governing income taxation, the taxpayer claiming its benefits must bring himself clearly within its ambit.[36] He then went on to hold that

> . . . [T]he title . . . provides only the *opportunity* to earn income . . . She was being paid for these appearances, not for winning the title of Miss America, and it is beyond dispute that if she had not made these appearances she would not have received the income at issue. Although it may be true that the plaintiff received invaluable preparation for competition in the Miss America contest through her participation in the activities previously enumerated, and that she did these with the object of becoming Miss America, the work which actually produced the income was performed only during the period of reign, and not in the years prior to her selection as Miss America.[37]

Thus the first precedent on the Major Accomplishment Rule was established.

B. The Heidel Case

In addition to *Wilson v. United States,* there is but one other case presently pending on the interpretation of the Major Accomplishment Rule. In *James B. Heidel,*[39] petitioner attempted to average a bonus received in the computation year for signing with a professional football club. Under his first contention, he stated that he had in fact provided more than fifty percent of his support since he had received a full grant-in-aid for playing football at the University of Mississippi. It was also his position that in the alternative his case was encompassed by the Major Accomplishment Rule.

Here the Commissioner argued that what the pro football team was paying Heidel for was *not* the years he played at Ole Miss, but rather for future services expected of him as well as for his signature on a player's contract. To say that he had "worked" for two of the four base period years on becoming a pro football player would be naive. Although some of the legislative history would indicate that athletes

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[35] Wilson v. United States, 322 F. Supp. 830, 27 A.F.T.R. 2d 71-535 (D. Kan. 1971).

The court found for the taxpayer on the scholarship issue, i.e., there was a material issue as to the facts and that evidence would be necessary before it could be decided whether or not the question was one of fact or law.

[36] *Id.* at 71-537, 322 F.Supp. at 832. *See, e.g.* United States v. Robertson, 190 F.2d 680 (10th Cir. 1951), *aff'd* 343 U.S. 711 (1952).

[37] *Id.* at 71-536 (emphasis by the court).

[38] *Id.*

[39] U.S. Tax Court, Docket No. 5405-68.

were intended to be covered,[40] it is generally believed that the athletes intended to be aided by the statute were seasoned competitors, rather than newly-drafted players.

Although no opinion has yet been rendered, the court may decide the case without reading the issue concerning the Major Accomplishment Rule. Since Mr. Heidel had received a full grant-in-aid scholarship for his football efforts at Ole Miss, he argued that this constituted over half of his support during the previous four-year period, thus qualifying him for averaging without the necessity of his falling within one of the exceptions provided in Section 1303. In response, the Government position was that the scholarship constituted support furnished him by the University and not support that he furnished for himself. Since there appears to be no cases directly in point in this area as well as in the Major Accomplishment Areas, the Tax Court's decision in *Heidel* should throw some light on future trends in qualifying for income averaging.

C. The Problem of Timing and the Major Accomplishment Rule

Under the provisions of the pre-1964 amendment, income received by authors and inventors could be averaged over the 36-month period preceding the year of receipt. Early cases, however, interpreted this provision as allowing the income to be spread over the years in which the actual work was done, whether or not they directly preceeded the year in which the income was received. In *Williams v. United States,*[41] the court allowed money received in 1942 to be averaged over the years 1929, 1930, and 1931 since these were the years in which the inventor had actually labored over his discovery. Three years later in the only case concerning income averaging to come before the United State Supreme Court, *Robertson v. United States,*[42] a composer who had written a symphony some years before, entered and won a music contest and attempted to average the $25,000 prize over the period during which he actually composed the work. There the Court determined that the 36-month period over which the income may be averaged, is that period *directly preceding* the year in question.

The general rule under sections 1301-1305 of the 1954 Code is to allow spreading of income back over the four previous years. How-

[40] President Kennedy's message to Congress recommending tax reduction and reform indicated the policy behind the averaging provisions:

> My proposal will go beyond the narrowly confined and complex averaging provisions of present law and will permit their elimination from the I.R.C. It will provide one formula of general application to those with wide fluctuation of income. This means fairer tax treatment for authors, professional artists, actors, and athletes, as well as farmers, ranchers, fishermen, attorneys, architects and others. President Kennedy message, 109 CONG. REC. 919 Jan. 24, 1963.

See also H. REP. No. 749, 88th Cong., 1st Sess. 110 (1963).

[41] 84 F. Supp. 362 (Ct. Cl. 1949).

[42] 343 U.S. 711 (1952) *affirming* 190 F.2d. 680 (10th Cir. 1951).

ever, as discussed at length above, the Major Accomplishment Rule requires work during at least two of the four base-period years. Thus it would appear that *when* the taxpayer receives the fruits of his labor, would determine whether he may average under the Major Accomplishment exception.

For example, *A*, an inventor, worked on and patented an invention throughout the years 1963 and 1964. During 1965, 1966 and 1967 he diligently attempted to market the patent. In 1968, he finally began negotiations toward an agreement with a large manufacutring firm, and in 1969, he received $100,000 for the right to exploit his patent. Assuming the other prerequisites of the rule were met, it would appear that *A* could not avail himself of the advantages of section 1301 *et seq.* on his 1969 tax return, since "work" on the patent was not performed during two years of the four-year base period. Section 1302 (e) (2) provides that the base period means the four taxable years *immediately preceding* the computation year. Although not controlling because of changes made in the law in 1964, the authority of *Robertson* would seem at least analogous.

Thus, while the announced purpose of the Major Accomplishment provision is to provide relief in just such cases, no relief is available. A return to the holding in *Williams*, that is, to allow averaging over the years in which the work was done, would seem more equitable, but would further complicate an already intricately complex area.[40] Further, a determination of when work began, of what "work" is, how long it continued, and whether it was continuous would be extremely difficult when a long period of time had elapsed between the work performed and the receipt of proceeds.

