University of Baltimore Law Review

Volume 15
Issue 1 *Fall 1985*

Article 4

1985

Commments: Continuing Vitality of the "Goods or Services" Test

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COMMENTS

CONTINUING VITALITY OF THE "GOODS OR SERVICES" TEST

The term "trade or business" is used frequently throughout the Internal Revenue Code, and the determination of whether a taxpayer's activities constitute a trade or business has a major impact on the applicable tax treatment. Unfortunately, no definition of trade or business is supplied in the Internal Revenue Code, the legislative history, or the Treasury Regulations. Consequently, the courts have been left this task and two different standards for determining trade or business status have emerged. In this comment, the author reviews the history of the term "trade or business," examines the decisional law, and analyzes the two current tests for determining whether a taxpayer is engaged in a trade or business.

I. INTRODUCTION

The determination of whether a taxpayer is "carrying on any trade or business" has a major impact upon the tax treatment of his income producing activities. For instance, the extent to which expenses[1] and bad debts[2] may be deducted, the ability to carryover/carryback net operating losses,[3] the availability of the business assets "write off,"[4] the use of the home office deduction,[5] the characterization of gains and losses from property transactions,[6] and the assessment of self-employment taxes[7] all turn upon this determination. Despite the importance of distinguishing trade or business activities from other kinds of activities entered into for profit, neither the Internal Revenue Code nor the Treasury Regulations supply a general definition of what constitutes a trade or business.[8]

To identify those profit motivated activities[9] which rise to the level

1. I.R.C. § 162(a) (1982).
2. *Id.* § 166(d)(2).
3. I.R.C. § 172(d)(4) (West Supp. 1985).
4. I.R.C. § 179(d)(1) (1982).
5. *Id.* § 280A(c).
6. *Id.* § 1221(2).
7. *Id.* § 1402(a).
8. *See infra* note 20 and accompanying text.
9. Section 183 of the Internal Revenue Code (Code) severely limits the deductions available to an activity not engaged in for profit. I.R.C. § 183 (1982). Therefore, the initial determination in a trade or business inquiry is whether the taxpayer engaged in the activity with the objective of earning a profit. Treasury Regulation section 1.183-2(b) lists several factors relevant to this determination, none of which is considered dispositive: the manner in which the taxpayer carries on the activity; the expertise of the taxpayer or his advisors; the time and effort expended by the taxpayer in carrying on the activity; the expectation that assets used in the activity may appreciate in value; the success of the taxpayer in carrying on other similar or dissimilar activities; the taxpayer's history of income or losses with respect to the activ-

of a trade or business, courts have traditionally required the taxpayer to pass two tests: the "goods or services" test and the "facts and circumstances" test.[10] To satisfy the "goods or services" test, the taxpayer must prove that he held himself out as engaged in the selling of goods or services.[11] Under the "facts and circumstances" test, courts analyze such factors as the extent, regularity, and continuity of the taxpayer's activities to determine whether the taxpayer is engaged in a trade or business.[12]

The continuing vitality of the two-test approach to defining a trade or business has been challenged in recent decisions rendered by the United States Tax Court[13] and the United States Court of Appeals for the Seventh Circuit.[14] In a sharp break with precedent, the Tax Court became the first court to reject the "goods or services" test.[15] The court rejected the test as being unduly restrictive and in conflict with Supreme Court precedent.[16] In addition to the reasons offered by the Tax Court, the Seventh Circuit found the "goods or services" test to be misfocused and of little value as an analytical tool.[17] The Tax Court and the Seventh Circuit have retained the "facts and circumstances" test as their sole criterion for determining trade or business status and thus have created the opportunity for more activities to be considered a trade or business.

This comment reviews the history of the term "trade or business" under past and present Internal Revenue Codes. The discussion surveys cases considering the "goods or services" test and analyzes the reasoning offered as support for, and against, its continued use. Finally, this comment concludes that the "goods or services" requirement should be retained as a criterion in determining trade or business status because that

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ity; the amount of occasional profits, if any, which are earned; the financial status of the taxpayer; and the elements of personal pleasure or recreation. Treas. Reg. § 1.183-2(b) (1972).

10. *See, e.g.*, Steffens v. Commissioner, 707 F.2d 478, 482-83 (11th Cir. 1983) (court held taxpayer passed "goods or services" test, then examined extent and regularity of taxpayer's purported business activities); Stanton v. Commissioner, 399 F.2d 326, 329 (5th Cir. 1968) (trade or business refers to more than mere profit motivated activity; it refers to substantial and repeated activity by which the taxpayer holds himself out as selling goods or services); McDowell v. Ribicoff, 292 F.2d 174, 178 (3d Cir.) (trade or business status requires a taxpayer to hold himself out as selling goods or services and to engage in extensive activity over a substantial period of time), *cert. denied*, 368 U.S. 919 (1961).
11. Deputy v. du Pont, 308 U.S. 488, 499 (1940) (Frankfurter, J., concurring).
12. *E.g.*, Snyder v. United States, 674 F.2d 1359, 1364 (10th Cir. 1982); Reese v. Commissioner, 615 F.2d 226, 230 (5th Cir. 1980); Meredith v. Commissioner, 49 T.C.M. (CCH) 318, 321 (1984).
13. *See, e.g.*, Groetzinger v. Commissioner, 82 T.C. 793, 797-803 (1984), *aff'd*, 771 F.2d 269 (7th Cir. 1985); Ditunno v. Commissioner, 80 T.C. 362, 369-71 (1983).
14. Groetzinger v. Commissioner, 771 F.2d 269 (7th Cir. 1985).
15. One court referred to the "goods or services" test as settled law prior to *Ditunno*. Gajewski v. Commissioner, 723 F.2d 1062, 1066 (2d Cir. 1983), *cert. denied*, 105 S. Ct. 88 (1984).
16. Ditunno v. Commissioner, 80 T.C. 362, 366-71 (1983).
17. *Groetzinger*, 771 F.2d at 277.

requirement is consistent with the maxims of statutory construction and offers the pragmatic benefit to both taxpayers and courts of providing a clear and rational basis upon which a trade or business may be distinguished from an activity merely engaged in for profit.

II. BACKGROUND

Provisions authorizing deductions for business expenses have been found in every tax act since 1913.[18] The present Code affords special treatment to items of income, expense, and loss attributable to the taxpayer's trade or business.[19] Despite numerous references to the term trade or business,[20] neither the Code nor the Treasury Regulations provide a general definition.[21] The paucity of legislative and administrative guidance has left to the courts the task of defining a trade or business. Unfortunately, courts have not reached any consensus. This lack of consensus has resulted in the present state of confusion concerning the essential characteristics of a trade or business.

Early decisions[22] relied upon the Supreme Court's definition of "business" rendered in *Flint v. Stone Tracy Co.*[23] In *Flint*,[24] there was an issue as to whether particular companies were "engaged in business," and thus subject to the Corporation Tax Law of 1909.[25] To define "business," the Court referred to the word's dictionary definition.[26] Justice Day, writing for the Court, noted that business "embraces everything

