TAXATION AND THE SUPREME COURT, 1937 TERM

Part II *

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VI. CLASSIFICATION

Practically there is no such thing as a universal tax. Inherent in all taxes, therefore, is a problem of classification. But this problem does not usually become acute unless the tax is highly selective or discriminatory, or unless there seems no other plausible ground upon which to attack it. The two cases at the last term which turned directly upon classification may fall in the latter category.

*Breedlove v. Suttles*¹⁰⁶ involved the constitutionality of a Georgia poll tax, imposed on all persons between twenty-one and sixty years of age with the exception of blind persons and women who did not register for voting. The petitioner was a white male citizen of Georgia, twenty-eight years old, who sued in a Georgia court to compel the defendant tax collector to register him for voting although he had not paid his poll tax. The state courts held that he was not entitled to registration, and the Supreme Court unanimously affirmed this decision. Mr. Justice Butler, speaking for the Court, said that it was not a denial of equal protection to restrict the tax to the class of persons named. Minors were reasonably excluded from a tax which would simply burden their fathers. Persons over sixty were properly excluded because they had already served the state. The petitioner conceded the validity of the exemption of the blind, and the Court found a sufficient reason for exempting females in the fact that they bear the burdens of perpetuating the race. Mr. Justice Butler then went on to point out that requiring payment of a poll tax as a prerequisite to voting did not deny any privilege or immunity conferred by the Fourteenth Amendment since the "privilege of voting is not derived from the United States, but is conferred by the State and, save as restrained by the Fifteenth and Nineteenth Amendments and other provisions of the Federal Constitution, the State may condition suffrage as it deems appropriate".¹⁰⁷ He added a further observation, which is significant

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106. 302 U. S. 277 (1937).

107. *Id.* at 283.

in view of *Colgate v. Harvey*¹⁰⁸ where the majority of the Court apparently adopted a conflicting position: "The privileges and immunities protected are only those that arise from the Constitution and laws of the United States and not those that spring from other sources."¹⁰⁹ This seems to be a reversion to the view which prevailed prior to the decision in *Colgate v. Harvey*, where the privilege protected by the Court was clearly not one granted by the Constitution and laws of the United States. Mr. Justice Butler concluded by dismissing the objection to the Georgia tax on the score of the Nineteenth Amendment.¹¹⁰

The other case on classification, already considered in connection with the decisions on the impairment of the obligation of a contract,¹¹¹ was *New York Rapid Transit Corporation v. New York*. A local law of New York City imposed a franchise tax on the corporation measured by a percentage of gross income. The corporation, in addition to the objection to the law on the ground that it impaired its contract with the city, contended that the tax violated the equal protection and due process clauses of the Fourteenth Amendment. The New York Court of Appeals had upheld the tax; the Supreme Court unanimously affirmed that judgment.¹¹² The appellant contended that there was a denial of equal protection because the tax was directed at utilities subject to the supervision of the department of public service. More specifically it argued that the tax as applied to it was unfair because it was peculiarly unable to shoulder the burden of the tax. Addressing himself first to the more general objection, Mr. Justice Reed pointed out that it is reasonable to classify utilities separately for purposes of taxation and that the definition of taxable utilities as those subject to the supervision of the department of public service was a traditional classification of the local laws. He further pointed out that the classification was reasonable in that the utilities thus embraced were protected from private competition; they had to file reports on the basis of approved systems of accounting, which would facilitate the administration of the tax; they furnished indispensable services, subject to relatively little fluctuation even in times of depression—all of which might reasonably be taken into consideration by the legislature in shaping the tax system. The Court had two answers for the narrower objection made by the appellant that the tax was unfair as applied to its specific situation, since, unlike private business and other utilities, it could not pass it on in the form of higher charges because it was bound to a five-cent fare by a contract with the city. In the first place, the situation of

108. 296 U. S. 404 (1935).

109. 302 U. S. at 283.

110. *Id.* at 284.

111. *Supra* pp. 21, 22.

112. Mr. Justice Cardozo did not participate in this decision.

the appellant was unique, and accidental hardship on a single member of a class does not invalidate a classification. Secondly, a tax need not be based on ability to pay. It may be exacted without reference to ability to pay as the appropriate price for the privilege taxed.

The appellant also argued that the classification created by the tax did not bear a fair and substantial relation to the object of the legislation inasmuch as the proceeds were explicitly earmarked for relief of unemployment and the taxpayers subject to the tax were no more responsible than others for unemployment. Without denying the premise that there must be a reasonable relation between legislative classification and the object of the legislation, Mr. Justice Reed denied that there was any violation of this doctrine. The appellant confused the distinction between the object of the tax and the object of the appropriation of the proceeds of the tax. The latter was to relieve unemployment; the object of the tax to raise revenue; and this object bore a reasonable relation to the classification.

