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TAX DECISIONS OF THE SUPREME COURT
OF THE UNITED STATES, 1938 TERM

A Paper by

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There is no causal connection between the growing revenue needs of government and the theories of taxation underlying the decisions of the Supreme Court, but it is an unmistakable reflection of the times that the tax decisions of the 1938 term have set a new pace in the liberalization of old restrictions upon the taxing power of both the federal and state governments. Such a change as the breakdown of the immunity of government salaries from taxation, because of its timeliness in spreading the costs of government to that growing segment of the population engaged in its work, make vivid to all taxpayers and most of all to the new ones their financial responsibility to their governments.

The time-honored phrase that the power to tax involves the power to destroy, which had already lost much of its Old Testament sound and fury, ceased to have the power of an incantation against the march of decisions concerned less with undue exercise of the government's power to tax than with undue immunities of many citizens from their obligations to support their governments. There was less emphasis on tax burdens and more on tax avoidance. When the court re-opened the way to multi-state taxation of intangibles, when it refused to pronounce an exclusive blessing on the common-law doctrine of a
single domicile, when it danced intricate verbal figures through the maze of restrictions which had long surrounded the taxation of interstate commerce, when it re-examined certain doctrines and abandoned others, it set the conditions for a new emphasis in taxation upon the obligation of citizens to support the governments whose protection they enjoy.

Fourteenth Amendment

The extent of permissible multi-state taxation of intangibles varies with the changing membership of the Supreme Court. Before 1930 it was widely permissible. Several decisions had upheld it in one form or another, but in that year, in Farmer's Loan and Trust Co. v. Minnesota1 and Baldwin v. Missouri2 the court renounced these decisions3 and in 1932, in First National Bank v. Maine4 it made emphatically clear its position that multi-state taxation of intangibles was not permissible at all. Thereafter interest centered upon speculation as to which one of two or more competing states with plausible claims to tax

1 (1930) 280 U. S. 204.
2 (1930) 281 U. S. 586.
3 See Peppin, The Power of States to Tax Intangibles or Their Transfer (1930) 18 Calif. L. Rev. 638, note 6.
4 (1932) 284 U. S. 312.
would win the court's approval of its claims.\(^5\) That two or more might tax seemed to be a dead issue but it was only dormant after the way of a sleeping volcano. There remained of the 1930 court majority only a minority in 1937 and the time grew ripe to renounce the renunciation. In that year there were still only portentous rumblings\(^6\) and it was not until the following year that the second renunciation was undertaken in *Schuykill Trust Co. v. Commonwealth of Pennsylvania*,\(^7\) upholding a state's ad valorem taxation of shares of a domestic corporation held by a non-resident while conceding that the same shares might also be taxed in another state where the shareholder resided. The case was concerned with property taxation, but whatever limitations the renunciation might have been susceptible to on that account were forestalled in 1939 by *Curry v. McCanless*\(^8\) and *Graves v. Elliott*,\(^9\) upholding multi-state inheritance taxation of intangibles.

\(^5\) Interest was centered particularly in the question whether the state of the owner's domicile would have to give way to a state in which the intangibles had a business situs.

\(^6\) First Bank Stock Corp. v. Minnesota (1937) 301 U. S. 234. See also Cohn v. Graves (1937) 300 U.S. 308.

\(^7\) (1938) 302 U. S. 506.

\(^8\) (1939) 59 Sup. Ct. 900.

\(^9\) (1939) 59 Sup. Ct. 913.
In the McCanless case intangibles were transferred in trust by a Tennessee settlor to an Alabama trustee. The trust instrument provided that the income of the trust should be paid to the settlor for life and reserved to her the power of which she availed herself to dispose of the trust estate by will. Suit was brought in Tennessee against the tax officials of both states under the Tennessee Declaratory Judgments Act to determine the extent to which the trust estate was taxable by each state, and it thus became possible for the claims of both states to be presented before the United State Supreme Court in the same case.

When the Tennessee courts "considered that the primary question for determination was the situs or location to be attributed to the intangibles of the trust estate at the time of decedent's death" they acted in obedience to the theory that the Fourteenth Amendment prohibited the multiple taxation of intangibles and therefore compelled a determination which would prevent their taxation elsewhere than at the situs determined upon. Since this was precisely the theory upon which the Supreme Court acted in 1930 and 1932, the state courts had no choice but to follow it, under the assumption that Supreme Court decisions are law until overruled. When the Supreme Court in 1939 commented that the Tennessee courts followed this theory "despite the impossibility in the circumstances of this case of attributing a single location to that which has no physical characteristics
and which is associated in numerous intimate ways with both states" it conveyed the impression that the Tennessee courts were unaware of that impossibility. Actually the quarrel of the Supreme Court majority of 1939 is not with the Tennessee courts, but with the Supreme Court majority of 1930-1932. The later majority wished to overrule the earlier decisions but not outright and so it repudiated the direct descendants of those decisions in the Tennessee courts.

The completeness of the break is dissimulated by an engaging lack of frankness:

"The doctrine, of recent origin, that the Fourteenth Amendment precludes the taxation of any interest in the same intangible in more than one state has received support to the limited extent that it was applied in Farmers Loan and Trust Co. v. Minnesota, 280 U. S. 204; Baldwin v. Missouri, 231 U. S. 586, First National Bank v. Maine, 234 U. S. 312. Still more recently this court has declined to give it completely logical application. It has never been pressed to the extreme now urged upon us and we think that neither reason nor authority requires its acceptance in the circumstances of the present case."

The court was more thoroughgoing in its stand than these words would intimate, for while it limited itself to a stout


declaration against inflation of the doctrine it effectively collapsed it.

This is not the first time that the court has overruled earlier decisions by indirection and dissimulated its volte-face by covert language. The passing reference to the recent origin of the doctrine served to belittle it and the grudging admission that it has received support to a limited extent serves actually to suggest that in the future even that limited application will be reduced to the vanishing point. The same reason and authority which operate against the doctrine in the present case would operate against the doctrine in the cases cited in the quotation. The Tennessee courts erred not in pressing the doctrine to the extreme but in invoking it at a time when the Supreme Court no longer approved of it, for the opinion of the four dissenting justices makes it evident that the court majority that laid down the doctrine would certainly have held it applicable to this case.

In reopening the way to multi-state inheritance as well as multi-state ad valorem taxation of intangibles the court faced the necessity of explaining why intangibles enjoyed a less favorable position than tangibles. Multi-state taxation of intangibles is as harsh as multi-state taxation of tangibles; it penalizes interstate as against local investments in the same way as it would in the case of tangibles and it differs only in degree in troubling
the waters of interstate relations. The court finds a
distinction, not because the reasons for multi-state taxa-
tion of intangibles could not also be applied to tangibles
but because the reasons against multi-state taxation of
tangibles are inapplicable to intangibles. Long engrained
doctrine in the common law and other legal systems localizes
the rights in tangibles for the purposes of jurisdiction of
courts, conflict of laws, and taxation in the state where the
tangible itself is located. That state alone can insure the
full benefit and protection of those rights and effectively
reach the property in the enforcement of the tax. Here then,
the court declares, is an exclusive dominion offering a basis
for an exclusive taxing jurisdiction, a situation without
parallel in the taxation of intangibles which have no physical
location.

The touchstone of the distinction between the taxa-
tion of tangibles and intangibles is physical location; its
presence effectively prevents multi-state taxation and its
absence opens the way to it. But cases arise, as in
Southern Pacific Co. v. Kentucky, where the touchstone

12 See Burnet v. Brooks (1933) 288 U. S. 378 and Estate of
McCreery (1934) 220 Cal. 26, distinguishing between the power
of Congress and the power of the states to tax intangibles.
The court repudiates this distinction in the McCanless case:
"If the 'due process clause' of the Fifth Amendment does not
require us to fix a single exclusive place of taxation of
intangibles for the benefit of their foreign owner, who is
entitled to its protection, Burnet v. Brooks, 288 U. S. 378;
cf. Russian Volunteer Fleet v. U. S., 282 U. S. 481, the
Fourteenth can hardly be thought to make us do so here, for
the due process clause of each amendment is directed at the
protection of the individual and he is entitled to its immunity
as much against the state as against the national government."

13 (1911) 222 U. S. 63.
fails to work, for a tangible which has no physical location in any state is as devoid of physical location for purposes of state taxation as any intangible. A new touchstone then comes into play, the same one which operates in the taxation of intangibles, namely, "control over the person at the place of his domicile and his duty there, common to all citizens to contribute to the support of government." Physical location then is not the sole criterion for determining the taxation of tangibles and others will be found whenever they are necessary to justify one state in levying a tax when all other states are powerless to do so. The ease with which one was found in *Southern Pacific Company v. Kentucky* to justify a tax which found no morrings in the hallowed doctrine of physical location indicates that the court will allow neither tangibles nor intangibles to escape taxation for lack of a suitable doctrine to justify a tax. Kentucky afforded no substantial protection to the rights taxed and could not effectively lay hold of any interest in the property in order to compel payment of the tax. The sum and substance of her power was relative and depended not upon physical location but upon what the other states could do.

The rule that tangibles are taxable in the state of their physical location or at the owner's domicile in the absence of physical location in any state prevents not only  

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14 59 Sup. Ct. 900, 905.
multi-state taxation on the one hand but complete avoidance of taxation on the other. Beneath its overgrowth of custom the rule is rooted not in inexorable logic but in expediency. For the most part this expediency has produced equitable results equivalent to those the states probably would have arrived at independently and it was natural enough that the court in 1930 should seek comparable protection against multi-state taxation for intangibles. It began with the rule that taxation should be at the state of the owner's domicile in the absence of better claims but did not specify what the alternative claims might be or when they were to take precedence. Conflicts inevitably arose, presaging more in their wake, which threw upon the court the difficult task of recognizing only one claim when more than one was plausibly entitled to recognition. *Curry v. McCanless* and *Graves v. Elliott* made it dramatically clear that when the court was faced with two convincing claims it could not select one without inventing reasons against the other and thus embarking upon limitations of state power which would either arbitrarily constrict a normally flexible legislative function within the iron lady of constitutional doctrine or breed confusion calling for constant restatement of those limitations. The court pulled up short and abandoned its position against multiple taxation of intangibles on the ground that it constituted an unwarranted curtailment of the power of states to tax persons whom they control and protect in those
relationships in which lie the origin of the rights constituting intangibles. Had the court followed this reasoning to the end it would not have concerned itself with the defense of its position against multi-state taxation of tangibles for the "control over the person at the place of his domicile and his duty there to contribute to the support of government" is not diminished by the nature of the property owned.

Physical location, upon which the court pegged its position against multi-state taxation of tangibles, could not be invoked against multi-state taxation of intangibles having no physical location, and the court refused to conjure up a fictitious physical location to force intangibles within the rule governing tangibles. Intangibles, said the court, are not related to physical things but represent relationships between persons, and jurisdiction to tax them arises from that dominion over and protection afforded the persons which alone can make the relationships effective. When relationships which are sources of actual or potential wealth are created between persons under the dominion and protection of more than one state, more than one state will have power to tax.

This was the situation in Curry v. McCanless. When the Tennessee decedent transferred the intangibles to an Alabama trustee while reserving a general power of appointment equivalent to ownership of the property, she created,
"two sets of legal relationships resulting in distinct intangible rights, the one embodied in the legal ownership by the Alabama trustee of the intangibles, the other embodied in the equitable right of the decedent to control the action of the trustee with respect to the trust property and to compel it to pay over to her the income during her life and in her power to dispose of the property at death."15

The power which she retained was a potential source of wealth which was property in her hands and the court regarded her as under the highest obligation to contribute from such wealth to the support of the government of Tennessee whose protection she enjoyed. When Tennessee imposed a tax upon the exercise of that power which she alone controlled in that state, she came directly within the rule of Bollen v. Wisconsin16 which had been temporarily eclipsed by the series of cases from 1930 to 1932. At the same time the legal ownership of the intangibles by the Alabama trustee, which under Safe Deposit & Trust Co. v. Virginia17 afforded a basis for subjecting them to a property tax in Alabama, served likewise as a basis for a tax upon their transfer even when effected by the decedent's testamentary act in another state. The court could not have chosen between the equally good claims of Tennessee and Alabama without discriminating against one state or the other, and in the final analysis it was the decedent herself who

15 59 Sup. Ct. 900, 907.
17 (1929) 280 U. S. 85.
opened up the way to multi-state taxation by creating a different set of legal interests in each state.

