

**Exh. DPK-7
Docket TP-190976
Witness: Danny Kermode**

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND PILOTS,

Respondent.

DOCKET TP-190976

**EXHIBIT TO
CROSS-ANSWERING TESTIMONY OF**

Danny Kermode CPA

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

*Internal Revenue Service
Rev. Rul. 54-614, 1954-2 CB 271*

July 13, 2020

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Revenue Rulings

Rev. Rul. 54-614, 1954-2 CB 271

1939 IRC Sec. 481 Regulations 118, Section 39.481-1: Net earnings from self-employment.

Headnote:

Rev. Rul. 54-614, 1954-2 CB 271 (Also Section 3797, Section 39.3797-4.)

Reference(s):

Amounts received by active and inactive river **pilots** from a river **pilots' association**, pursuant to an agreement whereby the fees for the services of active river **pilot** members are pooled and the combined net earnings, after payment of expenses, are distributed among the **pilot** members on a stated basis, constitute "net earnings from self-employment" as that term is defined in section 481(a) of the Self-Employment Contributions Act.

An unincorporated river **pilots' association**, formed to collect pilotage fees, pay expenses, and disburse the net earnings from pilotage fees to its members, is a **partnership** for Federal tax purposes.

Full Text:

Advice is requested whether the amounts received by active and inactive river **pilots** from a **pilots' association**, under the circumstances set forth below, constitute "net earnings from self-employment" as that term is defined in section 481(a) of the Self-Employment Contributions Act (subchapter E, chapter 1, Internal Revenue Code of 1939).

The **association** under consideration has a minimum of floating property which is owned by its members, each member holding a certificate evidencing his interest therein. Active members of the **association** must be licensed **pilots**. The interest of all members and the basis upon which they participate in earnings are fixed by the bylaws of the **association**. Bills for **pilot** services rendered by its members are turned over to the **association**. The **association** collects for such services and, after payment of expenses, distributes the net earnings among its **pilot** members in accordance with the bylaws.


A retired **pilot** retains his membership in the **association**, owns a lesser interest in the floating property, and continues to share in the distribution of the pooled earnings of active **pilots**, though to a lesser extent. A retired **pilot** has no license, performs no services as a **pilot**, and shares in the pooled earnings for any month only to the extent of one-fourth the net earnings of a first-class **pilot** for that month, but not to exceed 3 x dollars or to be less than 2 x dollars. There is no contribution by active **pilots** to a fund or other provision to insure a specified payment to any member in the event current monthly earnings are insufficient to pay all member **pilots**. <Page 272>


The activities and affairs of the **association** are managed and directed by a Board of Directors. The Board of Directors does not have the authority to purchase additional vessel property or dispose of that now held by the **association** without the consent of the members. Members of the **association** may not withdraw, sell, or assign their interest in the property held by the **association** without the written consent of four-fifths of its members.

Section 481 of the Self-Employment Contributions Act, defining certain terms relating to the tax on self-employment income, provides in part as follows:

(a) Net Earnings From Self-Employment.-The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this chapter [chapter 1 of the Code] which are attributable to such trade or business, plus his distributive share (whether or not distributed) of the ordinary net income or loss ***from any trade or business carried on by a partnership of which he is a member ***.

(b) Self-Employment Income.-The term "self-employment income" means the net earnings from self-employment derived by an individual ***during any taxable year beginning after December 31, 1950 ***.

Section 481(c) of that Act provides in part that the term "trade or business," when used with reference to net earnings from self-employment, shall have the same meaning as when used in  section 23 of the 1939 Code, except that such term shall not include the performance of service by an individual as an employee.

An association organized and operated in the manner set forth above is a partnership, for Federal tax purposes, which, under the provisions of  section 3797(a)(2) of the Code, includes a syndicate,

group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, for Federal tax purposes, a trust or estate or a corporation. In *Mobile Bar Pilots Association v. Commissioner*, 97 Fed. (2d) 695, Ct. D. 1417, C. B. 1939-2, 244, the court had before it the question of whether the **Association**, organized and operated similarly to the one involved here, was an **association** taxable as a corporation. The court, in holding that the **Association** was not taxable as a corporation, stated in part as follows:


Pilotage is personal service by an individual for which he has a maritime lien on the vessel. (*The Queen*, 206 F., 148.) A **pilot** is the servant of the owner of the vessel who is responsible to third persons for his negligence or want of skill. (*Sherlock v. Alling*, 93 U. S., 99.) But an **association** of which the **pilot** is a member, similar to petitioner, is not responsible for his acts. (*Guy v. Donald*, 203 U. S., 399.)

It would be impossible for petitioner to engage in the business of **piloting** as an independent contractor. Petitioner does no business except as an agent of its individual members.

It has been held that a **pilot**, a member of an organization similar to the one involved here, engaged by a steamship company to **pilot** its vessel in and out of a port is not an employee of that company for the purposes of the Federal unemployment tax. See Em. T. 420, C. B. 1941-2, 221.

From the foregoing, it is apparent that active **pilot** members of the **association** are not employees, but as partners in a **partnership** are independent contractors engaged in a trade or business, within the purview of section 481(a) of the Self-Employment Contributions Act, *supra*. Accordingly, an active **pilot's** distributive share of the **<Page 273>** pilotage fees collected by the **association**, less deductible expenses, constitutes "net earnings from self-employment" as that term is defined in section 481(a) of that Act, *supra*. Since the amounts received by inactive **pilots** are from the same source as amounts received by active **pilots**, they must be similarly classified. For the purposes of the tax on self-employment income, it is not necessary that a taxpayer be self-employed during the taxable year in which the self-employment income is received. It is only necessary that such income be derived during a taxable year beginning after December 31, 1950. See section 481 (b) of that Act, *supra*, and I. T. 4071, C. B. 1952-1, 149.

In some instances, river **pilots** have formed a corporation to hold title to their floating property, collect their pilotage fees, pay expenses therefrom and distribute the remainder of such fees to themselves (the **pilots**) on a stated basis. Since the pilotage fees are earned by the **pilots** as independent contractors, the corporation acts merely as their agent. In such cases, it appears that the various **pilots** as a group have divided the ownership of floating property, and other property used in their trade or business into equal parts represented by individual shares of capital stock. As such corporation is not authorized or qualified to engage in the business of **piloting**, such trade or business must be regarded as being carried on by the individual **pilots associated** together for that purpose. A business thus

conducted by **associated** individuals is a **partnership** within the meaning of  section 3797(a)(2) of the Code. Under such circumstances, since the corporation is merely the agent of the partners (**pilots**), the existence of such corporation will not affect the status of the distributive shares of **partnership** earnings for purposes of self-employment income. Cf. *Mobile Bar Pilots Association v. Commissioner*, *supra*.