VII. THE FEDERAL INCOME TAX

The federal income tax directly affects more taxpayers than any other federal tax. It is also the most complex and abstruse. Consequently, it is not surprising to find the Supreme Court at each session devoting more and more attention to an attempt to unravel its intricacies. At the last Term, twenty-nine,¹¹³ or more than half the cases on taxation, involved the federal income tax.

(a) *Income*

Compensation for past services is taxed as income while a gift is not. In *Bogardus v. Commissioner*¹¹⁴ the Court split five to four in deciding the proper category for a corporate distribution to former employees in recognition of faithful service. Universal Oil Products Company was organized in 1914 with a single asset: a patent for processing petroleum. By 1931 it had prospered to a point where, after the transfer of more than \$4,000,000 worth of its assets to the newly formed Unopco Corporation, its entire stock was sold to United Gasoline Corporation for \$25,000,000. After the sale, none of the former stockholders in Universal retained any interest in that company, nor did they acquire any interest in United. However, they became stockholders in Unopco with the same proportionate holdings that they had had in Universal; and about the time of the sale to

¹¹³. *Helvering v. Therrell*, 303 U. S. 218 (1938), and *Helvering v. Gerhardt*, 303 U. S. 630 (1938), considered in connection with the section on Intergovernmental Immunities, *supra* p. 2 *et seq.*, although involving the federal income tax, will not be discussed again in this section.

¹¹⁴. 302 U. S. 34 (1937).

United, held a meeting at which they decided to distribute \$607,500 to the employees of Universal in recognition of the outstanding success of that organization. This distribution was variously referred to in the course of the meeting and the corporate resolution as an honorarium, bonus or gift. It was explicitly stipulated, however, that the donors were under no obligation to the recipients and that the distribution was not intended as compensation for past services but as a gift. The recipients themselves had never been employed by Unopco, nor directly by Unopco stockholders. In some instances they were still employed by Universal. The petitioner received \$10,000 as his share of the distribution, which the Commissioner contended was additional compensation rather than a gift. The Board of Tax Appeals sustained the Commissioner's finding, and the circuit court of appeals upheld that decision. The Supreme Court, however, reversed the judgment of the circuit court of appeals. Mr. Justice Sutherland, writing for the majority, said that the finding of the Board was a conclusion of law or at least a mixed question of law and fact, which, as distinguished from "findings of primary, evidentiary, or circumstantial facts",¹¹⁵ was subject to judicial revision. Proceeding to revise the Board's determination, he found that it had no support in the primary or evidentiary facts, which showed only a gift and not compensation for past services, since the distribution was not made to discharge a legal or moral obligation or in anticipation of future benefits. The reference to the distribution as an honorarium or bonus was not fatal since it was also referred to as a gift, and the surrounding context showed that these terms were used to designate a gift. The recital that the distribution was made in recognition of past services, said Mr. Justice Sutherland, amounted "to nothing more than the acknowledgment of an historic fact as a reason for making the gifts".¹¹⁶ Mr. Justice Brandeis, for the dissenters, who included Justices Stone, Cardozo, and Black, took the position that the test of a gift or compensation for past services is not consideration for the payment but the intent of the donor. Mr. Justice Brandeis said that, although he might have drawn an inference favoring a gift from the facts found by the Board, there was a "fair basis" for the Board's determination, which the Court should not upset.

The division of the Court on the substantive problem is well defined. According to the majority the earmarks of compensation are the discharge of some obligation or the anticipation of future benefits. The minority test is more nebulous—the subjective intent of the person

115. *Id.* at 39.

116. *Id.* at 44.

making the payment. A more abstruse problem is presented, however, with respect to the scope of judicial review of a finding by the Board of Tax Appeals. According to the majority, when the Board determines a mixed question of law and fact, the Court may substitute its judgment for that of the Board. According to the minority, if there was an opportunity for opposing inferences, the judgment of the Board controls. It is not clear whether the minority rejects the distinction of the majority between findings of mixed law and fact and of primary or evidentiary facts, or whether Mr. Justice Brandeis simply felt that the distinction was badly taken in this case. Neither the majority nor the minority undertook the formulation of any definite criterion to distinguish between determinations of mixed law and fact and findings of pure or evidentiary fact.