The whole problem of multi-state taxation of intangibles takes on added significance when intangibles are held in trust and the settlor retains sufficient control or interest in them to render them subject to death taxation. When, as in Curry v. McCanless, the testatrix reserved the power to dispose of the trust estate by will, or as in Graves v. Elliott, the testatrix reserved a power of revocation, the intangibles which they placed in trust became somewhere subject to death taxes even though the location of the power to levy such taxes had to be determined by the court. The characteristic elusiveness of trust property in the field of taxation\(^\text{18}\) compels a certain latitude in locating the power to tax it and when the court in these cases allowed that latitude it shut the door to escape from taxation even though it opened the door to multi-state taxation. Had the dissenting justices prevailed and limited the power to tax to the state of the trustee’s domicile the way would have been open for intangibles held in trust to avoid some measure of taxation whenever the tax by the state of the settlor’s domicile exceeded 80% of the federal estate tax imposed under the Revenue Act of 1926\(^\text{19}\) for the settlor could then transfer the

\(^{18}\) See Traynor, State Taxation of Trust Income (1937).
22 Iowa L. Rev. 268.

\(^{19}\) I. R. C. section 813; Regulations 80 Art. 9.
intangibles to trustees in states which either impose no taxes thereon or taxes at low rates. Whenever the tax by the state of the settlor's domicile did not exceed that 80% no tax saving would have resulted from such a device for the tax would have been paid to the federal government instead of to the state. So long as only a few states imposed death taxes higher than that 80% and so long as the federal government allowed the 80% credit no widespread avoidance would have occurred but it would have been a menacing prospect in view of the growing pressure upon both the federal government and the states to find additional revenue.

When the court abandoned its struggle against multi-state taxation of intangibles it returned that problem to the states, where it appropriately belongs. It might in time have won on every front its battle against multi-state taxation but only by choking with restrictions the vital taxing power of the states and paving new ways for tax avoidance. It yielded to the lesser evil, which can be eliminated by the states themselves, to prevent greater ones which might not easily be undone in the wayward course of judicial recantations. The states themselves have already gone far to solve the problem. Twenty-two of them now provide for reciprocal exemption and ten for outright exemption from death taxes on intangible property of non-residents, and both expediency and self-interest will undoubtedly lead others

20 Tax Administrators News, v. 3, No. 8, August 1939, p.3.
to similar action. In the case of trusts, *Curry v. McCanless* and *Graves v. Elliott*, by removing obstacles to multi-state taxation, will paradoxically drive the states into preventing it themselves. When settlors taxable upon their intangibles at their domicile wish to select trustees in other states they will naturally be magnetized to those states which offer exemption. The eventual result will be that other states will likewise forego their power to tax the intangibles of non-residents in the realization that such a power would be a futile one if there were no trust property to tax.

Given the practical considerations which deter states from imposing taxes upon intangibles transferred to domestic trustees by non-resident settlors, the chances of tax avoidance are multiplied in cases where the property becomes a proper subject of death taxation by reason of the settlor's reservation of the income for life. Here there is no reservation of a general power of appointment as in *Curry v. McCanless* or of a power of revocation as in *Graves v. Elliott*, upon which might be posited the right of the state

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of the settlor's domicile to tax. The virtual ownership of trust property represented by such powers is very different from a life interest therein. In the first two instances the settlor retained control over the disposition of the whole property until the day he died. In the last instance he renounced control over all of the property except his life interest and one must determine whether the retention of that interest alone can serve as a basis for a death tax on the entire trust corpus by the state of the settlor's domicile. Unless it can serve as a basis there, the way is open to tax avoidance, given the impracticability of a tax by the state of the trustee's domicile. It is therefore pertinent to turn to the general reasons which justify a death tax to determine whether they govern the imposition of such a tax by the state of the settlor's domicile. There are two justifications in Helvering v. Bullard for the application of the federal estate tax to transfers of the kind in question. One is that the tax in this instance is tantamount to a gift tax and the application of a higher rate bracket resulting from the inclusion of the gift in the decedent's gross estate falls within the power of Congress to classify gifts for the purposes of taxation and to apply different rates to gifts with and without reservations of

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22 The only restraint on tax avoidance here, as in the situation discussed above would be the 30% credit allowed on the federal estate tax.
23 (1938) 303 U. S. 297.
life interests. The other justification is "the authority of Congress to treat as testamentary transfers with reservation of a power or an interest in the donor,"\(^{24}\) for the purposes of preventing tax avoidance. The reasons which make the federal tax consistent with the due process clause of the Fifth Amendment likewise make a tax by the state consistent with the due process clause of the Fourteenth Amendment when the settlor and the trustee are both domiciled in the same state and the transfer takes place entirely within its borders. The question arises whether the same certainty attaches to a tax by the state of the settlor's domicile when settlor and trustee are domiciled in different states and the negotiations surrounding the transfer of the intangibles are all carried on in the state of the trustee's domicile. It is established in *Curry v. McCanless* that such a state can tax a testamentary transfer by virtue of its control over the settlor from whom the trustee's title is derived, and of the settlor's obligation to contribute to the support of his state. Since it is also established that a transfer of property in trust with a reservation of a life interest can be treated as testamentary it would seem to follow that the state of the settlor's domicile at the time of the transfer is empowered to tax such transfer by virtue of its control over the settlor and of the settlor's

\(^{24}\) 303 U. S. 297, 299.
obligation to contribute to its support such a state, in the language of *Curry v. McCanless*, "is not deprived, by the taxpayer's activities elsewhere, of its constitutional jurisdiction to tax." 25

When the settlor moves to another state where he is domiciled at his death, a new question arises as to whether this state becomes empowered to impose a death tax with respect to the intangibles. There would seem to be no substantial basis for such a power for the new state is not even distantly related to the trust corpus and its thread of connection therewith lies entirely in the settlor's life interest. That thread would hardly bridge the distance between its taxing jurisdiction and property which was never owned within its borders and never transferred there. If the tangibles are to be subjected to state death taxation the choice of the taxing jurisdiction would seem to settle upon the state of the settlor's domicile at the time of their transfer. Even that state, however, must take measures to make its tax effective in the event the settlor moves to another state without leaving any property out of which the tax could be collected. It could anticipate that situation by imposing a gift tax at the time of the transfer in trust, to be duly credited against the subsequent death tax. 26 and


26 See I. R. C. section 936; Reg. 80 Art. 9 for federal provision for gift tax credit against federal estate tax.
exacting enough security to cover whatever amount the
death tax might represent in excess of the gift tax.

Mr. Justice Reed reserved his conclusion with regard
to the court's statement in Curry v. McCanless that,

"taxation of a corporation by a state where it
does business, measured by the value of the
intangibles used in its business there, does not
preclude the state of incorporation from imposing
a tax measured by all its intangibles." 27

It was not surprising, therefore, that only four members of
the court in Newark Fire Insurance Co. v. State Board of Tax
Appeals 28 voted to uphold, upon the authority of Cream of
Wheat Co. v. County of Grand Forks 29 a New Jersey personal
property tax upon the intangibles of a domestic corporation
with executive offices in New York City, regardless of the
taxing jurisdiction of other states. The other four left
open the question whether the intangibles could be taxed in
two states, and upheld the tax on the ground that the pre-
sumption of taxability in the state of domicile was not over-
come by "the mere fact that the general affairs of a foreign
corporation are conducted by general officers in New York
without further evidence of the source and character of the
intangibles." 30

27 59 Sup. Ct. 900, 906.
28 (1939) 59 Sup. Ct. 918.
29 (1920) 253 U. S. 325.
30 59 Sup. Ct. 918, 922.
In Guaranty Trust Company v. Commonwealth of Virginia\textsuperscript{31} the court held for the first time that the Fourteenth Amendment did not prohibit the state of residence of the beneficiary of a discretionary trust from taxing the net income received from a trust, even though the state where the trust was administered and the trustee domiciled had taxed the entire net income from the trust to the trustee. While the opinion places the question of multi-state taxation of income on the threshold of settlement\textsuperscript{32} it is cautious enough to enable the court to distinguish the case on the ground that the income was taxed to successive owners and not to the same owner and is therefore analogous to a case where one state taxes a corporation’s income and another taxes a resident’s dividend declared therefrom. There is little likelihood, however, that the court will make such a distinction\textsuperscript{33} and every indication from its present receptivity to multi-state taxation that it would uphold such taxation of income even to the same owner.

Prior to 1935, Wisconsin exempted dividends from the income tax, either in whole or in part, but in 1935 it placed a tax on dividends received in 1933 and 1934 which had not

\textsuperscript{31} (1938) 59 Sup. Ct. 1.


been subject to the income tax in those years. The tax was a special one in which the regular deductions were not applicable. A taxpayer contested the application of the tax to his 1933 dividends on the ground that it denied him equal protection of the laws by taxing his dividends more heavily than the income tax taxed other income, and by taxing his dividends retroactively, which it was argued was also a violation of due process. The court in Welch v. Henry denied the validity of each of these contentions.

The court reasoned that not only were dividends manifestly different from other forms of income but classification was additionally justified by the state's having previously either exempted them or taxed them at a lower rate than that applicable to other income. This former advantage may distinguish Welch v. Henry from other instances of special treatment of dividends, and prevent its being conclusive authority on the validity of the numerous special state taxes on dividends.

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34 Because the ordinary deductions allowed in computing net income were not allowed in computing the special dividend tax, the burden on dividends was greater.

35 (1938) 59 Sup. Ct. 121. Mr. Justice Roberts, Mr. Justice McReynolds and Mr. Justice Butler dissented.

36 In general the state courts have upheld these taxes. See Shields v. Williams (1929) 150 Tenn. 349, 19 S. W. (2d) 261. See also, Knights v. Treasurer (1921) 237 Mass. 493, 130 N. E. 40, affirmed on another point 260 U. S. 12. Colgate v. Harvey (1935) 298 U. S. 404, is not conclusive for there the taxpayer was not subjected to a greater tax burden because he received dividends.
The majority disposed of the argument that the retroactivity of the tax constituted a denial of equal protection of the laws by reference to federal retroactive tax laws. While the court failed to observe that the equal protection clause is not a limitation upon Congress but only upon the states, it went on to point out that the clause did not deny the power of state legislatures to equalize previous inequities. The retroactive nature of the tax was also held unobjectionable with regard to the due process clause. The majority opinion called attention to the numerous cases upholding the retroactive application of the federal income tax, including Cooper v. U. S. which probably presented a more doubtful issue than that involved here. It pointed out that previous notice of the tax, required in the gift tax cases, is not a prerequisite to validity where the tax is not one on a voluntary act. The majority makes it clear that their decision approves retroactivity only to the preceding legislative session.

37 (1930) 280 U. S. 409. The Revenue Act of 1921 which became effective November 25, 1921, was held validly to ascribe the donor's basis to gift property acquired and sold by the donee before that date. Mr. Justice McReynolds, who with Mr. Justice Roberts dissented in the instant case, wrote the opinion for a unanimous court and held that a retroactive income tax could be imposed on the value of gifts to prevent future tax avoidance.


39 The New York Court of Appeals held that the principal case did not mean that a tax on rentals passed in 1935 and retroactive to 1910 was valid. Such retroactivity was held invalid in N. Y. ex rel. Beck v. Graves, decided May 23, 1939, 6 Law Week 1566.
The decisions of the 1938 term with regard to interstate commerce continue the recent trend away from the restrictive effect of the commerce clause upon the state's power to tax. Nevertheless taxes on interstate commerce still meet with disapproval when they are not properly apportioned. On that ground the court in Gwin, White and Prince v. Henneford invalidated the application of the Washington "business activities" tax to the gross income of a domestic corporation. The corporation, with headquarters in Washington, was engaged in a general marketing business selling products of both Washington and Oregon fruit growers in other states and foreign countries and receiving a fixed commission for each box sold. The corporation maintained at numerous points outside the state representatives who negotiated sales, made deliveries and collected payments which they remitted to the corporation in Washington. It was stipulated that Washington made no claim to tax the Oregon business and the court was, therefore, concerned with the validity of the tax only as it was measured by the receipts of shipments from Washington.