18. Act to Reduce Tariff Duties and to Provide Revenues, Pub. L. No. 16, § 2(B), 38 Stat. 114, 167 (1913). The term "business or trade" appeared in the Revenue Act of 1916. Revenue Act of 1916, Pub. L. No. 271, § 5(a), 39 Stat. 756, 759 (1916). The term "trade or business" first appeared in the Revenue Act of 1918, Pub. L. No. 254, § 214(a)(1), 40 Stat. 1057, 1066 (1918). For a discussion of the terms "trade" and "business" prior to this period, see Messamer, *What Constitutes a Trade or Business Under Federal Tax Laws*, 3 U. KAN. L. REV. 99, 99-108 (1954).
19. *See supra* notes 1-7 and accompanying text.
20. One commentator has noted that the term "trade or business" appears in over 170 instances in at least 60 different Code sections. Saunders, *"Trade or Business," Its Meaning Under the Internal Revenue Code*, 12 MAJOR TAX PLAN. 693, 693 (1960).
21. The Code does provide definitions of trade or business for some specific Code sections. *E.g.*, I.R.C. § 355(b)(2) (1982) (defines a trade or business in the context of distribution of stock and securities of a controlled corporation); *Id.* § 502(b) (with respect to tax exempt organizations, certain activities do not constitute a trade or business); *Id.* § 7701(a)(26) (defines trade or business to include "performance of the functions of a public office"). Treasury Regulation section 1.513-1(b) is the closest attempt by the Treasury Department to define a trade or business. It is stated that the term trade or business under section 513 has the same meaning as under section 162 and "generally includes any activity carried on for the production of income from the sale of goods or performance of services." Treas. Reg. § 1.513-1(b), T.D. 7392, 1976-1 C.B. 162, 168 (1975).
22. *See, e.g.*, Rogers v. United States, 41 F.2d 865, 868 (Ct. Cl. 1930); Deering v. Blair, 23 F.2d 975, 976 (D.C. Cir. 1928); Wilson v. Eisner, 282 F. 38, 41 (2d Cir. 1922).
23. 220 U.S. 107 (1911).
24. *Id.* at 171.
25. Corporation Tax Law of 1909, Pub. L. No. 61-5, § 38, 36 Stat. 11, 112 (1909).
26. *Flint*, 220 U.S. at 171.

about which a person can be employed"[27] and is " '[t]hat which occupies the time, attention and labor of men for the purpose of a livelihood or profit'."[28] Although often cited in succeeding years,[29] the *Flint* definition is not particularly helpful in distinguishing business from nonbusiness activity because it is so broad that it encompasses nearly all taxpayer activity.[30]

In 1940, the Supreme Court addressed the trade or business issue in *Deputy v. du Pont*.[31] There, the taxpayer acted as a conduit by which E.I. du Pont de Nemours & Company funneled 9,000 shares of its common stock to nine key executives.[32] In furtherance of the transfer plan, the taxpayer borrowed 9,000 shares of du Pont Company stock from another holder and then sold the shares to the key executives, who paid with funds furnished by the company.[33] The loan agreement required the taxpayer to reimburse the lender for both the dividends declared while the stock was on loan and the tax consequences associated with the loan transaction.[34] The taxpayer deducted as "ordinary and necessary" business expenses nearly $648,000 in costs incurred in carrying out the plan.[35]

A majority of the Court accepted, for argument's sake, the taxpayer's claim that he was engaged in the business of "conserving and enhancing his estate,"[36] and held that the expenses were not deductible because they were not ordinary and necessary expenses of the taxpayer's purported business.[37] Disagreeing with the majority's rationale, Justice Frankfurter concurred in the result only. He was unwilling to accept,

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27. *Id.* (quoting BLACK'S LAW DICTIONARY 158).
28. *Id.* (quoting BOUVIER'S LAW DICTIONARY 273).
29. *See, e.g.*, Cecil v. Commissioner, 100 F.2d 896, 898 (4th Cir. 1939); Hughes v. Commissioner, 38 F.2d 755, 758 (10th Cir. 1930); Deering v. Blair, 23 F.2d 975, 976 (D.C. Cir. 1928).
30. *Hughes*, 38 F.2d at 758-59.
31. 308 U.S. 488 (1940). In the years between *Flint* and *du Pont*, the Court only addressed the meaning of "business" in the context of corporate activity. *See* Edwards v. Chile Copper Co., 270 U.S. 452, 455-56 (1926); Von Baumback v. Sargent Land Co., 242 U.S. 503, 516 (1917).
32. *du Pont*, 308 U.S. at 490.
33. *Id.* at 490-92. For business reasons, the du Pont Company wanted to give shares of common stock to the nine members of its newly formed Executive Committee. The company, however, held an insufficient number of shares in its treasury to complete the transaction. Traditional methods of transferring stock were rejected for economic reasons; the issuance of new shares would implicate the preemptive rights of existing shareholders and the purchase of 9,000 shares would substantially increase the market price per share. The taxpayer, therefore, borrowed 9,000 shares and sold 1,000 shares to each of the nine key executives. *Id.* at 490.
34. *Id.* at 491-92. The taxpayer entered into two such agreements. The controversy before the Court involved the second agreement, which was designed to provide shares to repay the lender under the first agreement. *Id.*
35. *Id.* at 492. This sum represents $567,648 in du Pont Company dividends received by the taxpayer during the loan period and $80,064 in federal income tax imposed on the lender due to the foregoing payment. *Id.*
36. *Id.* at 493-94.
37. *Id.* at 496-97. The Court noted that the costs of the transaction arose from the

even for the sake of argument, that the taxpayer was engaged in any trade or business and wrote:

> [I]t is not enough to incur expenses in the active concern over one's own financial interest. " . . . carrying on any trade or business," within the contemplation of § 23(a) [now section 162], involves *holding one's self out to others as engaged in the selling of goods or services.* This the taxpayer did not do.[38]

One year later, the Supreme Court squarely addressed the trade or business issue avoided by the majority opinion in *du Pont.* In *Higgins v. Commissioner,*[39] the taxpayer held extensive investments in real estate and securities which he actively managed from his Paris office.[40] The taxpayer's New York office handled his accounting matters and executed his investment decisions. The Commissioner disallowed the taxpayer's deductions for the incidental expenses associated with the New York office and contended that personal investment activities can never constitute carrying on a trade or business.[41]

Noting that no definition of trade or business had ever been formulated by Congress or the Secretary of the Treasury,[42] the *Higgins* Court acknowledged the definition of "business" stated by the Court in *Flint.*[43] The *Higgins* Court, however, found that the context of the *Flint* decision — the Corporation Tax Law of 1909 — made that definition inappropriate to cases involving an individual's tax liability under the Revenue Act of 1939.[44] The Court concluded that an examination of the facts in each case is required to determine whether a taxpayer's activities constitute a business.[45] Applying this "facts and circumstances" test the Court found as a matter of law that the evidence was insufficient to justify a reversal of the appellate court's decision.[46] The Court held that no matter how extensive the work required to manage a personal estate, the mere collection of interest and dividends and the concomitant record keeping do not qualify as a trade or business.[47]

The Court reiterated its "facts and circumstances" test in two cases decided later in 1941, the same year as *Higgins.*[48] In neither case did the

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business of the du Pont Company and not any business that the taxpayer may have claimed to have engaged in. *Id.* at 497.

38. *Id.* at 499 (Frankfurter, J., concurring) (emphasis added).
39. 312 U.S. 212 (1941).
40. *Id.*
41. *Id.* at 214-15.
42. *Id.* at 215.
43. *See supra* notes 23, 27, 28 and accompanying text.
44. *Higgins,* 312 U.S. at 217 ("A definition given for such an issue is not controlling in this dissimilar inquiry.").
45. *Id.*
46. *Id.* at 218.
47. *Id.*
48. United States v. Pyne, 313 U.S. 127 (1941); City Bank Farmers Trust Co. v. Helvering, 313 U.S. 121 (1941).

Court refer to Justice Frankfurter's "goods or services" test. Indeed, the "goods or services" test did not resurface in a Supreme Court opinion until 1974 in *Snow v. Commissioner*.[49] In *Snow*, the taxpayer claimed a deduction for his distributive share of losses incurred by a partnership formed to develop and market a special purpose incinerator.[50] In the year of its formation, the partnership attempted no sales activity. Nevertheless, the partnership incurred substantial expenses that it claimed were deductible under section 174, which allows a taxpayer to treat as a current expense those research and development costs incurred in connection with the taxpayer's trade or business.[51] In the absence of any attempt at sales activity, the Commissioner denied the deduction on the basis that the partnership was not engaged in a trade or business.[52] The Supreme Court disagreed.[53]

The Court stated that section 174 was enacted to "dilute" Justice Frankfurter's concept of a trade or business expressed in his concurring opinion in *du Pont* and thus encourage research and development expenditures.[54] The Court therefore found the partnership's lack of sales activity to be irrelevant and held that Snow's share of the partnership's research and development expenses were deductible.[55]

In contrast to the Supreme Court's neglect of the "goods or services" test, three circuits of the United States Courts of Appeals had explicitly adopted the test by 1943.[56] Over the succeeding years more courts chose to adhere to Justice Frankfurter's test,[57] including the United States Tax Court.[58]