The confusion surrounding the taxation of stock rights was increased by *Palmer v. Commissioner*¹¹⁷ where the decision is rational enough, but the judicial asides vastly perplexing. American Superpower Company acquired a large amount of the securities of United Corporation. In order to fortify its cash position and to create a wide market for United stock, Superpower on January 23, 1929 issued to its common stockholders of record on January 26, 1929, rights to purchase at \$25 a share, one-half share of United for each share of their common stock in Superpower. The petitioner was a stockholder in Superpower who received these rights and exercised them on February 15, 1929. Similar rights were granted to and exercised by the petitioner in May and June. The prices received by Superpower for the stocks distributed to its stockholders represented an increase over what it had paid for them. Superpower, consequently, reported this difference as a profit in its 1929 income tax return and treated the distribution as a sale to the stockholders. The petitioner did not dispose of any of the stock which he had acquired by the exercise of the rights in 1929, nor in making out his income tax return for that year did he return any income with respect to these transactions. The Commissioner, however, ruled that the rights to subscribe were dividends, and assessed a deficiency against the petitioner on the basis of the market value of the rights on the respective dates when they could first be exercised. The Board of Tax Appeals reversed the decision of the Commissioner, taking the position that the distributions were sales by Superpower to its stockholders and did not constitute the distribution of taxable dividends. In reaching this conclusion, the Board found that the fair market value of United stock during January, 1929, was \$25 a share. It did not find the fair market value of the stock pur-

117. 302 U. S. 63 (1937).

chased in May or June, but it was of the opinion that there was no reason to assume that the transactions were other than sales between Superpower and its stockholders as petitioner contended. The circuit court of appeals reversed the decision of the Board of Tax Appeals, holding that the distributions by Superpower constituted taxable dividends to the extent of the difference between the value of the stock acquired by the exercise of the rights at the dates when they were exercised and the prices paid to exercise them. The Supreme Court, in a unanimous opinion written by Mr. Justice Stone, reversed the judgment of the circuit court of appeals.

Mr. Justice Stone said that, where a corporation issues rights to its stockholders to acquire corporate assets at a price equivalent to the fair market value of these assets at the time the rights are issued, there is no distribution of corporate profits or taxable dividend. It is simply a sale. The mere fact that the property for which the rights call increases in value between the dates when the rights are issued and exercised does not constitute income to the stockholder since income is realized by selling at a profit rather than purchasing below the market. The situation is analogous, said Mr. Justice Stone, to that which exists where a person gives another an option to buy his property at a stipulated figure, and before the option is exercised, the value of the property rises above that figure. Income is not realized upon the exercise of the option because this amounts to nothing more than buying below the market. Mr. Justice Stone intimated that, if a corporation issues rights to its stockholders to acquire corporate assets below their then market value, this might amount to a distribution of corporate profits. However, he concluded that there was support for the conclusion of the Board of Tax Appeals that this was not the situation in the case at hand and the transactions were simply what they appeared on their face to be—sales. Since the Court did not undertake independent review of the decision of the Board of Tax Appeals, its finding that there were sales rather than a distribution of corporate profits must have been a finding of primary or evidentiary facts rather than a conclusion of mixed law and fact. It is difficult to see how the quality of the Board's judgment differed from that in the *Bogardus* case.

The narrow decision in *Palmer v. Commissioner* is straightforward enough. A stockholder does not realize any income when he receives or exercises rights to purchase corporate property, provided that the amount necessary to exercise the rights is substantially equivalent to the market value of the property at the time the rights are issued. This is a sale by the corporation, not a taxable distribution

of corporate profits. The Court, moreover, was careful to negative any intimation that a taxable dividend may not be effected by a sale of corporate property to a stockholder below its fair market value. But the opinion leaves the point at which rights to purchase corporate property become income badly confused. Prior to the *Palmer* case, it was generally thought that the distribution of rights to subscribe to stock resulted in a realization of taxable income if the rights called for property or securities which, if distributed directly, would have constituted a realization of taxable income. On the other hand, if the rights called for a class of stock, which, if distributed directly, would not have constituted a taxable dividend, no income was realized. The *Palmer* case requires modification of this opinion to the extent that the market value of the property for which the rights call must be examined in every case to determine whether there is a real distribution of profits or merely a sale of corporate assets. How much further modification is necessary is far from clear. "The mere issue of rights to subscribe and their receipt by stockholders," said Mr. Justice Stone, "is not a dividend. No distribution of corporate assets or diminution of the net worth of the corporation results in any practical sense. Even though the rights have a market or exchange value, they are not dividends within the statutory definition. . . . They are at most options or continuing offers, potential sources of income to the stockholders through sale or exercise of the rights. Taxable income might result from their sale, but distribution of the corporate property could take place only on their exercise."¹¹⁸ It is not entirely clear whether Mr. Justice Stone intended to limit his remarks to the case immediately before him, where there was a sale of corporate property, not a distribution of corporate assets. It is doubtful, however, whether he had this limitation in mind. It is not apparent from the language itself. Moreover, there is an intimation that distribution of the corporate property might take place upon the exercise of the rights, which is inconsistent with the notion that he was speaking only about rights whose exercise constitute a sale, not stock rights generally. If Mr. Justice Stone was philosophizing about the taxability of stock rights in general, then he seems to be saying that income cannot be realized from the mere receipt of stock rights, regardless of whether or not income may be realized from their exercise or sale somewhere later along the line. This seems to be an unfortunate position and one warranted neither by legal theory nor the practical exigencies of the situation. Conceding Mr. Justice Stone's premise that the right itself does not amount to a distribution of corporate property, but simply to