41 (1939) 59 Sup. Ct. 325.
In holding the tax invalid under the commerce clause the court was careful to specify that the tax was not apportioned to activities within the state. Thus, the "added reason" advanced by the court the previous year for sustaining the tax in the Western Live Stock case became the basis of its decision against the Washington tax. It pointed out that had this tax been valid other states to which the commerce extended might have levied a similar tax and interstate commerce would thus have become subject to cumulative burdens.

**Ficklin v. Shelby County Taxing District,** relied upon by the Washington Supreme Court, was distinguished by the United States Supreme Court in such a way as to lend forceful support to the apportionment theory. Despite some factual similarity the activities of the firm in the Ficklin case were all conducted within the taxing state whereas in the Gwin case they were carried on within and without the taxing state, and the tax upheld in the Ficklin case was imposed by the buyer's state, while the tax invalidated in the Gwin case was imposed by the seller's state. The commissions by which the tax was measured in the Ficklin case are comparable to the commissions deducted by the out-of-state agents in the Gwin case rather than the receipts less

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43 (1892) 145 U. S. 1.
44 (1938) 193 Wash. 451, 75 P. (2d) 1017.
commissions by which the Washington tax was measured. While a separable local business may also have existed in the Gwin case, as it did in the Ficklin case, taxability did not turn upon the existence of that business but upon the apportionment of the tax. The implication in the Gwin case is that the first condition would not have been required if the second had been present and in that respect it represents an advance over the Ficklin case. The court went out of its way to strengthen the theory of apportionment for it could have taken the traditional approach by declaring the tax invalid under the commerce clause on the basis of Heyman v. Hayes 45 and Crew Levick Co. v. Pennsylvania. 46

In his dissenting opinion Mr. Justice Black observed that the theory of apportionment was based upon a fear of multiple taxation which in this case he regarded as groundless. Earlier decisions of the court held that the activities of the corporation's representatives in other states could not be taxed therein, and as it had not actually been so taxed in this case, the multiple taxation which the court purported to avoid did not in fact exist. The decision, therefore, resulted in an actual discrimination against intrastate commerce. In Mr. Justice Black's view multiple taxation is a subject of legislative rather than judicial inquiry, but if the theory of apportionment is to be followed

45 (1915) 236 U. S. 178.
46 (1917) 245 U. S. 292.
by the court, it requires logical extension so that whatever cannot be apportioned to one state may be apportioned to another.

The general application of a use tax was upheld in Henneford v. Silas Mason Company but it remained undetermined whether the tax could be applied to property purchased for use in interstate commerce and whether the state in that event could require sellers maintaining places of business within its borders to act as collection agents in its behalf. Southern Pacific Co. v. Gallagher and Pacific Telephone and Telegraph Co. v. Gallagher upheld the application of the California Use Tax to property purchased outside the state and brought within its borders for subsequent

47 (1937) 300 U. S. 577.
So well established has the validity of the use tax become that the court dismissed for want of a substantial federal question in Bacon and Sons v. Martin (1938) 59 Sup. Ct. 82, an appeal from a judgment of the Kentucky Court of Appeals sustaining such a tax. The plaintiff contended that the Kentucky tax imposed on "the receipt of cosmetics in the State by a Kentucky retailer" was a tax on the "act of receiving" articles purchased from manufacturers and dealers in other states and transported to plaintiff at its place of business in Kentucky, and hence constituted a direct burden on interstate commerce. The state court had held that the word "receipt" was used in the statute in the sense of use following the consummation of the sale, and construed the tax as imposed not on the act of receiving but on the sale and use of the cosmetics by the retailer following receipt, and this construction was binding upon the Supreme Court. It may be noted in passing that the Court did not make the validity of the tax contingent upon the fact that a tax had not been paid in any other state with respect to the sale of the cosmetics.

48 (1939) 59 Sup. Ct. 389.
49 (1939) 59 Sup. Ct. 396.
use in the course of mixed intrastate and interstate commerce. \textsuperscript{51} Both the transaction which brought the goods into the state \textsuperscript{52} and the use to which the goods were put after introduction \textsuperscript{53} were protected from state taxation by the commerce clause, \textsuperscript{54} and the question turned upon whether there was a taxable event between interstate transportation and interstate use subject to the use tax. Much of the property was shipped directly to the place of use and installed as soon thereafter as possible, most of it was

\textsuperscript{51} In the Southern Pacific case the court pointed out that "The tax is not sought from personal property used in transactions entirely disassociated from any agency connected with interstate transportation. . . . but from tangible personalty purchased out of the state for immediate or subsequent installation in an interstate railway facility." \textsuperscript{59} Sup. Ct. 391. The Telephone Case involved two classes of property (1) special order equipment immediately installed in buildings devoted to mixed intra and interstate business, and (2) stand-by supplies stored "at points on the system suitable for prompt distribution."

\textsuperscript{52} The opinion in the Southern Pacific Case refers to the transactions as "extrastate purchases". \textsuperscript{59} Sup. Ct. 389, 391. In the Telephone case the opinion states that "appellant purchases outside California. . . materials and supplies which are shipped to it in interstate commerce." \textsuperscript{59} Sup. Ct. 396.

\textsuperscript{53} In the Southern Pacific case office equipment was placed in offices used to supervise interstate activities, materials were used to repair, replace and improve interstate facilities. In the Telephone case the property in question was used in the "necessary operation, maintenance and repair of" the mixed interstate and intrastate system.

\textsuperscript{54} The opinion in the Southern Pacific case points out that the state did not dispute the premise that a state excise "directly upon the privilege of using instrumentalities in carrying on interstate transportation is a direct and unconstitutional burden on commerce."
adapted only to railroad or telephone uses, and all of it was stored, if at all, only for brief periods. Nevertheless the court held (Mr. Justice Butler and Mr. Justice McReynolds dissenting) that there intervened between the conclusion of the interstate transit and the beginning of the interstate use a retention and installation of the goods which constituted a taxable event. "The interstate movement was complete," said the court. "The interstate consumption had not begun." In isolating a taxable event to support the constitutionality of the tax, the court held the cases governed by Nashville C. & St. L. Ry. Co. v. Wallace, and distinguished Nelson v. Kentucky which held invalid a Kentucky tax on the use of fuel, supplied at Ohio, in the operation of an interstate ferryboat.

However weakened the latter decision has been by subsequent decisions upholding taxes on storage, or withdrawal from storage and by the decisions in the instant cases that property purchased for use in interstate commerce is not used in that commerce while held or installed for use, it would still preclude the taxation of such property as railroad rolling stock which was used in interstate commerce

55 59 Sup. Ct. 389, 393.
56 (1933) 288 U. S. 249. This case upheld a tax on the storage or withdrawal from storage of fuel used as a source of motive power in interstate railroad operation.
57 (1929) 279 U. S. 245.
prior to its first entry into the state and was thereafter used in the state only in interstate commerce. Only by a fine distinction, therefore, does the court uphold the application of a use tax to railroad supplies while they are stored before use, or to telephone switchboards while they are installed, since the storage and the installation are done in furtherance of interstate commerce by owners who are engaged in interstate commerce. The retention or installation of necessity precedes actual use or consumption in the interstate railroad or telephone systems. It is not less essential to the operation of the systems than the actual use itself, and a tax imposed at the moment of storage or installation is not less a burden than a tax imposed at the moment of actual use.

The isolation from interstate commerce of a taxable event takes on significance in connection with the "cumulative burdens" doctrine of the *Western Live Stock* case. In *Southern Pacific Co. v. Gallagher* the court stated:

"Where a similar levy by another state may be imposed with consequent multiplicity of exaction on commerce for the same taxable event, local tax of a privilege, measured by total gross receipts from interstate transactions, is considered identical with an exaction on the commerce itself."60

The "cumulative burdens" rule would thus seem to be limited to cases where one taxable event is exposed to the taxing power of more than one state and inapplicable to a taxable

59 Supra note 42.

event isolated from interstate commerce removed from the taxing power of more than one state. While the California Use Tax Act exempts property, the gross receipts from the sale of which are subject to the state sales tax, it has no provision for a credit for sales tax paid to some other state, but as there was no evidence of the payment of any such tax the court held there was no discrimination against interstate commerce from "a second exaction for use after a foreign tax on sale." Since the essence of the cumulative burdens doctrine is the exposure to the risk of discriminatory multiple tax burdens rather than their actual imposition it is unlikely that the use tax will be held invalid under that doctrine as there was an evident risk here of exposure to a sales tax in another state. The court's recognition of a particular taxable event localized in the state as an appropriate subject for the use tax, however, would seem to indicate that a use tax will not be invalidated by the risk of sales taxes which cannot reach the same taxable event.

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61 This limitation is implicit in the court's decision last term in Coverdale v. Arkansas-Louisiana Pipe Line Co. (1938) 303 U. S. 604.

62 While the court in Henneford v. Silas Mason Co. (1937) 300 U. S. 577, emphasized the degree of equality made possible by the credit provision, it was careful to point out that it did not intend to imply that the credit provision was necessary to the constitutionality of the tax.

63 See note 61 supra.
Apart from theoretical considerations a requirement that a state imposing a use tax give credit for taxes paid to other states would be beset by practical difficulties. It would be extremely difficult for one state to check when and where such taxes had been paid in other states. In some cases the credit might be claimed even before the tax was paid to the seller state because of different reporting periods in the states. Even if it were feasible for states to make investigations for one another such factors as the discontinuance of the seller's business or the destruction of his records would make it impracticable to verify claims for credit. The sales tax paid at the state of origin may be subject to refund, which might be made long after the credit has been allowed at the state of destination. Finally, there would be uncertainty as to whether the credit requirement would apply not merely to sales taxes but to manufacturers' excise and other taxes which can be passed on to the consumer.

With their constitutionality established, use taxes needed only the decision in *Felt & Tarrant, Inc. v. Gallagher*\(^{64}\) to insure their practicability. The court there held constitutional the provision of the California Use Tax Act requiring the collection of the tax from purchasers, for subsequent remittance to the state, by sellers maintaining places of business within the state. The seller

\(^{64}\) (1939) 59 Sup. Ct. 376.
in this case was an Illinois corporation maintaining offices in California with two general agents who solicited orders in California subject to approval at the home office. It did no intrastate business in California and contended that the provisions requiring it to collect the tax on the use of comptometers which it sold in interstate commerce to users in this state, was a burden on interstate commerce and a denial of due process.

In upholding a method by which the states may avoid the effect of decisions invalidating taxes on sellers in interstate commerce, the court relied principally upon the authority of Monomotor Oil Co. v. Johnson. In that case, upholding the application of collection provision in an Iowa fuel tax law with respect to a sale in interstate commerce, the State clearly had jurisdiction over the collecting agent inasmuch as its business in Iowa included both local and interstate sales. The business of the Felt and Tarrant Co. in California, however, consisted exclusively of interstate commerce, all its activity in the state being in furtherance of the sale of comptometers which were shipped pursuant to contracts of sale with purchasers in California from a point outside the state to the seller's agents in the state for delivery to the purchasers.

In so far as the commerce clause is involved, the

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65 (1934) 292 U. S. 86
decision is adequately supported by the Monamotor case, for the obligation imposed upon the sellers to collect the tax with respect to its interstate sales of property was precisely the same in each case, regardless of the fact that the Felt and Tarrant Company was engaged exclusively in interstate commerce while the Monamotor Oil Company was not. The court referred to the due process issue only to note that it agreed with the view of the trial court that this issue, as well as the one based on the commerce clause, was foreclosed by Bowman et al v. Continental Oil Co.,66 Monamotor Oil Co. v. Johnson67 and Henneford v. Silas Mason Co.68

Inasmuch as the Silas Mason case was limited to the validity of a use tax, and the Bowman and Monamotor cases were limited to the validity of certain statutory requirements with respect to sales in interstate commerce by sellers engaged in both interstate and intrastate commerce, they do not seem entirely conclusive on the due process issue. Nevertheless that issue was squarely presented in the instant case, and the decision therein establishes that the state had sufficient jurisdiction over the sellers to require them to collect and

66 (1921) 256 U. S. 642.
67 Supra note 65.
68 Supra note 47.
Since the Felt and Tarrant case arose through a suit to enjoin the state from enforcing the statutory requirement that the company collect and remit the amount of the tax, it leaves unsettled the question of the sanctions which may be imposed for the failure of a seller to comply with that requirement. The California Use Tax Act requires the seller to pay to the state the amount of tax he was required to collect from his purchasers during the period covered by his return. The state can clearly impose a penalty for the failure of a seller to comply with the statutory duty upheld by the court and the requirement that the seller pay to the state the entire amount he was obligated to collect appears to be a reasonable method for insuring compliance with that duty.