In *Barrett v. Commissioner*,[59] the Internal Revenue Service levied self-employment tax on earnings generated by the taxpayer under a consulting agreement.[60] The taxpayer received sums pursuant to a contract that required him to be available to render consulting services to the

49. 416 U.S. 500 (1974).
50. *Id.* at 501-02.
51. *Id.*
52. *Id.* at 501.
53. *Id.* at 504.
54. *Id.* at 502-03; *see infra* text accompanying note 147.
55. *Id.* at 504.
56. Daily Journal Co. v. Commissioner, 135 F.2d 687, 688 (9th Cir. 1943); Helvering v. Highland, 124 F.2d 556, 561 (4th Cir. 1942); Helvering v. Wilmington Trust Co., 124 F.2d 156, 159 (3d Cir. 1941), *rev'd on other grounds*, 316 U.S. 164 (1942).
57. *E.g.*, Grosswald v. Schweiker, 653 F.2d 58, 58 (2d Cir. 1981); Stanton v. Commissioner, 399 F.2d 326, 329 (5th Cir. 1968); McDowell v. Ribicoff, 292 F.2d 174, 178 (3d Cir.), *cert. denied*, 368 U.S. 919 (1961).
58. *E.g.*, Gestrich v. Commissioner, 74 T.C. 525, 529 (1980); Gentile v. Commissioner, 65 T.C. 1, 5-6 (1975); Barrett v. Commissioner, 58 T.C. 284, 290 (1972). *Cf.* Fischer v. Commissioner, 50 T.C. 164, 171 (1968) (deductions related to airplane denied when taxpayer testified that he did not hold himself out as being in the business of chartering aircraft).
59. 58 T.C. 284 (1972).
60. *Id.* at 284.

company after his retirement.[61] The Tax Court noted that under the terms of the contract, the taxpayer was precluded from offering his consulting services to any potential competitor of his former employer.[62] Under a strict reading of Justice Frankfurter's language, the Tax Court held that the taxpayer was not engaged in a trade or business because he could not hold himself out to "others" as engaged in the selling of "goods or services."[63] Therefore, the taxpayer was not subject to self-employment tax.[64]

Three years after *Barrett*, the Tax Court again considered the trade or business issue in the context of self-employment tax. In *Gentile v. Commissioner*,[65] the Tax Court was concerned with a taxpayer whose total reported earnings were attributable to his gambling activities.[66] As a gambler, Gentile visited race tracks one to four times a week and spent a "considerable portion" of his time studying racing forms.[67] At no time during the period in question did he accept wagers on behalf of others, operate a casino, or sell advice on gambling; he gambled solely for himself.[68]

The Commissioner, seeking to prove that the taxpayer was engaged in a trade or business,[69] profferred the following definition of that term: "an individual's everyday efforts to earn a living, characterized by continuity, regularity, and profit motive."[70] The Tax Court conceded that the definition offered by the Commissioner contained elements of "carrying on any trade or business," but held these elements in themselves were insufficient.[71] The Tax Court stated that the Supreme Court had, in *Snow*, reaffirmed the vitality of the "goods or services" test as the dominant characteristic of a trade or business.[72] The Commissioner's failure to establish that Gentile held himself out to others as offering "goods or services" proved to be fatal to the Commissioner's case.[73]

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61. *Id.* at 285-87.
62. *Id.* at 290.
63. *Id.*
64. Code sections 1401 and 1402 subject trade or business income of the taxpayer to self-employment tax. For this purpose, "trade or business" has the same meaning as under section 162 which provides for the deduction of ordinary and necessary expenses incurred in carrying on any trade or business. I.R.C. § 1402(c) (West Supp. 1985).
65. 65 T.C. 1 (1975).
66. *Id.* at 2. The taxpayer reported winnings from dice, cards, private gambling on sporting events, and racetrack wagers. *Id.*
67. *Id.*
68. *Id.*
69. The Commissioner's objective was to assess self-employment tax on the taxpayer's winnings. *See supra* note 64.
70. *Gentile*, 65 T.C. at 3.
71. *Id.* at 4. "A trade or business involves something more than the production of income for Federal income tax purposes. Compare sec. 162 with sec. 212." *Id.* at 4-5.
72. *Id.* at 5.
73. *Id.* at 6. The *Gentile* court noted: "Upon stepping up to the betting window, petitioner was not holding himself out as offering any goods or services to anyone." *Id.*

The Tax Court continued to employ the "goods or services" test until its 1983 ruling in *Ditunno v. Commissioner*.[74] *Ditunno*, like *Gentile*, involved a full time gambler who did not hold himself out as offering any goods or gambling services.[75] From 1977 through 1979, the taxpayer reported approximately $60,000 in winnings per year and deducted nearly the same amount in gambling losses.[76] Based on *Gentile*, the Commissioner contended that the taxpayer's personal gambling activities did not constitute a trade or business and, therefore, the losses generated by the taxpayer were not properly deductible to arrive at adjusted gross income under section 62(1).[77] The Commissioner characterized the losses as itemized deductions subject to the minimum tax on tax preference items.[78]

The Tax Court took this opportunity to reconsider the "goods or services" test and declared the test "overly restrictive."[79] According to the *Ditunno* court, the *Gentile* court's reliance on *Snow* was misplaced.[80] *Ditunno* viewed *Snow*'s reference to Justice Frankfurter's definition of trade or business as neither an affirmance nor an adoption of that standard.[81] According to the Tax Court, the reference was merely an indication of the Court's desire to select a restrictive definition of trade or business for contrast with the more liberal definition that it planned to provide for the term as used in section 174.[82] The *Ditunno* court, relying on *Higgins*, held that the proper test of whether an individual is conducting a trade or business "requires an examination of all the facts and circumstances involved in *each* case."[83]

In its analysis of the "facts and circumstances," the Tax Court contrasted Ditunno's activities with those activities the Supreme Court found not to constitute a trade or business.[84] In distinguishing *Higgins*, the Tax Court emphasized that Ditunno was not merely investing in a relatively permanent and stable portfolio;[85] he was not assured a return

74. 80 T.C. 362 (1983).
75. *Id.* at 363. The court noted that the taxpayer visited the racetrack six days a week, year round. *Id.*
76. *Id.* at 364.
77. *Id.* at 364-65.
78. *Id.* Presently, wagering losses are not subject to minimum tax. I.R.C. § 55(e)(1)(A) (1982).
79. *Ditunno*, 80 T.C. at 366.
80. *Id.* at 370.
81. *Id.*
82. *Id.* The dissent considered the majority's claim to be unfounded. Chief Judge Tannenwald stated: "But the fact of the matter is that the Court found it necessary to select a standard for comparing section 162 with section 174 and, in so doing, selected Justice Frankfurter's holding-out test. If this does not constitute approval, I do not know what does." *Id.* at 374 (Tannenwald, C.J., dissenting) (footnote omitted).
83. *Id.* at 366-67 (emphasis in original).
84. *Id.* at 371-72.
85. *Cf.* City Farmers Trust Co. v. Helvering, 313 U.S. 121, 125 n.3 (1941) (taxpayer-

when he placed a bet.[86] Furthermore, the court noted that Ditunno spent most of his time either gambling or studying racing forms, as opposed to merely collecting dividends and interest.[87] Upon these facts, the Tax Court held that full-time gambling qualified as a trade or business.[88]

Four months after *Ditunno*, the Eleventh Circuit, in *Steffens v. Commissioner*,[89] implicitly adopted the "goods or services" test.[90] There, the Commissioner assessed self-employment tax against the taxpayer for his work as a corporate director of, and as a consultant to, his former employer.[91] The Tax Court below, in a decision rendered prior to *Ditunno*, reasoned that the taxpayer was not subject to self-employment tax with respect to his consulting activities because his consulting agreement contained an exclusivity clause which precluded him from seeking other consulting engagements.[92] Based upon its ruling in *Barrett*,[93] the Tax Court concluded that the taxpayer was not engaged in a trade or business because he did not hold himself out to "others" as selling "goods or services."[94]

The Eleventh Circuit disagreed with the Tax Court and rejected as senseless the practice of making a distinction between a taxpayer who holds himself out to one employer and a taxpayer who holds himself out to many employers.[95] The court concluded that the proper focus of the trade or business inquiry is the activity generating the clients or customers, not the number of clients generated.[96]

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trustee primarily collected interest); Higgins v. Commissioner, 312 U.S. 212, 218 (1941) (taxpayer merely collected interest and dividends from his securities).