There is a corollary to the requirement under the Major Accomplishment Rule that work be "performed by (the taxpayer) in *substantial* part during 2 or more of the base period years. . . ."[45] Thus there would be some question as to the eligibility of *A*, our inventor, if he had designed and built a protoype during 1964, and in 1965 and in 1966 had only changed a detail or two in the blueprints. In keeping with the policy throughout the Code, the burden of proving the "substantial" nature of the work falls upon the taxpayer. A few cases decided under similar provisions of the old law may provide some guidelines. Mere conception of an idea[46] or the taking of a few notes would not qualify as "substantial work."[46]

[43] The burden of proving that he has worked during at least two of the four base period years rests upon the taxpayer. *Cf.* Holbrook v. United States, 194 F. Supp. 252 (D. Ore. 1961).

[44] *See* note 5, *supra* and accompanying text to note 48 *infra*.

[45] CODE, § 1303 (c) (2) (B) (emphasis added).

[46] *Cf.* John K. Standley, 35 T.C. 59 (1960).

> 'Work' in the meaning of the statute [that is, when the work begins], must connote something more than the germinating of the idea and

> What is necessary is work; probably something such as making a model, working out formulas, writing the music, or rehearsing and acting in a movie or commercial, etc.[47]

III. Planning and Filing

In the previous discussion, it was indicated that certain other sections of the Code, when related to the income averaging provisions, pesent complications.[48] Perhaps the most common concerns whether deductions taken in previous years must be recomputed when income is spread back over those years when income averaging is elected. Several deductions are allowed by the Commissioner based upon tables in which one variable is adjusted gross income. An example are those tables allowing a deduction for state sales tax based upon family size and adjusted gross income. Thus, an individual who is a resident of Kentucky and is earning $14,000 per annum whose family consists of three persons, is entitled to a deduction of $268 for sales tax.[49] No proof is necessary to sustain this deduction. When this same individual earns $30,000 in the following year, and elects to spread income over the entire period, may this deduction be recomputed based on the "average" earnings. No such intention can be found in either the Code or its legislative history. The same is true of the standard deduction, deduction for medical and drug expenses and charitable contributions, each of which is limited with respect to the amount of adjusted gross income. Since the income averaging provisions do not affect adjusted gross income in past years, but merely provide a *Computation method,* no recomputations are necessary. Moreover, since income is higher in the computation year, the individual does in fact reap the benefits of a higher charitable limitation, an increased sales deduction, etc.[50]

Cash-accrual accounting. Under the earlier language of the income averaging statute, 80 percent of the receipts resulting from the sale of the author's novel, the inventor's patent, etc. had to be received in a single year. Thus, whether the individual could enjoy a tax saving depended upon the personal accounting system he employed. If he were on an accrual method, it is more likely that he could accrue at least 80 percent of the receipts in a single year. But, if he were on a cash basis, as are most individual taxpayers, he must receive or constructively receive 80 percent *in cash* or its equivalent during the computa-

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mental taking of passing data prior to the demonstrable decision to take affirmative action to perfect the idea. Beardsley v. United States, 140 F. Supp. 541, 543 (1956).

[47] M. Schlussel, *supra* note 9, at A-6.

[48] *See, e.g.* note 5, *supra.*

[49] 1970 Optional Sales Tax Tables.

[50] In United States v. Behle, 316 F.2d 134 (10th Cir. 1963), decided prior to the enactment of the 1964 amendment, the court held that deductions must be recomputed, since what occurred was the actual reallocation of income to earlier years. Since adjusted gross income is not recomputed under the new law, it would seem that the result in *Behle* may be distinguished.

tion year. If he does not, even though the sale of the copyright or patent has been completed, he cannot average.[51]

Although this requirement is no longer a part of the Code, the cash-accrual apparitions still abound. If one uses an accrual system of accounting, few problems arise with resptect to averaging. Once the income is "earned," it may be included in the amount to be averaged regardless of when the cash is received.

On the other hand, on a cash accounting system, employed by the great majority of individuals, the cash must be received before it must be included for income tax purposes.[52] The exception to this rule is the "doctrine of constructive receipt." Under this court-formulated doctrine, the cash method taxpayer must include income which, although not yet received, is payable on demand. For example, salaries not yet paid, but credited to corporation officers on the books of the corporation, usually fall within the ambit of the doctrine.[53] Thus there would seem to be no question but that income includible under constructive receipt could be "averaged" by a cash method taxpayer even though no cash had actually been received. For planning purposes, especially in the small business entity, it would be worthwhile to check for the possibility of averaging when fixing year-and office bonuses. If an additional bonus of a few hundred dolllars would make the officer eligible for averaging, the tax savings may be signifiicant, especially in higher tax brackets.

In brief, *anytime* income is substantialy increased in one year, whether one has control over the amount of the increase or not, it is advisable to consider the possibility of income averaging. In addition, because of the possibility of averaging in an already closed year, it is best to maintain all tax records for eight to ten years.

[51] *See* Whitman v. Commissioner, 182 F.2d 624 (7th Cir. 1950).
[52] Hyland v. Commissioner, 175 F.2d 422 Cir. (1949); Kyle v. Commissioner, 43F. 2D 291 (3d Cir. 1930), *cert. denied* 282 U.S. 897 (1931).
[53] *See, e.g.* Ross v. Commissioner, 169 F.2d 483 (1st Cir. 1948) and Ward v. Commissioner, 159 F.2d 502 (2d Cir. 1947).