The case is in marked contrast to James v. United Artists Corp., holding that a motion picture distributor which received payment in New York for the use of its films

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69 See International Harvester Co. of America v. Kentucky (1914) 234 U. S. 579, which upheld the jurisdiction of a state with respect to the service of process upon the local agent of a firm doing a wholly interstate business in the state. See also Natural Gas Pipeline Co. v. Slatery (1937) 302 U. S. 300, which upheld the imposition of a duty of furnishing a State Commerce Commission with information from affiliated interests of public utilities, upon a foreign corporation engaged exclusively in interstate commerce, and denied the contention that the duty involved a violation of the commerce clause and the fourteenth amendment.

70 (1939) 59 Sup. Ct. 272.
was not subject to a West Virginia tax on "every person engaging... within this state in the business of collecting incomes from the use of real or personal property... ."
The distributor was a foreign corporation having no office or place of business in West Virginia. It periodically sent a solicitor into that state to obtain contracts for the showing of its pictures, and sent its films to West Virginia exhibitors who returned them after use to points outside the state. Payment by the exhibitors was made by holding the United Artists share of each night's receipts in trust until the picture's run was completed, and then remitting it to the United Artists Corporation at points outside the state. The court interpreted the statute as requiring the presence of the distributor within the state and the actual collection by it within the state of the payments from the exhibitors. The United Artists Corporation did not come within either of these conditions. 71

The importance of the case lies not in its holding, which is merely statutory interpretation, but in its implications. The court pointed out that the statute did not

71 A three judge district court in holding the tax an unconstitutional burden on interstate commerce relied upon Binderup v. Pathe Exchange (1923) 263 U. S. 291, which held that the business of furnishing films through shipments in interstate commerce was interstate business notwithstanding "that in accordance with the contracts the films were delivered through a local exchange ... through which they were first consigned and transported." The Binderup case, however, involved a question of federal regulation which the court recognized could not be governed by cases involving state taxation of interstate commerce.
raise the issue of the right of a state to tax income derived from sources within it. In concluding its opinion the court reiterated its view that there was "no legislative purpose in cases like the present to tax gross receipts apart from the business or activity of collecting them."

The inference that a different conclusion might have been reached by the court had the tax been on income,\(^3\) may reaffirm the court's inference at its previous term that taxable income is realized in the state where sales are solicited and obtained.\(^3\) This inference, while not inconsistent with the Supreme Court's own decisions,\(^4\) is inconsistent with at least two decisions reached by other courts.

In *Commissioner v. East Coast Oil Co.*,\(^7\) it was held

\(^7\) Had the tax been on net income it would have been valid, notwithstanding the activities of the taxpayer were solely in interstate commerce so far as West Virginia was concerned, if the income was in fact derived from West Virginia. *U. S. Glue Co. v. Oak Creek (1918) 247 U. S. 321, Peck & Co. v. Lowe (1918) 247 U. S. 165.* Had the tax been on gross income it would apparently have been equally valid under the same circumstances. See *Adams Mfg. Co. v. Storcn and Gwin, White & Prince v. Henneford, supra.\(^3\)

\(^3\) In *Adams Mfg. Co. v. Storcn* the court invalidated the Indiana gross income tax because it did not provide for apportionment of income to the states in which the goods were sold. Since the reasoning was that there might thus arise multiple taxation of interstate business the inference is that the states wherein the goods were sold could also tax a portion of the income.

\(^4\) While *Compania General de Tabacos v. Collector (1929) 279 U. S. 305,* is frequently cited as holding that income is not derived from soliciting and making sales and is not taxable by the state wherein goods are sold, neither the stipulation of facts on which the case was tried nor the court's opinion supports this view.

\(^7\) *(C. C. A. 5, 1936) 85 F. 322.*
that income from sales was produced in Mexico, where title to the product passed, and not in the United States where agents of the seller solicited and obtained the sales.\textsuperscript{76}

Similarly, in \textit{Curles Clothing Co. v. Oklahoma Tax Commission},\textsuperscript{77} the Oklahoma Supreme Court overturned a state income tax on a corporation soliciting and making sales in that state.

States are becoming increasingly concerned with the problem of taxing interstate vehicles which use their highways. \textit{Dixie Ohio Express Co. v. State Revenue Commission}\textsuperscript{78} placed in issue the constitutionality of the tax imposed by the Georgia Maintenance Tax Act on trucks, tractors and trailers. The tax was graduated on trucks and tractors according to capacity and on trailers according to weight. The rate applicable to vehicles hauling for hire was greater than the rate applicable to other vehicles and the proceeds from the tax were allocated exclusively to rural post roads. The taxpayer was engaged exclusively in interstate commerce and used about 100 vehicles on the highways of the state, but did not use the rural post roads to which the proceeds of the tax were allocated. The tax, amounting to about

\textsuperscript{76} See, however, Tootal Broadhurst Lee Co. v. Commissioner (1929, C. C. A. 2) 30 F. (2d) 239, cert. den. 49 S. Ct. 419; Billwiller's Estate v. Commissioner (1929, C. C. A. 2) 31 F. (2d) 286 and Birkin (1926) 5 B.T.A. 402.

\textsuperscript{77} (1937) 68 F. (2d) 834.

\textsuperscript{78} (1939) 59 Sup. Ct. 435.
$6,000, was upheld against contentions that it was repugnant to the commerce and equal protection clauses of the federal Constitution.

The court held that the tax was exacted as compensation for the use of the roads of the state and that it was immaterial that the state used "part or all of the proceeds of the tax for purposes other than the construction, improvement or maintenance of its highways." The decision recognizes that even where it appears that the tax is compensation for highway use, the taxpayer may question it whenever its amount appears unreasonable. In this case, however, the taxpayer failed to prove such a contention. The court denied the contention that the Act violated the equal protection clause by imposing higher taxes on vehicles hauling for hire on the ground that such vehicle presumably used the roads to a larger extent than other vehicles. The case indicates that the reasonable compensation to a state for the use of its highways may be measured by their value to the user rather than by expenditures made by the state in building, maintaining and policing the highways.

In Clark v. Paul Gray, Inc.,\(^79\) however, upholding the constitutionality of the California Caravan Act of 1937,\(^80\)

\(^79\) (1939) 59 Sup. Ct. 744.

\(^80\) Enacted as a substitute for the act held unconstitutional in Ingles v. Morf (1937) 300 U. S. 290, because the fees which it imposed were excessive.
the court discussed the reasonableness of the fees in terms of compensation to the state to meet the costs incurred by it as a result of the caravan traffic. The act before the court in the Clark case defines caravaning as the "transportation of any vehicle .... operated on its own wheels, or in tow of a motor vehicle for the purpose of selling or offering the same for sale within or without this State," and exacts two license fees of $7.50 each for a six months' permit for caravaning a vehicle on the highways of the state. While the annual graduated tax in Dixie Ohio Express Co. was exacted as compensation for the use of state highways, the California Act provides for the exaction of one fee to reimburse the state for expenses incurred in administering police regulations incident to the Act and of another fee in return for the use of the state's highways. It provides for two zones within the state and exempts intrazone movements from its provisions.

The taxpayer was engaged in caravaning cars interstate for the purpose of sale in California and contended that this activity could not be subjected to the Act without violating the commerce, due process and equal protection clauses of the Constitution. The court, citing the Dixie Ohio Express Co. case among others, declared that the commerce clause does not prevent states from imposing reasonable fees for the use of highways or from classifying vehicles according to their use of its highways. There was evidence in this case that the state's expenses resulting from the interstate caravaning
exceeded the fees collected. As for the due process and 
equal protection issues, the court, relying upon Morf v. 
Bingaman, held that it was reasonable to classify separately 
vehicles coupled together and moved under the control of 
casual employees and to impose fees both for use of the 
highways and expense of policing. The exemption of intra-
zone caravanning was likewise held reasonable since there 
was evidence that such caravanning caused fewer traffic 
problems and resulted in less wear and tear on the high-
ways than the caravans driven to California from other 
states. The court also refused to consider whether there 
was an invalid discrimination as between cars driven into 
the state singly for sale, and those driven in singly for 
other purposes or those driven singly to market intrazone, 
for the appellee did not transport any cars singly or in 
intrazone movements, but moved all of its cars interstate in 
caravans of nineteen to twenty-five cars, and was, therefore, 
not in the class against which it alleged a discrimination 
 existed.

A recent attempt by Florida to protect its cement 
industry from foreign competition was thwarted by the court 
in Halc v. Bimco Trading Co. The Florida statute stated 
that approximately 30% of all cement sold and used in the


82 (1939) 59 Sup. Ct. 526.
state was imported from foreign countries, that much of this cement was of inferior quality, and that its use "not only jeopardizes public safety but amounts to unfair competition being forced on this great industry in Florida." It authorized the State Roads Department to fix a minimum standard for all cement offered for sale, sold or used within the state and required an inspection and the payment of an inspection fee of fifteen cents per hundred weight for all cement brought into Florida from any foreign country.

The court reasoned that an inspection of domestic cement would be as essential to "public safety" as that of foreign cement, which was discriminated against by an inspection fee amounting to sixty times the actual cost of inspection. The statutory reference to protection from unfair competition was regarded by the court as "a candid admission that the very purpose of the statute is to keep out foreign goods." The statute was, therefore, clearly invalid under the Commerce Clause and its demise was hastened by the bald candor of its language.

Inter-Island Steam Navigation Co. v. Hawaii upheld the application of a tax measured by gross income, imposed under the Utilities Act of 1913 of the Territory of Hawaii, to a common carrier of freight and passengers by water between different points in the Territory. A substantial

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part of its gross income was derived from transporting freight destined for trans-shipment to foreign or mainland points. After determining that it was not the intent of Congress that its Shipping Act of 1916\(^84\) wholly supersede the Territorial Act with regard to carriers like the petitioner, the court held that even if it were assumed that the petitioner were engaged in interstate and foreign commerce, Congress in the Act of 1916 had subjected petitioner to the Territorial law under which the tax was levied. Congress exercised its power to regulate commerce in this instance by enabling the Territory to impose the tax. The court held that, apart from its power under the commerce clause, Congress could subject the petitioner to the tax by virtue of its plenary authority over Territories of the United States.

**GOVERNMENTAL IMMUNITY**

The court has advanced far beyond *Helvering v. Gerhardt*\(^85\) in its inroads against the long-standing governmental immunity from taxation in three cases upholding the taxation of governmental salaries. *New York ex rel Graves v. O'Keefe*\(^86\) upheld a non-discriminatory income tax by New York on the salary of one of its residents employed by the Home Owners Loan Corporation on the ground that it was a tax neither on the national government nor on the property or income of the Home Owners

\(^85\) (1938) 304 U. S. 405.
\(^86\) (1939) 59 Sup. Ct. 585.
Loan Corporation but on the employee's income which became isolated from its government source upon receipt as compensation. The court determined that whatever indirect burden the tax imposed upon the federal government did not unduly interfere with its functions. Collector v. Day and New York ex rel Rogers v. Graves were expressly overruled, "so far as they recognize an implied constitutional immunity from income taxation of the salaries of officers or employees of national or a state government or their instrumentalities."

In Van Cott v. State Tax Commission of Utah the court held that the salary of an attorney for the Reconstruction Finance Corporation and the Regional Agricultural Credit Corporation was not immune from a non-discriminatory state income tax imposed by Utah.

O'Malley v. Woodrough upheld a tax under section 22(a) of the Revenue Act of 1932 on the salary of a federal judge appointed after June 6, 1932. In holding that the payment, in common with other citizens, of a non-discriminatory income

87 "The theory which once won a qualified approval, that a tax on income is legally or economically a tax on its source is no longer tenable..." 59 Sup. Ct. 595, 598. Contrast Pollock v. Farmers Loan & Trust Co. (1895) 157 U. S. 429.

88 (1870) 11 Wall. 113.

89 (1936) 299 U. S. 401.

90 (1939) 59 Sup. Ct. 605.