86. *Ditunno*, 80 T.C. at 372.
87. *Id.* at 371-72; *see supra* note 85.
88. *Ditunno*, 80 T.C. at 372.
89. 707 F.2d 478 (11th Cir. 1983).
90. *Id.* at 482. It should be noted that it is unclear whether the Eleventh Circuit continues to follow the "goods or services" test. The court affirmed by unpublished order a Tax Court decision employing the "facts and circumstances" test. Nipper v. Commissioner, 746 F.2d 813 (11th Cir. 1984), *aff'g*, 47 T.C.M. (CCH) 136 (1983). This holding appears irreconcilable with the "goods or services" test because the case involved a full time gambler. *Nipper*, 47 T.C.M. (CCH) at 136.
91. *Steffens*, 707 F.2d at 480.
92. Steffens v. Commissioner, 42 T.C.M. (CCH) 1585, 1589 (1981), *rev'd*, 707 F.2d 478 (11th Cir. 1983). The Tax Court also held that the taxpayer's activity as a director did not constitute a trade or business because the taxpayer served only one board and never presented himself as generally available to serve on other boards. *Id.* at 1588.
93. Barrett v. Commissioner, 58 T.C. 284 (1972); *see supra* notes 59-64 and accompanying text.
94. *Steffens*, 42 T.C.M. (CCH) at 1589.
95. *Steffens*, 707 F.2d at 482. *Compare* Barnett v. Commissioner, 69 T.C. 609 (1978) (taxpayer held to be in trade or business when consulting contract contained an exclusive service clause that permitted taxpayer to render services outside employer's city, even though the taxpayer only rendered services to that one company) *with* Barrett v. Commissioner, 58 T.C. 284 (1972) (taxpayer held not to be in trade or business when consulting contract permitted taxpayer no outside consulting work).
96. *Steffens*, 707 F.2d at 482; *cf.* Grosswald v. Schweiker, 653 F.2d 58, 61 (2d Cir. 1981)

Holding that the taxpayer was in the trade or business of consulting, the court next considered whether the taxpayer's service on a corporation's board of directors constituted a trade or business. The court first noted that serving on a single board satisfied the "goods or services" test.[97] The court then employed a "facts and circumstances" analysis and determined that based upon the nature of the duties of the taxpayer as a corporate director and the continuity and regularity of the taxpayer's activities, the taxpayer was engaged in a trade or business.[98]

The first appellate case to consider expressly the Tax Court's rejection of the "goods or services" test was *Gajewski v. Commissioner*.[99] In *Gajewski*, as in *Ditunno*, the taxpayer was a full time gambler who did not hold himself out as selling "goods or services."[100] Unlike *Ditunno*, however, the Second Circuit held that a full time gambler is not in the trade or business of gambling because he does not offer "goods or services" to the public.[101] The *Gajewski* court maintained its allegiance to the Frankfurter standard for several reasons. *Gajewski*, like earlier Tax Court decisions,[102] claimed that the Supreme Court's *Snow* decision indicated implicit approval of the "goods or services" test.[103] The Second Circuit noted as additional support for its holding that a majority of the circuits had expressed approval of the "goods or services" test either explicitly or implicitly.[104] Moreover, the *Gajewski* court labeled the Tax

("[E]ven though he [Justice Frankfurter] referred to 'others' in his *Deputy* opinion . . . it is clear that he was distinguishing between managing one's own investments and rendering services or selling goods to one or more others.").

97. *Steffens*, 707 F.2d at 482.

98. *Id.* at 483. "These duties include being entrusted with the management of the affairs of the corporation while exercising diligence in managing and preserving the corporation's assets." *Id.* The court also noted that the taxpayer had been a director of the company since 1949. *Id.*

The Tax Court, five months after *Steffens*, laid to rest the distinction between a taxpayer who holds himself out to one employer and a taxpayer who holds himself out to many employers. In *Hornaday v. Commissioner*, the petitioner signed a written consulting agreement with his former employer. 81 T.C. 830, 831 (1983). Although the petitioner remained available to render consulting services, the company did not request his services during the years in question. *Id.* at 833. The petitioner, relying on *Barrett* and *Barnett*, maintained that he was not engaged in a trade or business because he did not offer his services to more than one company. *Id.* at 835. The Tax Court repeated the holding in *Ditunno* that failure to offer "goods or services" to others is insufficient in itself to preclude a finding that the taxpayer is engaged in a trade or business and stated that *Barrett* and *Barnett* would, therefore, no longer be followed. *Id.* at 837. The court, upon reviewing the "facts and circumstances" presented, noted that the taxpayer "stood ready and able to render services if requested during those years" and held that the taxpayer was engaged in a trade or business. *Id.* at 839-40.

99. 723 F.2d 1062 (2d Cir. 1983), *cert. denied*, 105 S. Ct. 88 (1984).

100. *Id.* at 1063.

101. *Id.* at 1066-67.

102. *E.g.*, Gestrich v. Commissioner, 74 T.C. 525 (1980); Gentile v. Commissioner, 65 T.C. 1 (1975).

103. *Gajewski*, 723 F.2d at 1065.

104. *Id.* at 1066 (citing Weiberg v. Commissioner, 639 F.2d 434, 437 (8th Cir. 1981); Stanton v. Commissioner, 399 F.2d 326, 329 (5th Cir. 1968); McDowell v. Ribicoff,

Court's new approach as a "nontest" because it does not state which "facts and circumstances" indicate the existence of a trade or business.[105] Against this background, and with the belief that the "goods or services" test is fairer to taxpayers than the amorphous "facts and circumstances" approach, the Second Circuit concluded that a trade or business is "a commercial activity in which a person seeks to earn a livelihood by furnishing goods or services to others for a price [and] [h]olding one's self out for such purposes is the universal characteristic of a businessman or trader in a free enterprise society."[106]

In light of *Gajewski*, the Tax Court reconsidered its rejection of the "goods or services" test. In *Groetzinger v. Commissioner*,[107] the taxpayer was also a full time gambler who spent virtually all his time making wagers.[108] Presented with the trade or business issue, the Tax Court reaffirmed its use of a "facts and circumstances" analysis and held that the gambling activities of the taxpayer constituted a trade or business, thus making his losses deductible to arrive at adjusted gross income.[109] To support its position, the court supplemented the reasoning found in its *Ditunno* decision with two new arguments. First, the Tax Court questioned whether those circuits claiming to support the "goods or services" test truly do.[110] Citing several circuit court decisions that indicate a wavering adherence to the test, the *Groetzinger* court stated its uncertainty as to how those and other circuits would rule in the future.[111] Second, the court recognized that a body of case law has developed which holds that a taxpayer trading in securities for the purpose of capitalizing on short-term market swings is engaged in a trade or business.[112] The court found the holdings in these "trader" cases irreconcilable with the "goods

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292 F.2d 174, 178 (3d Cir.), *cert. denied*, 368 U.S. 919 (1961); Daily Journal Co. v. Commissioner, 135 F.2d 687, 688 (9th Cir. 1943); Helvering v. Highland, 124 F.2d 556, 561 (4th Cir. 1942); Helvering v. Wilmington Trust Co., 124 F.2d 156, 158-59 (3d Cir. 1941), *rev'd on other grounds*, 316 U.S. 164 (1942)).

105. *Gajewski*, 723 F.2d at 1066.

106. *Id.*

107. 82 T.C. 793 (1984), *aff'd*, 771 F.2d 269 (7th Cir. 1985).

108. *Id.* at 794 (taxpayer spent 60-80 hours per week on gambling related activities).

109. *Id.* at 803 n.26.

110. *Id.* at 799.