91 (1939) 59 Sup. Ct. 838.
tax did not constitute a diminution of compensation which might threaten the independence of the judiciary, the court has cleared the way for the eventual overruling of Evans v. Gore.92

The reciprocal taxation by the federal and state governments of the salaries of all government employees now has a statutory basis in the Public Salary Tax Act of 193993 which, apart from the remedial provisions designed to avert the retroactive application of such taxation, is essentially a codification of the Gerhardt, O'Keefe and Woodrough cases. Title I subjects the salaries of all public officers and employees, including Federal constitutional judges inducted into office on or before June 6, 1932, to the Federal income tax and consents to the non-discriminatory taxation by the states of the salaries of all Federal officers and employees received after December 31, 1938. Title II relieves all state and municipal officers and employees from retroactive Federal taxation on salaries received before January 1, 1939, provided similar treatment is accorded Federal officers and employees by the states.

The doctrine that a net income tax is not a tax upon its source may easily become the premise for a future denial of tax immunity to interest derived from government securities

92 (1920) 253 U. S. 245.
if it appears that taxation will not increase interest rates sufficiently to interfere with the borrowing power of the federal or state governments.\textsuperscript{94}

\textbf{FEDERAL INCOME TAX}

For nearly twenty years the Treasury Department has followed the theory that a lessor realizes taxable income whenever a lessee completes improvements which will have value at the expiration of the lease and will revert with the fee,\textsuperscript{95} because such improvements presumably increase

\textsuperscript{94}Estimates of the increase in the interest rate for state and municipal securities vary from \(\frac{1}{4}\) to \(\frac{3}{5}\) of \(1\%.\) See Lutz, The Fiscal and Economic Aspects of the Taxation of Public Securities, a report for the Comptroller of the State of New York, incorporated in Hearings before the Special Committee on Taxation of Government Securities and Salaries pursuant to S. Res. 303, (75th Cong.), 76th Cong., 1st Sess. (1939) 91-186, p. 12. Hillhouse, Inter-governmental Tax Exemption, Municipal Year Book (1939), p. 375. Wenchell, Federal State Reciprocal Taxation of Income from Public Securities (1939) 17 Taxes, The Tax Magazine 507; Studenski, Federal Taxation of State and Municipal Bonds (1939) 17 Tax Mag. 5; Tobin, The Constitutional Immunity of State and Municipal Securities (1939) Address delivered before the Ninth Tax Clinic of the Committee on Federal Taxation, San Francisco, July 11, 1939; Foley, Twenty-Five Years of Tax Exemption Privileges (1939) Fordham Alumni Magazine 30. These authorities also disagree whether state and municipal governments will gain more from the taxation of interest on federal securities than they will pay out in increased interest rates on their own securities.

\textsuperscript{95}The revenue laws have never specifically designated revertible improvements erected by a lessee as income to the lessor, but in the Revenue Acts since 1913 definitions of gross income have been attended by omnibus clauses including "income derived from any source whatever" and broad enough to include any income within the meaning of the Sixteenth Amendment. I. R. C. section 22(p) defines gross income as including "gains, profits, and income derived from . . . rent . . . .
the current value of the fee which the lessor has power to sell.

95 (cont)

or gains or profits and income derived from any source what-
ever." The definitions of earlier revenue acts have been sub-
stantially the same. In 1917 the Treasury Department ruled
that a lessor realized income at the end of the term to the
extent of the depreciated value of revertible improvements
erected by a lessee. T. D. 2442 Feb. 6, 1917. This ruling
was the basis of Treas. Reg. 33 (revised), Art. 4, par. 50
(Act of 1916, as amended by Act of Oct. 3, 1917) and Art. 48
of Reg. 45 (Act of 1918). These Regulations were invalided
(1919) 250 U. S. 667, which held that a lessor realized no
taxable income when in 1916, upon default of a lessee, he
took possession of a building erected by the lessee in 1907.
See also Cryan v. Wardell (D. C. Cal. 1920) 263 F. 248. Both
cases contained dicta that the enhancement of value resulting
from erection of the buildings constituted income upon com-
pletion of the improvements. The Treasury Department in 1920
accordingly ruled:

"When buildings are erected or improvements are made
by a lessee in pursuance of an agreement with the
lessee, and such buildings or improvements are not
subject to removal by the lessee, the lessor receives
income at the time such buildings or improvements are
completed, to the extent of the fair market price or
value of such buildings or improvements subject to the
lease."

Bull. 90 (1921). This ruling has been continued in all
regulations and has constituted one of three alternative pro-
cedures under Treas. Reg. 101, Art. 22 (a) - 13 of the Revenue
Act of 1938 (incorporating provisions of Art. 48 of Treas.
Reg. 62 (1921) Rég. 65 (1924) and Reg. 69 (1926); Art. 63 of
Reg. 64 (1928) and Reg. 77 (1932), and Art. 22(a) - 13 of Treas.
Reg. 86 (1934) and Reg. 96 (1936).

The taxpayer had the option of reporting the present value
of the improvements, of spreading the depreciated value over
the term of the lease and reporting an aliquot portion each
year, or of reporting the entire value of the improvements
upon completion. The regulations were upheld in Kentucky
Block Coal Co. v. Lucas (D. C. Ky. 1933) 4 F. Supp. 266 (re-
pairs and additions 'to miners' houses by lessee of coal mine)
and were approved by dicta in U. S. v. Boston & Providence
R. R. Corp. (C. C. A. 1st 1930) 37 F. (2d) 670 and Crane v.
Commissioner (C. C. A. 1st 1934) 68 F. (2d) 540.
The theory was dealt a preliminary blow in *Hewitt Realty Co. v. Commissioner* where it was held that improvements erected by a lessee became merged with the fee under the law of fixtures, and the lessor therefore realized no taxable income therefrom until sale of the fee. Nevertheless, the Treasury refused to adopt this holding and the Board of Tax Appeals continued to uphold its regulations.

In *M. E. Blatt Co. v. U. S.* the court undermined the theory followed by the Treasury Department by holding that an aliquot portion of the estimated depreciated value at the expiration of the lease, of improvements erected by a lessee pursuant to the requirements in the lease but not as rent, did not constitute taxable income to the lessor in the first year of the lease when the improvements were

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completed. In its view the improvements did not constitute additional rent, as the Court of Claims had held, and the lessor did not therefore realize any taxable income upon their completion.

The logical conclusion of such a view would ordinarily be that had the improvements been made as rentals, the lessor would have realized taxable income. The court, however, far from carrying this view to completion, leaves it dangling without foundation by its subsequent dictum that the improvements are indistinguishable from improvements made by a lessor, and therefore constitute "an addition to capital; not income within the meaning of the statute." If that were true they would never be designated as rent for the lessor would not subject himself to a tax liability which he might as easily avoid. If improvements are additions to capital, they are unrealized gains and not income, and they are not transformed into income by the magic of nomenclature. It is therefore difficult to follow the reasoning of the court that the improvements in question are not taxable income because they are not rentals, in the light of its dictum that they are not taxable income because they are additions to capital.

Although the court cited Eisner v. Macomber for

59 Sup. Ct. 186, 190.


Ibid.
its proposition that the improvements did not constitute taxable income, it did not refer to income within the meaning of the Sixteenth Amendment, but "within the meaning of the statute." Yet section 22a of the Revenue Act of 1932 followed the Sixteenth Amendment in defining gross income to include "income from any source whatever", and Congress, by repeated re-enactment of the statute, impliedly approved the Treasury Regulation which rendered such gains as those represented by the improvements in the instant case taxable under the statute. As the statutory definition could hardly be broader, or Congressional approval of it more consistent, the court's limitation of the definition seems to run counter to the manifest intent of Congress.

The court took issue not only with the theory that improvements not made as rents represented taxable income to the lessor, but with the method of determining the hypothetical value of the improvements upon reversion by estimating their depreciation from the original cost. In its own view the value of such improvements at the end of the lease must be determined by attributing to them a proportion of the value

102 101 Art. 22 (a)-13. See Helvering v. Reynolds Tobacco Co. (1939) 59 Sup. Ct. 423. If Treasury Regulations are conclusive regarding exclusion of income once Congressional approval is given by re-enactment they would seem equally conclusive regarding inclusion of income.

103 Cf. Irwin v. Cavit (1925) 268 U. S. 181, which recognizes Congress's intention in the revenue laws to reach gains, profits and income of every description unless specifically exempted.
of the fee or structure of which they form a part. Since estimating the future value of improvements in this manner would result in figures as conjectural as the estimated depreciated value of the improvements alone, with attendant administrative difficulties the Treasury would be virtually compelled to forego imposition of the tax during the term of the lease.

By dictum the court stated that even if the value of the improvements upon termination of the lease were established it would not constitute income during the first year of the lease, for the acquisition of the reversion in the improvements "did not amount to contemporaneous realization of gain within the meaning of the statute." The same reasoning could apply to each year of the lease and implies that the improvements could not be evaluated upon their completion since their value would have to be determined in conjunction with the value of the whole fee upon reversion. The present worth of the future reversionary value of the improvements could likewise not be determined under the present procedure, which is based on depreciated value of the improvements alone upon reversion. Nor could an aliquot portion of the estimated future reversionary value of the improvements alone be assigned to each year of the lease.

104 The assumption is that the value of an improvement inheres in its adaptation to the reality. Its salvage value, the excess of its value as an article severed from the building over its cost of removal, is as a rule relatively small.

105 The cost of a building is normally a fair approximation of its value at the date of completion. Because of intervening depreciation, however, its value at the expiration of a lease is conjectural. Not only would the Treasury Department have the burden of inspecting the premises and reaching an estimate of future values but it might under the principal case have the burden of proving that the figure reached was not conjectural.

106 The improvements could not be evaluated upon their completion since their value would have to be determined in conjunction with the value of the whole fee upon reversion. The present worth of the future reversionary value of the improvements could likewise not be determined under the present procedure, which is based on depreciated value of the improvements alone upon reversion. Nor could an aliquot portion of the estimated future reversionary value of the improvements alone be assigned to each year of the lease.
lessor realizes no gain before the termination of the lease.\textsuperscript{107}

It is suggested that realization may not even occur until sale of the fee, on the theory of \textit{Hewitt Realty Co. v. Commissioner}.\textsuperscript{108} The adoption of that theory would call into play the court's formal distinctions between capital and income. Under the law of fixtures, revertible improvements erected by a lessee become one with the land and possess their principal value only in relation to it. If the fee is considered as the capital res, improvements appreciate its value without basically changing the asset of the lessor. The tax would be deferred, but might ultimately be imposed at higher rates on that account with fewer difficulties of administration.

It must be remembered that the \textit{Blatt} decision is merely a ruling on the facts, and that the majority opinion, together with Mr. Justice Stone's separate opinion, give evidence that the court's members were sharply at issue as to the grounds on which to rest their decision. It is to be hoped that the Treasury will develop a conflict between the circuit courts on the issue of the realization of income.


\textsuperscript{108} \textit{(C. C. A. 2d 1935) 76 F. (2d) 880, A. L. R. 1201, 1207}.
where the lessor comes into possession of the improvements. 109

In Lyeth v. Hoey 110 property received by an heir in compromise of a will contest was held exempt from income tax as "property acquired by gift, bequest, devise or inheritance." 111 The court determined that the question as to whether petitioner acquired property by "inheritance" within the meaning of the federal statute was not governed by local law, 112 and held that the property was inherited by petitioner

109 The freeing of this asset from an obligation to permit another to use it might justify treating the value of the improvements as independent income at this time, apart from the value of the land itself. Compare U. S. v. Kirby Lumber Co. (1931) 284 U. S. 1, Helvering v. American Chicle Co. (1934) 291 U. S. 426.

Meanwhile the lower courts seem to regard themselves as bound to hold that the lessor does not realize income when he comes into possession of valuable improvements through the premature termination of a lease. Nicholas v. Fifteenth Street Investment Co. (C. C. A. 10th, 1939) 105 F. (2d) 289, Helvering v. Brunn (C. C. A. 8th, 1939) 105 F. (2d) 442. The Board of Tax Appeals has likewise refused to follow the Treasury Regulations since the Blatt decision. Cleveland Trust Co. v. Commr. (1939) 39 B. T. A. No. 18; Merkra Holding Co. v. Commr. (1939) B. T. A. No. 19.


111 Sec. 22(b) (3) of the Revenue Act of 1932.

112 The lower court held controlling the Massachusetts rule to the effect that compromise settlements are derived by contract and not by inheritance. See Notes in (1939) 14 Indiana L. J. 270 and (1939) 19 Boston U. Law Rev. 335 for a discussion of this phase of the decision.

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because he took as an heir "in spite of the will and as in the case of intestacy... the compromise serving to remove pro tanto the impediment to his inheritance."

Gain or loss must be computed on the basis of what is actually sold and not what is intended to be sold. In Davidson v. Commissioner a taxpayer directed his broker to make two sales of certain lots of stocks. Each time the bank which held the stock certificates as collateral delivered to the broker certificates other than those it had been instructed to deliver. The court held that the taxpayer's gain on the sale is to be determined on the basis of the cost of the certificates actually delivered. "His intention to sell, even when coupled with his order to the broker and direction to the bank, cannot be held to constitute a sale... The case is not different from what it would have been, if petitioner himself had delivered to the broker the certificates sent by the bank... The Commissioner rightly computed gain on the basis of what was done rather than on what petitioner intended to do."

In rendering its decision upon this basis the court avoided the question whether amounts received in compromise of a will contest constitute income within the meaning of the Sixteenth Amendment. See Eisner v. Macomber (1920) 252 U. S. 189, 207, and Stratton's Indpendence v. Howbert (1913) 231 U. S. 399. This question might arise from the compromise of a contest involving claimant's heirship, for it could not be established that property so received was acquired by inheritance without first establishing the very matter in controversy, i.e. that the claimant was an heir.

(1938) 59 Sup. Ct. 43.
Fairbanks v. United States\textsuperscript{115} presented the question whether the redemption of bonds before maturity by the issuing corporation was a sale or exchange within the meaning of section 208(a)(1) of the 1926 Act and section 101(c)(1) of the 1928 Act, which rendered a bondholder's gain from retirement of the bonds a capital gain subject to the 12\% percent rate imposed by those acts. It was held that payment and discharge of a bond is neither a sale nor exchange within the commonly accepted meaning of the words, and that the gain constituted ordinary income. The change in the Revenue Act of 1934, Section 117(f), providing that amounts received on retirement of bonds shall be considered amounts received in exchange therefor, was found to be a material addition and not an attempt to construe prior acts.\textsuperscript{116}

The proper basis for determining the amount of deduction for uncompensated losses from damage to non-business property has long been a controversial subject\textsuperscript{117} by reason of certain inconsistent provisions of the Revenue Act of 1934. In

\textsuperscript{115} (1939) 50 Sup. Ct. 607.

\textsuperscript{116} Until this change the taxpayer could sell the bond just before its maturity date and thus have the transaction treated as a sale or could retain the bond until redemption and thus be taxed on the basis of ordinary gain or loss whichever was to his advantage.

\textsuperscript{117} See (1939) 37 Mich. L. Rev. 616, for a discussion of the history of this problem.
Helvering v. Owens the court repudiated the literal meaning of these provisions as contrary to the intent of Congress and held that a taxpayer whose pleasure automobile was damaged in a collision could deduct only the amount of the actual damage, namely, the difference between the depreciated value immediately before the accident and the value immediately thereafter.

The actual damage amounted to only $35, but the taxpayer contended that since he was allowed no depreciation on his automobile, its original cost was, under section 23(h) of the Revenue Act of 1934, the proper basis for determining the amount of loss. He therefore claimed a deduction of $1,635, the difference between the cost of the automobile, $1,825, and the value immediately after the collision, $190.

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118 (1939) 59 Sup. Ct. 260. Obici v. Helvering, involving the same problems, was decided at the same time and covered by the same opinion. Neither party disputed that collision is a casualty. See Shearer v. Andersen (C. C. A. 2nd 1927) 16 F(2d) 995; G. C. M. 1902, VI-L Cum. Bull. 219 (1927); cf. Clinton Graham (1925) 1 B. T. A. 775, Charles N. Burch (1926) 4 B. T. A. 604 and G. D. 629, 3 Cum. Bull. 158 (1920), 4 Cum. Bull. 160 (1921). In the Obici case a boat, boathouse and pier used solely for pleasure were totally destroyed by storm. There was no dispute that this was a casualty. The court denied the taxpayer's claim that the original cost was the basis of the deduction.

119 Art. 23 (1)-2 of Regulations 36 provides that "The deduction of an allowance for depreciation is limited to property used in taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure. . . ."

120 This section provides that the basis for determining the
The claim was so plausible under the literal provisions of the Act that the court was able to deny it only by denying that these provisions expressed the intent of Congress. Subsection e(3) of Section 23 allowed the taxpayer to make a deduction for a casualty loss of non-business property sustained during the taxable year. Subsection (h) provides that the amount of the deduction shall be determined on the adjusted basis set forth in section 113(b) applicable to losses from the sale or other disposition of all property. The very fact that non-business property was allowed no depreciation made it fall, under the terms of Section 113(b), within the scope of section 113(a), and served paradoxically to enable the taxpayer to claim a deduction of all of the depreciation which had ever accrued. The adjusted basis in this case, thus became by reference the unadjusted basis set forth in section 113(a), for Congress, which had consistently denied any allowance of depreciation for non-business property elsewhere in the Revenue Acts, neglected to make the special provision that was necessary here to insure that depreciation would not be allowed in the case of loss of such property.

120 (cont.)

amount of deduction for losses sustained from damage to property not connected with trade or business shall be the adjusted basis provided in section 113(b). That section provides for adjustments of the basis for depreciation "to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws".
The result was that while the Revenue Acts have also consistently denied the allowance of losses except in the year sustained, or the allowance of any but actual losses, the taxpayer here was able to claim a full deduction on the basis of the original cost of non-business property damaged by casualty, even though such property might be of negligible value at the time of the casualty. Even if the actual damage of $35 had been covered by insurance, he could still have claimed a deduction of $1600, namely, the cost of the automobile, $1825, less not only the amount of its value after the collision, $190, but the loss covered by insurance, $35.

The curious loophole in the Act resulted less from negligence than from an abundance of caution. Section 23(e) not being confined to non-business property, provided for the deduction of all losses incurred by individuals and corporations. Congress, intent upon preventing this subsection from operating to allow any depreciation already allowable elsewhere in the Act to property other than non-business property, provided that all losses should be determined upon the adjusted basis in section 113(b). In its preoccupation with the prevention of a loophole for business property, it opened up a loophole for non-business property. Had section 23(e) not been concerned with other losses besides those to non-business property, there would have been no need for section 23(h), and the loophole which
followed in the wake of the latter section would have been obviated:

The hiatus in draftsmanship presented the court with a dilemma. If it accepted the conclusion compelled by a literal reading of sections 23(h) and 113(b) it authorized deductions contrary to express provisions elsewhere in the Act. When it refused to follow this conclusion, and held that the taxpayer's deduction must be limited to the actual damage to the property, it carried out the intent of Congress but changed the literal meaning of the sections in question. In effect it wrote into subsection (h) an exception of non-business property. The Circuit Court of Appeals did the same thing with more boldness when it stated:

"The rule is well settled, however, that in such case the statute should be construed as containing such exception when necessary to avoid a consequence which Congress clearly did not intend. Sorrells v. U. S... (287 U. S. 435), U. S. v. Kirby... (7 Wall. 482). As said in the case last cited, pp. 4, 6: 'All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression or an absurd consequence. It will always, therefore, be presumed that the legislature intended exceptions to its language, which would avoid results of this character. The reason of the law in such cases should prevail over its letter.' 121

The court resolved its dilemma only to raise another, namely, that the rejection of the literal wording of a statute is fraught with the danger of depriving both the taxpayer and the government of any assurance that a statute will be interpreted to mean what it says. There is a question

whether the court should undertake to correct even the most obvious of oversights when Congress has within its power the correction, albeit delayed, of its own lapses. There is always the possibility that Congress may have intended a provision to apply as written despite its seemingly anomalous results. Even more serious is the danger that neither taxpayers nor the Bureau could rely upon the written word as the authentic meaning of a given provision.

Yet it is virtually impossible for Congress always to cloak its intent in unmistakable language, when the problems on which it must legislate are multifarious and complicated. The legislative process is a cumbersome one, and there are not enough skilled draftsmen available to anticipate and eliminate all possibility of error. The revenue acts themselves, which deal with the most intricate problems, are models of draftsmanship, and they could hardly be improved except at prohibitive cost. It might well be argued that if the written word is to be subject to overtones of judicial interpretation which amount to cancellation or contradiction, the already difficult task of understanding the revenue acts may become hopeless. Yet the very excellence of draftsmanship which would seem to justify a general rule of literal interpretation might with even more reason justify a departure from that rule in the case of manifest error. If the draftsmanship of the revenue acts were less excellent,

their errors would be less manifest, but inconsistencies become glaring when they emerge from language generally characterized by deliberation and care. If the intent of Congress is clearly expressed elsewhere in the act, the Court would seem justified in rejecting the literal meaning of an inconsistent provision. 

Section 23 (n) of the Revenue Act of 1932, like corresponding sections of other Revenue Acts, allows a deduction from gross income of charitable contributions not exceeding 15% of the taxpayer's net income before the deduction. In *United States v. Pleasants*¹²³ the taxpayer deducted charitable contributions in the taxable year amounting to $3,496. The Commissioner denied the deduction on the ground that as the taxpayer had a capital loss of $154,921.98 which exceeded his ordinary net income of $94,963.52, there was no net income against which to make a deduction for contributions. The government argued that since a capital net gain must be included in computing the net income of the taxpayer for the purpose of ascertaining whether the deductions for charitable contributions under 23(n) reached the 15% limit,¹²⁴ it followed that capital net losses must similarly be taken into account. The court rejected the government's contention on the ground that

¹²³ (1939) 59 Sup. Ct. 281.
¹²⁴ Helvering v. Bliss (1934) 293 U. S. 144.
section 23(n) referred to "the taxpayer's net income" which is actually subject to tax. "We think that Congress, in the application of the special provision of section 101(b) for an offset in case of a capital net loss, intended to make the taxpayer's net income, ascertained irrespective of that loss, the subject of the tax and that the provision in section 21(n) allowing a deduction for charitable contributions is applicable to that taxable income." 125

The confusion surrounding the deductibility of bond discounts and expenses has yet to be entirely dispelled. 126 Frequent reorganizations of corporate structures in the last decade have resulted in litigation which, while stopping short of the Supreme Court, have crowded the calendars of the Board of Tax Appeals and the appellate courts. From their decisions emerge two loosely formulated rules regarding the right of parent corporations to deduct the unamortized portion of the bond discount and expense of subsidiaries which they liquidate in such a manner as to become legally liable for the payment of the bonds of the subsidiaries. If the liquidation and transfer of assets represents a merger or consolidation under state law, the continuing corporation is permitted to deduct, when it retires the

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125 59 Sup. Ct. 281, 284.
merged corporation's bonds, the unamortized portion of the
bond discount and expense incurred by the merged corporation.
If the liquidation and transfer of assets represents a re-
organization in which the continuing corporation assumes
liability for the bonds by contract and not as a matter of
law, the deductions are not permitted.\textsuperscript{127}

In Helvering \textit{v. Metropolitan Edison Co.}, Helvering \textit{v.}
Pennsylvania Water and Power Co., General Gas and
Electric Corp. \textit{v. Commissioner}\textsuperscript{128} the Supreme Court appears
to recognize and approve these rules in so far as it grounds
its decisions as to deductibility on a determination in each
case of whether the merger or consolidation in question was
a \textit{de facto} or a \textit{de jure} merger under Pennsylvania law. While
observing the distinction implicit in these rules, however,
the court takes no cognizance of the fact that the distinction

\textsuperscript{127} American Gas & Electric Co. \textit{v. Commissioner} (1936, C. C.
A. 2d) 85 F. (2d) 527; see 1 Paul & Mertens, op. cit., p. 200
et seq. While this distinction may not be wise as a matter
of policy, because it breeds litigation and is not founded on
real differences, its appearance is not surprising when it is
remembered that the whole question of bond discount has been
left open by the statute. The distinction is founded on the
difficulty of permitting one corporation to deduct another's
expense when the statute does not so provide. Hence the
distinction was evolved between mergers and consolidations,
where the old corporation is a component part of the new, and
other reorganizations where the old corporation sells out to
another and expires, or continues separate from the purchaser.