111. *Id.* *Compare* McDowell v. Ribicoff, 292 F.2d 174 (3d Cir.) (goods or services), *cert. denied*, 368 U.S. 919 (1961) *and* Helvering v. Highland, 124 F.2d 556 (4th Cir. 1941) (goods or services) *and* Snow v. Commissioner, 482 F.2d 1029 (6th Cir. 1973) (goods or services), *rev'd*, 416 U.S. 500 (1974) *and* Daily Journal Co. v. Commissioner, 135 F.2d 687 (9th Cir. 1943) (goods or services) *with* Commissioner v. Moffat, 373 F.2d 844 (3d Cir. 1967) (facts and circumstances) *and* Commissioner v. Nubar, 185 F.2d 584 (4th Cir. 1950) (facts and circumstances) *and* Walsh v. Commissioner, 313 F.2d 389 (4th Cir. 1963) (facts and circumstances) *and* Main Line Distributors, Inc. v. Commissioner, 321 F.2d 562 (6th Cir. 1963) (facts and circumstances) *and* Purvis v. Commissioner, 530 F.2d 1332 (9th Cir. 1976) (facts and circumstances) *and* United States v. Keeler, 308 F.2d 424 (9th Cir. 1962) (facts and circumstances) *and* Wineberg v. Commissioner, 326 F.2d 157 (9th Cir. 1963) (facts and circumstances).

112. *Groetzinger*, 82 T.C. at 800; *see infra* notes 167-77 and accompanying text.

or services" test.[113] The court found no meaningful distinction between a gambler and a person speculating on short-term changes in the stock market.[114]

Six months after the *Groetzinger* decision, the Sixth Circuit addressed the trade or business issue. In *Estate of Cull v. Commissioner*,[115] the taxpayer was a professional gambler similar to the taxpayers in *Ditunno* and *Groetzinger*.[116] Holding that gambling for oneself does not constitute a trade or business,[117] the court did not address the criticisms raised in *Groetzinger*. Instead, the Sixth Circuit focused on harmonizing *Higgins* with the "goods or services" test.[118] The court agreed with the Second Circuit[119] that the *Higgins* "facts and circumstances" test is a non-test because it fails to state which "facts and circumstances" are crucial to the determination that a taxpayer is engaged in a trade or business.[120] The court concluded that *Higgins* and the "goods or services" test compliment one another; the former stands for the general proposition that determining whether one is involved in a trade or business is a question of fact, while the latter sets forth the minimum facts necessary to establish taxpayer involvement in a trade or business.[121]

The Seventh Circuit, in *Groetzinger v. Commissioner*,[122] is the most recent circuit to express a view on the trade or business controversy. In affirming the Tax Court's holding below,[123] the Seventh Circuit rejected the "goods or services" test in favor of a "facts and circumstances" approach to identifying trade or business activity.[124] The court claimed that the "goods or services" test is of "dubious value as an analytical tool."[125] To support its opinion, the court made two observations: first, only one case[126] outside the gambler context has ever expressly applied the "goods or services" test to conclude that the taxpayer was not engaged in a trade or business;[127] and second, in most trade or business

113. *Groetzinger*, 82 T.C. at 802.
114. *Id.* at 801-02. The Tax Court stated: "The essential nature of these activities is identical; to state it simply, one gambles on stocks, the other on dogs. Both bet, or trade, solely for their own account and do not enter into any transactions with specific individuals; rather, their profits or losses depend solely upon their ability to predict outcomes in an impersonal and (presumably) nonmanipulatable market or pari-mutuel event." *Id.*
115. 746 F.2d 1148 (6th Cir. 1984), *cert. denied*, 105 S. Ct. 2701 (1985).
116. *Id.* at 1149. The taxpayer placed wagers almost daily and gambled only with his own money. *Id.*
117. *Id.* at 1151-52.
118. *Id.*
119. Gajewski v. Commissioner, 723 F.2d 1062, 1066 (2d Cir. 1983), *cert. denied*, 105 S. Ct. 88 (1984).
120. *Estate of Cull*, 746 F.2d at 1151.
121. *Id.*
122. 771 F.2d 269 (11th Cir. 1985).
123. *See supra* notes 107-14 and accompanying text.
124. *Groetzinger*, 771 F.2d at 277.
125. *Id.*
126. Snow v. Commissioner, 482 F.2d 1029 (6th Cir. 1973), *rev'd*, 416 U.S. 500 (1974).
127. *Groetzinger*, 771 F.2d at 272.

cases the taxpayer's status as one providing goods or services is not at issue.[128] Moreover, the court stated that a literal reading of the test requires the taxpayer to hold himself out to "others" and thus would exclude from trade or business status employees working for a single employer, despite settled case law and a Code provision that provide for such status for employees.[129]

The Seventh Circuit also declared that the "goods or services" test is misfocused.[130] The court conducted an obfuscated analysis of Code section 62[131] and concluded that a trade or business should be broadly defined as "any person's occupation or livelihood."[132] Because the "goods or services" test does not focus on identifying occupations or livelihoods, the court rejected it in favor of the "facts and circumstances" test.[133]

III. ANALYSIS

The major cause of the controversy concerning the propriety of the "goods or services" test is the lack of a clear holding on the matter by the Supreme Court. The present state of case law leaves those courts following the "goods or services" test as adamant in their claims of Supreme Court approval as the Tax Court is in rejecting the test.[134] These conflicting positions are primarily founded upon differing interpretations of *Higgins v. Commissioner*[135] and *Snow v. Commissioner*.[136]

The Supreme Court in *Higgins* held that the determination of whether a taxpayer is "carrying on any trade or business" requires an examination of the facts in each case.[137] Had this decision been rendered

128. *Id.* at 276 n.9.
129. *Id.* at 273, 276. *See supra* notes 89-98 and accompanying text.
130. 771 F.2d at 276-77.
131. Code section 62(1) allows non-employee trade or business expenses to be deducted in arriving at adjusted gross income. I.R.C. § 62(1) (1982). Code section 62(2) provides the same treatment for certain trade or business expenses incurred by employees. *Id.* § 62(2).
132. *Groetzinger*, 771 F.2d at 273.
133. *Id.* at 277.
134. *Compare* Estate of Cull v. Commissioner, 746 F.2d 1148, 1152 (6th Cir. 1984) ("The continued vitality and importance of [the 'goods or services' test] has been acknowledged in a number of circumstances. *See, e.g., Snow v. Commissioner* . . . ."), *cert. denied*, 105 S. Ct. 2701 (1985) *and* Gajewski v. Commissioner, 723 F.2d 1062, 1065 (2d Cir. 1983) ("Although the Court has never expressly adopted the 'goods and services' requirement, it has been implicitly approved. For example, in *Snow v. Commissioner* . . . ."), *cert. denied*, 105 S. Ct. 88 (1984) *with* Groetzinger v. Commissioner, 82 T.C. 793, 798 (1984) ("In announcing a review of all the facts approach, the [Higgins] Court implicitly rejected various other attempts, including that of Justice Frankfurter, to formulate a precise definition of [trade or business]."), *aff'd*, 771 F.2d 269 (7th Cir. 1985) *and* Ditunno v. Commissioner, 80 T.C. 362, 369 (1983) ("Thus in *Higgins*, the Supreme Court set forth a test of fact and circumstance . . . and also established that no particular fact or set of facts was sufficient, by itself, to satisfy that test.").
135. 312 U.S. 212 (1941).
136. 416 U.S. 500 (1974).
137. *Higgins*, 312 U.S. at 217.

before Justice Frankfurter announced his "goods or services" test in *Deputy v. du Pont*,[138] perhaps there would be less confusion over the impact of *Higgins*. *Higgins*, however, was rendered one year after *du Pont*, yet it did not allude to the "goods or services" test despite the lower court's reliance in part on Justice Frankfurter's language.[139] From this omission, a cogent argument is made that *Higgins* was an implicit rejection of the "goods or services" test.[140]