\textsuperscript{128} (1939) 59 Sup. Ct. 634
\textsuperscript{129} (1939) 59 Sup. Ct. 638
originates in concepts of state law, which vary from state to state.\textsuperscript{130} The Revenue Act in its silence cannot be interpreted as resting either expressly or impliedly on these concepts. The Supreme Court has held elsewhere in the same term\textsuperscript{131} that differences of local law are not controlling and that distinctions based thereon are not to be recognized in the administration of the Revenue Act. Such differences can exist to an exceptional degree since the right to form and merge corporations, together with the right to leave property to one's heirs at death, are subject to greater state control than any other rights. The question is therefore still open whether the Supreme Court will hold that, in the absence of any requirement in the Revenue Act that state laws control, the deductibility of unamortized bond discount and expense, like the exemption of bequests, is to be determined without reference to distinctions based on local law.

The specific language of section 115(c) of the Revenue Act of 1928,\textsuperscript{132} its legislative history, the judicial

\textsuperscript{130} The court states the opposing contentions of counsel and adds: "The question, then, is solely one respecting the law of Pennsylvania." However, the cases were presented to the court on that basis, counsel conceding the validity of the distinction referred to supra note 127.

\textsuperscript{131} Lyeth v. Hoey (1939) 59 Sup. Ct. 155.

\textsuperscript{132} "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section

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construction of the section as it appeared in the 1918 Act, the reports of the Congressional Committee, and the repeated reenactment of the section with the consequent adoption of the long-standing Treasury Regulation constitute an unusually solid basis for the court's decision in *White et al exrs. v. United States*, that a stockholder's loss on the liquidation of a corporation is a capital loss, the deduction of which is subject to the capital loss provisions.

A long needed decision dispelling confusion in the important field of taxpayers' remedies was rendered in *United States v. Bertelsen & Petersen Engineering Co.* and

132 (Cont.) but shall be recognized only to the extent provided in section 112. The same language is found in the corresponding provision of subsequent revenue acts.

133 See section 201(c) of 1918 Act, held in *Hellmich v. Helman* (1928) 276 U. S. 233 to require a stockholder's gains upon liquidation to be treated as gains from the sale of property.

134 See Report of Senate Committee on Finance Report No. 398, 68 Cong. 1st Sess., and Report of the House Ways and Means Committee, Report No. 178, 68th Cong. 1st Sess., discussing section 201 (c) of the 1924 Act the relevant portion of which is identical with section 115 (c) of the 1928 Act.

135 Article 1545 of Regulations 65 and 69, Article 625 of Regulations 74 and 77.

136 (1938) 59 Sup. Ct. 179. See also *Helvering v. Chester N. Weaver Co.* (1938) 59 Sup. Ct. 185, involving the same problem under the 1934 Act.
United States v. C. T. Jaffray et al.,\textsuperscript{137} holding that the Commissioner's crediting of an overpayment for one year against an alleged deficiency for another year amounts to disallowance, to the extent of the credit, of the claim for refund for the first year, and that suit may be brought for the disallowance of that claim without filing another claim for refund. Until this decision it was uncertain because of conflicting lower court decisions\textsuperscript{138} whether crediting an overpayment amounted to an account stated, to disallowance of the claim for refund or to payment for the year against which the credit was applied. There was corresponding uncertainty as to whether the taxpayer should sue upon an account stated, or upon the claim for refund, or should file another claim and sue for the refund of the payment by way of credit for the year against which the credit was applied. As different periods of limitation existed for each remedy the taxpayer found himself without any remedy if he did not guess correctly as to which one he must pursue.

The issue in the instant cases\textsuperscript{139} centered upon the jurisdiction of the District Courts. These courts have

\textsuperscript{137} (1939) 59 Sup. Ct. 541.

\textsuperscript{138} See 5 Paul & Mertens §51.35.

\textsuperscript{139} In the Bertelsen case, more than $10,000 of an admitted overpayment upon 1917 taxes was credited upon a declared deficiency for 1918 taxes then barred by the statute of limitations. As only the question of jurisdiction was open, the court did not consider whether the 1918 deficiency
jurisdiction concurrent with the Court of Claims for the recovery of internal revenue taxes in the case of claims against the United States not exceeding $10,000 \(^{140}\) and for claims exceeding $10,000 if the collector of internal revenue by whom the tax was collected is dead or out of office at the time the suit is commenced. With one exception, the credits involved in these cases exceeded $10,000 and the collectors were either dead or out of office at the time the suits were commenced. The court sustained the District Court's jurisdiction and rejected the contention that credits of overpayments of certain years against alleged deficiencies of others amounted to payment for the years against which they were applied and constituted a defense to the claim for refund of the overpayment of taxes for 1917. See 5 Paul & Mertens §51.34 for discussion of cases holding that an overpayment cannot be credited against a barred deficiency. As to credits made after the effective date of the 1928 Act, I. R. C. section 3775(a) (section 609 of the Revenue Act of 1928) provides: "Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607." In Rosenstadt & Waller v. United States (Ct. Cls. 1934) 7 F. Supp. 287, the Court of Claims rejected the contention that this section converted a credit of an overpayment of taxes for one year into an overpayment for the year against which the credit was applied. The cases discussed in the text involved credits made before the effective date of section 609 of the Revenue Act of 1928 so that the effect of that section was not before the court. The convincing opinion of the Court of Claims makes it doubtful that the Supreme Court will find any language in section 609 of the Revenue Act of 1928 which would lead it to distinguish the Bertelsen and Jaffray cases.

\(^{139}\) (cont.

\(^{140}\) Tucker Act, U. S. C. A. Title 28, sec. 250 (1).
the contention that as it was the Commissioner and not the collector who made the credits the District Court was without jurisdiction. The court sustained the holding of the Circuit Court of Appeals that the suit sought to recover overpayments made to the collector regarding which timely claims for refund had been filed. It approved the declaration of the court below that "The crediting of the overpayments, by the Commissioner, against taxes due from the taxpayer for other years was a matter of defense, a justification for the failure to refund, and not a matter which destroyed the taxpayer's cause of action or ousted the court of jurisdiction."\textsuperscript{141}

An action by an Internal Revenue agent pursuant to section 3173 of the Revised Statutes\textsuperscript{142} to compel a witness to testify was held in McCrone v. United States\textsuperscript{143} to be a civil\textsuperscript{144} and not a criminal proceeding. Accordingly, as a judgment of contempt for failure to testify was governed by the statutory rules of civil appeals the petitioner's appeal was properly dismissed by the Court of Appeals for non-compliance with those rules. The text followed by the

\begin{itemize}
  \item \textsuperscript{141} 59 Sup. Ct. 541, 543.
  \item \textsuperscript{142} I. R. C. section 3615.
  \item \textsuperscript{143} (1839) 59 Sup. Ct. 685.
  \item \textsuperscript{144} In Interstate Commerce Commission v. Brimson (1894) 154 U. S. 447, relied upon by the court in this case, an action by the Interstate Commerce Commission to compel a witness to testify was held to be a civil proceeding.
\end{itemize}
court in distinguishing civil from criminal contempts is thus succinctly stated by Mr. Justice Black: "A contempt is considered civil when the punishment is wholly remedial, serves only the purposes of the complainant and is not a deterrent to offenses against the public."\textsuperscript{145} The action in the present case met this test because judicial assistance was invoked solely to obtain the petitioner's testimony, "to buttress the procedure for collection of taxes and not in 'vindication of the public justice' as in criminal cases."\textsuperscript{146}

An intricate question of statutory interpretation involving the limitation period upon assessment under the Revenue Act of 1926 in the case of a transferee of a transferee of a taxpayer came before the court in United States v. Continental National Bank and Trust Company.\textsuperscript{147} As the 1926 Act did not specifically provide any limitation period for such case the answer had to be derived from implications to be found in the specific provisions of that act relating to transferee liability. The basic provision, section 260(a), provides that the liability of "a transferee of property of a taxpayer in respect of the tax" shall be assessed, collected and paid in the same manner and subject to the same limitations as in the case of a deficiency in a tax. There is no mention of a transferee of a transferee either.

\textsuperscript{145} 59 Sup. Ct. 685, 686.

\textsuperscript{146} 59 Sup. Ct. 685, 687.

\textsuperscript{147} (1930) 59 Sup. Ct. 308.
in this section or in section 280(b)(1) providing that transferee liability must be assessed within one year from expiration of the period of limitation for assessment against the taxpayer. Such a person is within the scope of these provisions, therefore, either because the statute contemplates no distinction between a transferee of property of a taxpayer and a transferee of such transferee or because a preceding transferee is regarded as a taxpayer under section 280(a) on principles applied in the Updike case, and his transferee is accordingly "a transferee of property of a taxpayer."

Under the first alternative the limitation period in the case of a transferee of a transferee would be the same as in the case of an initial transferee. Under the second there would be an additional year after the expiration of the period of limitation for assessment against the preceding transferee. The period under the second alternative might be considerably longer than under the first not only because of the additional year for each preceding transferee but

148 (1930) 261 U. S. 489. In this case the court rejected the government's contention that section 260 differentiates between taxpayers and transferees holding that a transferee was a taxpayer within the plain words of section 280(a)(1) and as such entitled to the benefit of the six year period of limitation upon collection under section 278(a). The court does not purport to overrule the Updike case although it is difficult to see how a transferee can consistently be held to be a taxpayer for the purpose of one statute of limitations, i.e., section 278(d) and held not to be a taxpayer for the purpose of another statute of limitations, i.e., section 280(b)(1), particularly when the controlling provision, i.e., section 280(a) is the same in both cases.
because of waivers of the statute of limitations or suspension thereof as in the instant case during the pendency of deficiency proceedings in the Board of Tax Appeals.\textsuperscript{149}

The court adopted the first alternative and held the action in this case barred because not brought within one year after the expiration of the period of limitation for assessment against the original taxpayer. Mr. Justice Stone, dissenting, with whom Mr. Justice Black concurred, advanced the second alternative as being compelled by the Updike case. Under this alternative the action would have been timely because of the suspension of the statute arising from the deficiency proceedings in the Board of Tax Appeals with respect to the initial transferee.

The 1928\textsuperscript{150} and subsequent Revenue Acts specifically fix the assessment period with respect to the liability of a transferee of a transferee. The decision in this case therefore is of significance primarily in connection with transferee liability under the 1926 Act. An important dictum in the court's opinion, however, may be of additional interest. The initial transferee in this case died while the proceeding with respect to his liability was pending in the Board of Tax Appeals. Some twenty-two months after his death the Board made an order of redetermination in the amount proposed by the Commissioner with interest. During

\textsuperscript{149} Revenue Act of 1926, section 277(b), 274(a).

\textsuperscript{150} L. R. C. section 311. 

\ldots 69 \ldots
the following month the Commissioner made a jeopardy assessment against the deceased in the amount fixed by the Board. The court rejected the government's contention that it had six years under section 278(d) from the time of that assessment to bring suit against the testator's transferees on the ground that no assessment was made against them and that section 278(d) was not broad enough to impose liability upon them on account of the assessment against the testator. The court went on, however, to point out that in any event the jeopardy assessment was made too late. The suspension of the statute pending the deficiency proceedings in the Board does not continue indefinitely after the death of the petitioner where no substitution is made, and the Commissioner had allowed more than a reasonable time to elapse without obtaining a dismissal of the proceedings for lack of a necessary party or want of prosecution.

The definition of gross income has been re-enacted without change by Congress in all the revenue acts, and its broadness has given rise to numerous interpretative Treasury regulations, authorized by the acts themselves. From 1920 until 1934, there existed a regulation which interpreted the definition as not inclusive of gains to a corporation from the purchase or sale of its own stock,

151 I. R. C. section 62.
152 See Reg. 74, Art. 66.
and this regulation applied uniformly to the revenue acts from 1913 to 1932. In 1934 it was amended by the Treasury to make such gains taxable income, and subsequently the definition of gross income was reenacted unchanged in the Revenue Acts of 1936 and 1938.

Helvering v. R. J. Reynolds Tobacco Co.\textsuperscript{153} involved the question whether the amendment, in changing the interpretation of the statutory definition of gross income, in effect repealed the original regulation with regard to the gains realized by a corporation in 1929 from the sale of its own stock which it had purchased over several preceding years. The Court held that the original regulation had the force of law, by virtue of the implied approval conferred upon it by Congress in the repeated re-enactment in the revenue acts of the definition of gross income which the regulation interpreted.

The Commissioner argued that the broad statutory definition of gross income represented the intent of Congress to tax all that is constitutionally income, and its scope could not therefore be restricted by interpretative regulations.\textsuperscript{154} The Court agreed with the court below that the nature of such gains as those in question was debatable.

\textsuperscript{153} Helvering v. R. J. Reynolds Tobacco Co. (1939) 59 Sup. Ct. 423.

\textsuperscript{154} This argument had the support of Koshland v. Helvering (1936) 298 U. S. 441, and Manhattan etc. Co. v. Commissioner (1936) 297 U. S. 129.
enough to warrant interpretative regulations. In the court's view the regulation that they were not income was controlling with regard to tax liability for the years in which it was in force, and the reenactment of the same statutory definition of income in the Revenue Acts of 1936 and 1938 did not imply Congressional approval of the retroactive application of the amended regulation. 155

In view of the statutory provisions for the retroactive application of regulations, 156 and the fact that the original regulation promulgated in 1920 was retroactive, it would seem that the Court forbade the retroactive application of the amended regulation not because it lacked Congressional approval, but because its interpretation of the statutory definition of income was preceded by a conflicting interpretation which had also received Congressional approval. If the Treasury had elected to make no interpretation before 1934, its interpretation in 1934 might have been held applicable to the particular gains in question. If it had elected to make no interpretation at any time, it might likewise have been free to require payment of tax on the gains under the broad statutory definition of income. Broad as the definition was, the Treasury was authorized but not compelled to interpret it, and a certain irony attaches to the fact that if it exercises its authority to

156 I. R. C., section 370(b).
interpret in one year, it may thereby constrict its freedom to do so in another. It is a paradoxical situation that the later interpretation should yield to the earlier one when Congress by continuing to reenact the statutory provisions impliedly gives its blessing to both of the Treasury's conflicting regulations. 157

Earlier in the session the court, in Helvering v. Winmill, 158 applied the rule of implied Congressional approval by reenactment to a regulation interpreting brokers' commissions for purchasing stock as part of the cost of the stock to be added to the basis. The regulation was upheld on the ground that it had been continued unchanged since 1916, and repeated reenactments without change of the statutory sections which it interpreted signified Congressional approval thereof. In this case neither the Treasury nor Congress wished to change the regulation, and since it was an admissible interpretation of the law there was every reason for the court to uphold it. There would seem to be no less compelling reasons to respect the wishes of the Treasury and Congress to change a regulation as to respect their wishes not to change it.

157 The court has already relied on implied Congressional approval of its own decisions. Hecht v. Malley (1924) 265 U. S. 144, and of lower court decisions, United States v. Ryan (1931) 284 U. S. 167.

158 59 Sup. Ct. 45.
The question remains open whether the original regulation would be superseded by the amended regulation with regard to a corporation's gains from dealings in its own stock realized subsequent to the amendment. The question may soon be settled since the court has granted certiorari in a series of cases involving the doctrine of Congressional approval by reenactment. Its language in the instant case suggests that the doctrine will not be followed so mechanically that approval of an administrative interpretation in one period of time will forever congeal it into a statute. The whole purpose of flexible statutory provisions would be destroyed if they were harshly bound by interpretations that had once received Congressional approval, and it is hardly conceivable that if Congress can approve one interpretation, it cannot in time withdraw its approval from that interpretation by conferring it upon another.

**FEDERAL ESTATE TAX**

It is common knowledge that an estate tax is an excise imposed upon the transfer of property at death and

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160 59 Sup. Ct. 423, 426.
is not a tax upon the property.\textsuperscript{161} Federal bonds exempt
by statute from all taxation have been held subject to a
federal inheritance tax,\textsuperscript{162} and federal bonds exempted by
state taxation in any form have been held subject to state
inheritance taxes.\textsuperscript{163} It was inevitable, therefore, that
the court would hold as it did in \textit{United States Trust Co. v. Helvering},\textsuperscript{164}
that the proceeds of War Risk Insurance are in-
cludible in a decedent's gross estate despite the provisions
of section 22 the World War Veterans Act of 1924 exempting
such insurance "from all taxation", and the amendment to
that Act of August 12, 1935 providing that "Payments of
benefits due or to become due . . . shall be exempt from
taxation . . . ." The exemption of such insurance, like that
of federal bonds, cannot be amplified into an exemption of
its transfer at death.

\begin{verse}
\textit{Tyler v. United States},\textsuperscript{165} \textit{Third National Bank and
}\end{verse}

\begin{footnotes}
\item[161] Reinecke \textit{v. Northern Trust Co.} (1929) 278 U. S. 339;
\hfill
\item[162] Chase National Bank \textit{v. United States} (1929) 278 U. S. 327;
\item[164] Murdock \textit{v. Ward} (1900) 178 U. S. 139.
\item[165] Plummer \textit{v. Coler} (1900) 178 U. S. 115.
\item[166] (1939) 59 Sup. Ct. 692.
\item[167] (1929) 281 U. S. 497, holding that the full value of
\textit{an estate by the entirety} may constitutionally be included
in the decedent's gross estate.
\end{footnotes}
Trust Co. v. White,\textsuperscript{166} Gwinn v. Commissioner,\textsuperscript{167} and Foster v. Commissioner\textsuperscript{168} made inevitable the decision in United States v. Jacobs \textit{et al.}\textsuperscript{169} upholding the constitutionality of section 302(h) of the Revenue Act of 1924 requiring the inclusion in the gross estate of the decedent of the full value of property purchased with his own funds and held with his wife under a joint tenancy set up before the enactment of the estate tax in 1916.

The majority found that technical differences between joint tenancies and tenancies by the entirety too insubstantial to distinguish the first two cases\textsuperscript{170} and there was nothing

\textsuperscript{166} (1932) 287 U. S. 577, holding that the full value of the property passing to a survivor under a tenancy by the entirety created prior to the estate tax of 1916 could be included in the gross estate. Accord, Helvering v. Bowers (1938) 303 U. S. 618.

\textsuperscript{167} (1932) 287 U. S. 224, holding that estate tax may constitutionally apply to half of a joint tenancy created prior to the adoption of the estate tax, where the decedent alone had furnished consideration for the joint property. See also Griswold v. Helvering (1933) 290 U. S. 56.

\textsuperscript{168} (1938) 303 U. S. 618, holding that Congress may constitutionally apply the estate tax to the whole of a joint tenancy created after the enactment of the estate tax.

\textsuperscript{169} (1939) 59 Sup. Ct. 551.

\textsuperscript{170} Although the differences in the types of tenancies may have their origin in an "amiable fiction" and "shadowy and intricate distinctions of common law property rights" they are of considerable practical importance. As pointed out by dissenting Justices McReynolds, Butler and Roberts a joint tenant can destroy the joint estate, can transfer or incumber his interest or otherwise obtain the fruits of it. The tenant by entirety cannot. It was contended, therefore, that the
in the last two to militate against taxing the full value of the property of a joint tenancy created before the enactment of the estate tax act.

The tax was not retroactive because the death, which was the generating source of the shift in economic interest giving rise to the tax, occurred after the adoption of the taxing act, just as it did in Foster v. Commissioner, and the cases are, therefore, indistinguishable in this respect even though the joint tenancy in one was created before and in the other after the enactment of the tax. There was no undue hardship in either case since at any time before the death the joint tenancy could have been severed and the tax avoided.

The complaint was not that no part of the value of the survivor's half interest should be included in the decedent's gross estate but that too much of that value was included. The property rights that were brought into being or ripened for the survivor with respect to her half interest were the right to dispose of her half interest by will or to allow it to pass to her heirs, and the right surviving joint tenant receives nothing more than the decedent's half interest and that no more can be subject to a death duty. This argument which would be equally applicable to joint tenancies created after the adoption of the taxing act, was rejected in Foster v. Commissioner, supra. There is little force to the argument that an estate tax is not materially different from a gift tax with date of payment and computation of rate postponed, and that creators of joint tenancies after the enactment of the tax are forewarned as creators of previously created joint tenancies cannot be. That lack of warning works no disadvantage in view of the power before decedent's death to sever the joint tenancy and avoid the tax.
to sell the entire property without that risk of loss which might have resulted from partition or separate sale of her interest while the decedent lived. The measure of the tax, however, was not limited to the value of these newly acquired rights but included the full value of her half interest. This lack of complete correspondence between the subject of the tax and its measure was disposed of by court as follows: "It is immaterial that Congress chose to measure the amount of the tax by a percentage of the total value of the property, rather than by a part, or by a set sum for each such change. The wisdom both of the tax and of its measurement was for Congress to determine."

In Dimock v. Corwin,\(^{171}\) decided with the Jacobs case, the joint tenancy was not only created before the 1916 Act but property which the survivor had been given by the decedent without consideration was contributed to the joint tenancy. Because her contribution had been acquired "from the decedent for less than an adequate and full consideration in money or moneys worth" the full value of the joint tenancy property was held, pursuant to section 302(h) of the Revenue Act of 1926, includible in the decedent's gross estate despite the fact that the gift had been made before the 1916 Act.

It has long been apparent that the provision requiring the inclusion of gifts in contemplation of death in the

\(^{171}\) (1939) 59 Sup. Ct. 556.
The futility of the provision is once more illustrated by the decision in Colorado National Bank of Denver et al. v. Commissioner holding that an irrevocable transfer in trust was not a gift in contemplation of death although the decedent, while in good health, was eighty years old, when he made it. His dominant motive was to set aside enough to care for his descendants after his death in the event his stock market speculations proved disastrous. The court's declaration that the "mere purpose to make provision for children after a donor's death is not enough conclusively to establish that action as 'in contemplation of death,'" together with its approval of the conclusion of the Board of Tax Appeals that the facts disclosed an effective motive "not directly springing from apprehension of death," virtually limit gifts in contemplation of death to gifts causa mortis.

The review of the evidence in Mr. Justice Black's vigorous dissenting opinion clearly demonstrates that the

172 See United States v. Wells (1931) 283 U. S. 102, 116, where the court in speaking of the provision states: "The dominant purpose is to reach substitutes for testamentary dispositions and thus to prevent evasion of the estate tax."


175 59 Sup. Ct. 48, 49.
donor in this case was motivated by a desire to provide for his dependents after his death. The trust agreement was substantially identical as to parties, recipients, amounts, terms and conditions with a will made by the donor two years earlier. Neither the will nor the trust agreement permitted any payments to the beneficiaries until the settlor's death. In the Wells case, upon which the majority rely, the donor's dominant motive was to attain an object desirable to him during his lifetime, training and experience for his children in managing their finances. In the instant case the contemplated speculations of the donor increased the importance of providing for his descendants after his death and would seem, therefore, to emphasize rather than distinguish the testamentary nature of the gift in question.

**FEDERAL EXCISE TAXES**

The National Firearms Act, enacted in 1934 as part of the Justice Department's campaign against crime, regulated the importation and interstate transportation of sawed-off shotguns, machine guns and weapons other than pistols and revolvers which discharged shots by explosives and were capable of being concealed on the person, and imposed a

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177 I.R.C. sections 2720-2733; 5260-5266
stamp tax on their transfer.

The court upheld the tax in United States v. Miller, relying on the authority of Sonzinsky v. United States and several cases under the Harrison Narcotic Act for the proposition that the Firearms Act was a revenue measure and not a regulatory measure imposing a penalty and usurping power reserved to the states. More difficult was the problem under the Second Amendment—"A well regulated Militia being necessary to the security of a free State, the right of people to keep and bear arms, shall not be infringed." The amendment was adopted because of the strong sentiment against standing armies to assure the continuation and effectiveness of the Militia which comprised "all males physically capable of acting in concert for the common defense" who when called for service were expected to appear bearing arms supplied by themselves and of the kind in use at the time. As there was no evidence in this case tending to show that the possession or use of a "sawed-off shotgun" has at this time some reasonable relationship to the preservation or efficiency of a well regulated Militia the court refused to hold that the Second Amendment guarantees the right to keep and bear such an instrument.

178 (1939) 59 Sup. Ct. 816.
179 (1937) 300 U. S. 506, 513.
To recover cotton in the possession of a ginner, a producer paid a tax, imposed by the Bankhead Cotton Act, which the collector of internal revenue assessed against the ginner. Since a volunteer may not recover the payment of another's tax the question came before the court in Stahlman v. Vidal whether the Act imposed the tax on the ginner or the producer. The court held that the tax was intended to fall on the producer and as his payment was not voluntary, but under duress of goods, he was empowered to maintain the suit for refund even though the possibility existed that the tax might be on the ginner.


182 (1938) 59 Sup. Ct. 41.