Such an argument fails to consider two important aspects of the decision. First, Justice Reed authored the Court's *Higgins* opinion in which Justice Frankfurer joined. [141] It is unlikely that Justice Reed, who earlier joined in Justice Frankfurter's *du Pont* concurrence,[142] and Justice Frankfurter himself, would so soon abandon the "goods or services" test without comment. Second, the facts viewed as dispositive by the Court in *Higgins* are similar to those which would be dispositive under a "goods or services" approach. The Court held that the taxpayer's activities, which consisted of keeping records and collecting interest and dividends through managerial attention, were insufficient as a matter of law to constitute a trade or business.[143] Such activities also would fall far short of providing any "goods or services," and thus fail a "goods or services" analysis as a matter of law.[144] In light of the authorship of the *Higgins* opinion, the participation of Justice Frankfurter in that opinion, and the similarity of the results of that opinion to the results which would have been achieved under an explicit "goods or services" analysis, it is tenuous to claim that *Higgins* stands for a rejection of the "goods or services" test.[145]

Although *Higgins* has been misinterpreted as a rejection of the "goods or services" test, *Snow*[146] has been misinterpreted as approval of the test. In *Snow*, Justice Douglas, writing for the Court, stated that the

138. 308 U.S. 488, 499 (1940) (Frankfurter, J., concurring).
139. Higgins v. Commissioner, 111 F.2d 795, 797 (2d Cir. 1940), *aff'd*, 312 U.S. 212 (1941).
140. Groetzinger v. Commissioner, 82 T.C. 793, 798 (1984), *aff'd*, 771 F.2d 269 (7th Cir. 1985); Ditunno v. Commissioner, 80 T.C. 362, 369 (1983).
141. *Higgins*, 312 U.S. at 213.
142. 308 U.S. 488, 499 (1940) (Frankfurter, J., concurring).
143. *Higgins*, 312 U.S. at 218.
144. By giving managerial attention to his personal investments, Higgins did not hold himself out as selling goods or rendering services. One commentator suggests that all security investor cases, starting with *Higgins*, could be reconciled by focusing on the failure of the investor to offer any services to the public. Bolling & Carper, *The Evolving Definition of "Trade or Business":* Ditunno *and Beyond*, 63 TAXES 73, 78 (1985).
145. *Cf.* Gajewski v. Commissioner, 723 F.2d 1062, 1067 (2d Cir. 1983) ("In referring to the necessity for 'examination of the facts in each case' the *Higgins* Court did not establish a new standard. Nor did it imply that a person not offering goods or services . . . could be carrying on a trade or business.") (footnote omitted), *cert. denied*, 105 S. Ct. 88 (1984); Helvering v. Wilmington Trust Co., 124 F.2d 156, 159 (3d Cir. 1941) (*Higgins* does "not necessarily detract from the weight of Mr. Justice Frankfurter's conception."), *rev'd on other grounds*, 316 U.S. 164 (1942).
146. Snow v. Commissioner, 416 U.S. 500 (1974).

purpose of section 174, which allows a taxpayer to treat as expenses those research and development costs incurred in connection with his trade or business, was:

> to dilute some of the conception of "ordinary and necessary" business expenses under § 162(a) . . . adumbrated by Mr. Justice Frankfurter in a concurring opinion in Deputy v. Du Pont [sic] . . . where he said the section in question (old § 23(a)) "involves holding one's self out to others as engaged in the selling of goods or services."[147]

The *Snow* opinion raises the question as to the implication to be drawn from the Court's use of Justice Frankfurter's language. Some courts have viewed *Snow* as implicit approval of the "goods or services" test under section 162 because the Court chose to characterize the term "trade or business" under that section by referring to Justice Frankfurter's language.[148] The context in which the test is quoted, however, does not support any claim of approval. The Court's reference to Justice Frankfurter's language is not expressed in the context of the Supreme Court's view of its relative merits.[149] Instead, the Court merely identifies the "goods or services" test as the impetus for Congressional passage of section 174.[150] Whatever this may imply about Congress's view of the "goods or services" test or the Court's view of Congress's motivation for enacting section 174, it provides no insight into the Court's position on the use of the "goods or services" test outside the context of section 174.[151] Courts claiming to find approval of the "goods or services" test in the Supreme Court's neutral usage of Justice Frankfurter's language, in effect, divine meaning from the Court's failure to engage in *obiter dictum* and thoroughly denounce the test while discussing it in the context of section 174.[152]

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147. *Id.* at 502-03.

148. *See, e.g.*, Estate of Cull v. Commissioner, 746 F.2d 1148, 1152 (6th Cir. 1984), *cert. denied*, 105 S. Ct. 2701 (1985); Gajewski v. Commissioner, 723 F.2d 1062, 1065 (2d Cir. 1983), *cert. denied*, 105 S. Ct. 88 (1984). The Tax Court adhered to such a position, *see* Gentile v. Commissioner, 65 T.C. 1, 5 (1975), until its *Ditunno* decision. Ditunno v. Commissioner, 80 T.C. 360, 370 (1983).

149. *Snow*, 416 U.S. at 502-03.

150. *Id.*

151. *See* Groetzinger v. Commissioner, 82 T.C. 793, 798-99 n.17 (1984) (A "fair reading" of *Snow* does not suggest that the Court intended to do more than compare the liberal allowance provisions of section 174 with the generally more restrictive requirements of section 162.), *aff'd*, 771 F.2d 269 (7th Cir. 1985); Ditunno v. Commissioner, 80 T.C. 362, 370 (1983) ("[T]he *Snow* reference to Justice Frankfurter's concurrence in *Deputy v. du Pont* does not indicate that the Supreme Court intended . . . to approve his definition.").

152. Moreover, some critics have found significance in Justice Douglas's use of the word "adumbrated" to describe Justice Frankfurter's test. *See, e.g.*, Roth, *Trade or Business Requirement of Sec. 162 and the Deductibility of Preoccupancy Expenses Incurred in Rental Real Estate Projects*, 57 TAXES 33, 41 n.79 (1979) ("adumbrated" indicated that the Court viewed Justice Frankfurter's language as clouding the issue); *Groetzinger*, 82 T.C. at 798-99 n.17 ("We also note that in *Snow*, the Court

The significance to be attached to *Higgins* and *Snow* is not the only point of contention in the "trade or business" controversy. Although nine United States Courts of Appeals claim adherence to the "goods or services" test,[153] the Tax Court has questioned whether these circuits actually apply the test.[154] In *Groetzinger v. Commissioner*,[155] the Tax Court listed a number of cases rendered by "goods or services" test jurisdictions that ignored the test and instead quoted the language of *Higgins*.[156]

The absence of Justice Frankfurter's language is easily explained in most cases. For example, in *United States v. Keeler*,[157] the existence of a trade or business was uncontested, thus reference to the "goods or services" test was unnecessary.[158] The issue before the court was whether a debt incurred by the taxpayer was sufficiently related to his trade or business to constitute a business bad debt.[159] Similarly, in *Walsh v. Commissioner*,[160] the court considered whether a loan in default was sufficiently related to the taxpayer's existing business to constitute a business bad debt.[161] In *Wineberg v. Commissioner*,[162] the existence of a trade or busi-

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referred to Justice Frankfurter's test as having been 'adumbrated.' "), *aff'd*, 771 F.2d 269 (7th Cir. 1985).

153. Estate of Cull v. Commissioner, 746 F.2d 1148, 1152 (6th Cir. 1984), *cert. denied*, 105 S. Ct. 2701 (1985); Gajewski v. Commissioner, 723 F.2d 1062, 1066 (2d Cir. 1983), *cert. denied*, 105 S. Ct. 88 (1984); Snyder v. United States, 674 F.2d 1359, 1364 (10th Cir. 1982); Weiberg v. Commissioner, 639 F.2d 434, 437 (8th Cir. 1981); Stanton v. Commissioner, 399 F.2d 326, 329 (5th Cir. 1968); McDowell v. Ribicoff, 292 F.2d 174, 178 (3d Cir.), *cert. denied*, 368 U.S. 919 (1961); Daily Journal Co. v. Commissioner, 135 F.2d 687, 688 (9th Cir. 1943); Helvering v. Highland, 124 F.2d 556, 561 (4th Cir. 1942). The Eleventh Circuit adopted the "goods or services" test in Steffens v. Commissioner, but the current status of the test in that circuit is unclear. *Compare* Steffens v. Commissioner, 707 F.2d 478, 481-82 (11th Cir. 1983) (implicitly adopting the "goods or services" test) *with* Nipper v. Commissioner, 746 F.2d 813 (11th Cir. 1984) (per curiam) (affirming by unpublished order a Tax Court decision finding a professional gambler to be engaged in a trade or business), *aff'g*, 47 T.C.M. (CCH) 136 (1983).

154. Groetzinger v. Commissioner, 82 T.C. 793, 798-99 (1984), *aff'd*, 771 F.2d 269 (7th Cir. 1985).

155. *Id.* at 793.

156. *Id.* at 799 & n.19. The Tax Court found the following cases to be decided on the "facts and circumstances" test rather than on the "goods or services" test: Purvis v. Commissioner, 530 F.2d 1332 (9th Cir. 1976); Commissioner v. Moffat, 373 F.2d 844 (3d Cir. 1967); Walsh v. Commissioner, 313 F.2d 389 (4th Cir. 1963); Wineberg v. Commissioner, 326 F.2d 157 (9th Cir. 1963); Main Line Distributors, Inc. v. Commissioner, 321 F.2d 562 (6th Cir. 1963); United States v. Keeler, 308 F.2d 424 (9th Cir. 1962); Commissioner v. Nubar, 185 F.2d 584 (4th Cir. 1950). *Id.* at 799 n.19.

157. 308 F.2d 424 (9th Cir. 1962).

158. *Id.* at 428.

159. *Id.* at 429. The court held that the taxpayer's loans to a Canadian corporation were not sufficiently connected to his industrial laundry business in Seattle, Washington to constitute business bad debt upon their default. *Id.* at 430.

160. 313 F.2d 389 (4th Cir. 1963).

161. *Id.* at 391. The court held that loans made to an engineering company were not related to the taxpayer's business of selling paper. *Id.* at 392.

162. 326 F.2d 157 (9th Cir. 1963).

ness was at issue.[163] Although the "goods or services" test was not mentioned, the court based its holding that the taxpayer's timber sales constituted a trade or business upon its factual finding that the taxpayer operated under the name "Wineberg Timber Company" and used means other than newspaper advertising to attract customers.[164] The court thus applied the "goods or services" test without characterizing it as such.[165]

Although the cases cited in *Groetzinger* do not fully support the Tax Court's contention that those courts claiming adherence to the "goods or services" test are inconsistent in its use, a few cases do support the contention that in one area the test has not been used by any court.[166] No court has employed the test when faced with the issue of whether a taxpayer is engaged in the trade or business of trading in securities (trader cases).[167] Instead, courts have looked to distinguish trading from investing, the former being a business and the latter being merely the production of income.[168] To this end, courts generally employ the functional standard elucidated by the Tax Court in *Liang v. Commissioner*:[169]

> The distinction between an investment account and a trading account is that in the former, securities are purchased to be held for capital appreciation and income, usually without regard to short-term developments that would influence the price of securities on the daily market. In a trading account, securities are bought and sold with reasonable frequency in an endeavor to catch the swings in the daily market movements and

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163. *Id.* at 160.

164. *Id.* at 162-63.

165. In Commissioner v. Moffat, 373 F.2d 844 (3d Cir. 1967) (also cited in *Groetzinger*, 82 T.C. at 799) the taxpayer leased to a corporation land with coal deposits. *Moffat*, 373 F.2d at 845. The court held that leasing the land constituted a trade or business and that defaulted loans made by the taxpayer to the lessee were business bad debts. *Id.* at 847. Although the court did not mention the "goods or services" test, it stressed that the taxpayer spent a significant portion of his time attending to the proper operation of his coal land. *Id.* As such, the taxpayer was holding himself out as offering his services as a lessor of property. *See* Bolling & Carper, *The Evolving Definition of "Trade or Business": Ditunno and Beyond*, 63 TAXES 73, 77 (1984). That the taxpayer only held himself out to one tenant should be irrelevant to the trade or business issue. *See* Fegan v. Commissioner, 71 T.C. 791, 814 (1974) (lessor of even a single parcel of real estate can be in a trade or business); *cf.* Steffens v. Commissioner, 707 F.2d 478, 482 (11th Cir. 1983) (that taxpayer only held himself out to one employer is irrelevant to trade or business determination); Grosswald v. Schweiker, 653 F.2d 58, 61 (2d Cir. 1981) (illogical to distinguish between a taxpayer holding himself out to one or many employers).

166. Purvis v. Commissioner, 530 F.2d 1332 (9th Cir. 1976); Main Line Distributors, Inc. v. Commissioner, 321 F.2d 562 (6th Cir. 1963); Commissioner v. Nubar, 185 F.2d 584 (4th Cir. 1950).

167. The only court to consider the "goods or services" test in the "trader" context distinguished *du Pont* on its facts and, therefore, held its use inappropriate. Fuld v. Commissioner, 139 F.2d 465, 468-69 (2d Cir. 1943).

168. *E.g.*, Moller v. United States, 721 F.2d 810, 813 (Fed. Cir. 1983); Levin v. United States, 597 F.2d 760, 765 (Ct. Cl. 1979); *Purvis*, 530 F.2d at 1334.

169. 23 T.C. 1040 (1955).

profit thereby on a short-term basis.[170]

The application of the "goods or services" test in the trader context would be dispositive to the trade or business issue. In common parlance, securities are not goods and a trader provides no services. Yet, the dispositive effect of the test may be the reason why lower courts have not utilized it. Although the Supreme Court has yet to find a taxpayer to be in the trade or business of trading in securities, the Court alluded to this possibility several years before the formulation of the "goods or services" test.[171] Notwithstanding Justice Frankfurter's concurrence in *du Pont*[172] and the holding in *Higgins*,[173] the Court in *Spreckels v. Commissioner*[174] implicitly reaffirmed the possibility that a trader in securities could be in a trade or business. There, the Court assumed that the taxpayer was in the trade or business of trading in securities and held that the commission expenses incurred were not deductible under the predecessor of section 162.[175] The Court did not mention the "goods or services" test and implicitly rejected a broad reading of *Higgins* which seemingly would preclude all personal investment activity from being treated as business activity.[176] In light of the clear signal given by the Supreme Court, the absence of the "goods or services" test in lower court decisions in the trader context is not surprising because use of the "goods or services" test would eliminate any possibility of a trader qualifying for trade or business status, a possibility the Supreme Court has not foreclosed.[177]

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170. *Id.* at 1043. The Ninth Circuit has stated that the relevant considerations in determining whether the taxpayer is a "trader" include "the taxpayer's investment intent, the nature of the income to be derived from the activity, and the frequency, extent, and regularity of the taxpayer's securities transactions." *Moller*, 721 F.2d at 813.

171. Snyder v. Commissioner, 295 U.S. 134 (1935). A taxpayer who "devotes the major portion of his time to speculating on the stock exchange may treat losses thus incurred as having been sustained in the course of a trade or business." *Id.* at 139 (dictum).

172. 308 U.S. 488, 499 (1940) (Frankfurter, J. concurring).

173. 312 U.S. 212 (1941).

174. 315 U.S. 626 (1942).

175. *Id.* at 627.

176. *Higgins*, 312 U.S. at 218.

177. Although not dealing with the issue of a trader in securities, the Court's decision in Whipple v. Commissioner, 373 U.S. 193 (1963) would also lend support to the view that a "trader" can be engaged in a trade or business. The *Whipple* Court was faced with the issue of whether a taxpayer had proven trade or business status by virtue of his furnishing regular services to several companies of which he was a substantial owner. The Court held that devoting time and energy to the affairs of a corporation, in itself, does not constitute a trade or business. The income generated by the taxpayer, though substantially the result of his own efforts, is nevertheless income distinctive to the process of investing and legally arises as a result of the successful operation of the corporation and not as a result of any trade or business of the taxpayer. *Id.* at 202.

Applying this principle to the "trader" context, it can be argued that the nature of the income generated by the "trader" does not legally arise from the successful operation of the investee corporation. Rather, the trader's income is the result of the taxpayer's ability to buy or sell securities at opportune moments.

The pragmatic approach taken by courts in the trader cases should not be viewed as support for the abandonment of the "goods or services" test in other contexts lacking the unique case history and characteristics of the trader cases. The goal of any court deciding whether to eliminate the "goods or services" test should be to select the approach that will best distinguish an activity merely engaged in for profit from one rising to the level of a trade or business.[178] The existence of an exception to the use of the "goods or services" test has no relevance to that selection.

The "goods or services" test has the advantage of satisfying two maxims of statutory construction: (1) in the absence of a clear Congressional definition of a term, "the words of statutes — including revenue acts — should be interpreted where possible in their ordinary, everyday senses";[179] and (2) deductions are a matter of legislative grace and should be construed narrowly.[180] The term trade or business in common, everyday usage conjures up the image of a person offering "goods or services" for sale, not a person betting on pari-mutuel races.[181] Furthermore, the results attainable under the "goods or services" test are more narrowly confined than under the "facts and circumstances" test.[182]

Pragmatically, the majority approach requiring the taxpayer to pass both the "goods or services" and "facts and circumstances" tests is favorable to a singular "facts and circumstances" analysis. As the Second and Sixth Circuits properly state, a court applying the "facts and circumstances" test is left with the task of determining which "facts and circumstances" are sufficient to constitute a trade or business.[183] In their analyses, courts primarily have focused upon the extent, continuity, and

178. *Compare* I.R.C. § 162 (1982) (trade or business expense) *with* I.R.C. § 212 (1982) (nontrade or nonbusiness expense). The Court's decision in *Higgins* created an inequitable situation in which the income earned from a profit seeking activity, such as the management of investments, was taxable, yet the expenses associated with the activity were not deductible. Congress chose to remedy this inequity by creating a separate deduction for nontrade and nonbusiness activity rather than liberalizing the requirements for trade or business status. Revenue Act of 1942, Pub. L. No. 56-753, § 121, 56 Stat. 798, 819 (1942); *see* H.R. REP. NO. 2333, 77th Cong., 1st Sess. 43, 46, *reprinted in* 1942-2 C.B. 372, 410.

179. Malat v. Riddell, 383 U.S. 569, 571 (1966); Crane v. Commissioner, 331 U.S. 1, 6 (1947).

180. Deputy v. du Pont, 308 U.S. 488, 493 (1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934). The Seventh Circuit apparently rejects this maxim because it explicitly holds that "trade or business" status should be construed broadly. Groetzinger v. Commissioner, 771 F.2d 269, 274 (7th Cir. 1985).

181. *See* Gajewski v. Commissioner, 723 F.2d 1062, 1066 (2d Cir. 1983) ("Holding one's self out for such puposes [as selling goods or services] is the universal characteristic of a businessman or trader in a free enterprise society."), *cert. denied*, 105 S. Ct. 88 (1984).

182. *Compare* Estate of Cull v. Commissioner, 746 F.2d 1148 (6th Cir. 1984) ("goods or services" test applied — individual gambler not in trade or business), *cert. denied*, 105 S. Ct. 2701 (1985) *with* Groetzinger v. Commissioner, 82 T.C. 799 (1984) ("goods or services" test not applied — individual gambler is in trade or business), *aff'd*, 771 F.2d 269 (7th Cir. 1985).

183. *Estate of Cull*, 746 F.2d at 1151; *Gajewski*, 723 F.2d at 1066-67.

regularity of the taxpayer's activities.[184] Such ambiguous terms offer no guidance to the taxpayer, the courts, or the Internal Revenue Service as to how extensive, continuous, or regular an activity must be to satisfy the "facts and circumstances" test. Use of this test effectively turns every section 212 income producing activity into an inchoate section 162 trade or business activity, for, as Judge Sterrett of the United States Tax Court stated, under a "facts and circumstances" approach, "almost any sec. 212 activity can be transformed into a sec. 162 activity by intensification of the taxpayer's participation in the activity."[185] As a result of this uncertainty, needless litigation has occurred and is bound to continue — litigation that would be avoidable by the use of the "goods or services" test.[186]

IV. CONCLUSION

Despite the important role the term "trade or business" plays in the American scheme of taxation, neither the Code nor the Treasury Regulations have attempted to define what is meant by the term. From the earlier broad "livelihood" definition supplied and later rejected by the Supreme Court, a more restrictive two-test approach developed. This approach requires the taxpayer first to show that he is holding himself out as selling "goods or services." If this showing is made, the taxpayer must then pass the "facts and circumstances" test which weighs such factors as the extent, continuity, and regularity of the activity.

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184. *E.g.*, Snyder v. United States, 674 F.2d 1359, 1364 (10th Cir. 1982) (requires taxpayer to show extensive or repeated activity over a substantial period of time); Reese v. Commissioner, 615 F.2d 226, 230 (5th Cir. 1980) (lack of continuity and frequency in an endeavor is "strong indicia" that the taxpayer is not engaged in a trade or business); McDowell v. Ribicoff, 292 F.2d 174, 178 (3d Cir.) (trade or business refers to "extensive activity over a substantial period of time"), *cert. denied*, 368 U.S. 919 (1961).

185. Hoopengarner v. Commissioner, 80 T.C. 538, 543 n.8 (1983) (dictum). For example, assume that a taxpayer devotes his full attention to studying real estate market trends by attending real estate seminars and by gathering population expansion data. Based on these efforts, the taxpayer purchases parcels of real estate to hold for long-term appreciation rather than for sale. Is this taxpayer engaged in a trade or business? An application of the "goods or services" test would yield a negative response; the taxpayer did not hold himself out as selling "goods or services" when he purchased realty for long-term appreciation. Under a "facts and circumstances" approach, however, the result is not so clear. The taxpayer may not have had frequent purchases or sales, but he did devote his full energy to the endeavor on a continuous and regular basis. Orbach & White, *How to Establish Existence of a Trade or Business in Light of Recent Conflicting Decisions*, 13 TAX'N FOR LAW. 38, 43 (1984).

186. The Seventh Circuit in adopting the "facts and circumstances" test noted that most often the "goods or services" criteria have not been at issue in trade or business litigation. Groetzinger v. Commissioner, 771 F.2d 269, 272, 276 n.9 (7th Cir. 1985). The court fails to consider that the reason for the dearth of cases turning on the "goods or services" test may be that a taxpayer can determine for himself whether he has met the criteria. If he has not, then litigating a tax assessment becomes pointless.

Recently, the United States Tax Court and the United States Court of Appeals for the Seventh Circuit have rejected the "goods or services" element of the two-pronged approach as being overly restrictive. The courts base their conclusion primarily upon the Supreme Court decision in *Higgins v. Commissioner*, a trade or business case in which the Court stated that a determination of the existence of a trade or business requires an examination of the facts in each case. In contrast, the Second and Sixth Circuits find *Higgins* an unpersuasive reason to reject the "goods or services" test because courts normally must consider the facts in each case. The issue remains which facts are necessary to constitute a trade or business. The "goods or services" test is a major step in resolving that issue.

Continued use of the "goods or services" test can be supported by reference to two common maxims of statutory construction: Words of a statute should be given their ordinary meanings and tax deductions should be narrowly construed. "Holding one's self out" and selling "goods or services" are commonly recognized characteristics of a person engaged in a trade or business as the term is understood in its ordinary, everyday sense. Further, because trade or business status creates opportunities for deductions, the term should be narrowly construed. The "goods or services" test permits fewer activities to be considered a trade or business than an open "facts and circumstances" analysis.

The maxims aside, the most compelling reason to continue the use of the "goods or services" test is that it offers a degree of certainty that is lacking in a "facts and circumstances" analysis. By its nature, a "facts and circumstances" approach leads to confusion for the taxpayer, the Internal Revenue Service, and the courts. How "extensive" must an activity be? How "continuous" or "regular"? Reasonable people can and will differ over such questions. Taxpayers will exploit this uncertainty in an attempt to create a set of "facts and circumstances" that some court may construe as indicative of a trade or business. Needless litigation has occurred and will continue unless the "goods or services" test is applied consistently in all courts.

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