118. 302 U. S. at 71.

an option, there is no apparent reason why the distribution of valuable options might not constitute a realization of income. If *A* agrees to work for *B* in return for a thirty day option to purchase Blackacre, a farm belonging to *B*, would one hesitate to say that *A* had not realized income upon the receipt of the option? Mr. Justice Stone seems to confuse the receipt of something of value, which is income, with the subsequent disposition which is made of the receipt, which ordinarily does not affect the problem of whether income has been received.

Although *Palmer v. Commissioner* increased the confusion surrounding the taxation of stock rights, there were several cases which clarified the Court's position with respect to the somewhat analogous question of the taxation of stock dividends. To appreciate their significance it will be well to review very briefly the stock dividend problem in an effort to portray the recent decisions against their proper context. After the decision in *Eisner v. Macomber*,¹¹⁹ which held that a dividend of common stock on common stock was not constitutionally taxable as income, Congress provided that "a stock dividend shall not be subject to tax".¹²⁰ There was some doubt at the time as to the congressional intent—whether Congress meant to exempt all stock dividends from the income tax, or simply those which it had no constitutional power to tax. The Treasury took, and for a number of years adhered to, the position that the statutory provision exempted all stock dividends without exception regardless of whether or not they were constitutionally taxable. As a logical corollary the regulations provided for the recognition of taxable gain or loss upon the sale of stock received by way of a dividend, which was to be computed by taking as the basis of the stock dividend a proportionate part of the basis of the original stock on which the dividend was declared. In *Koshland v. Helvering*,¹²¹ however, the Supreme Court in a surprising decision upset this part of the regulations. *Koshland v. Helvering* involved a common stock dividend on preferred stock. The stockholder had sold the original preferred stock and the Commissioner, instead of allowing her to take the full cost of the stock as the basis for computing the gain on the sale, had in accordance with the applicable regulations allocated part of the cost of the original stock to the stock dividend. The Supreme Court found that the Commissioner's action was without statutory authorization and allowed the taxpayer

119. 252 U. S. 189 (1920).

120. 42 STAT. 228 (1921); 43 STAT. 255 (1924); 44 STAT. 11 (1926); 45 STAT. 822 (1928); 47 STAT. 204 (1932); 48 STAT. 712, 26 U. S. C. A. § 115 (f) (1934). After the decision in *Koshland v. Helvering*, 298 U. S. 441 (1936), Congress provided that stock dividends should be taxed as income to the extent that they were constitutionally taxable. 49 STAT. 1688 (1936), 26 U. S. C. A. § 115 (f) (Supp. 1937). This is the present rule. Pub. L. No. 554, 75th Cong., 3d Sess. (May 16, 1938) § 115 (f).

121. 298 U. S. 441 (1936).

to take as her basis the full cost of the preferred stock. In reaching this conclusion the Court drew a distinction between stock dividends which are constitutionally income and stock dividends which are not. The Court found that a common stock dividend on preferred stock was income in the constitutional sense and that, therefore, it could not be used to reduce the basis of the original stock since the statute did not authorize reducing the basis of stock because of the receipt of a dividend which was in its essential nature income. *Koshland v. Helvering* not only upset preexisting departmental practice, but it left open at least four perplexing problems of immediate practical significance. Although the Court laid down some vague criteria to distinguish between stock dividends which are and are not constitutionally income, it left open the application of those criteria in concrete cases. That is, it left considerable room for speculation as to just what stock dividends are and are not income. The next three questions were closely interrelated. *Koshland v. Helvering* repudiated the practice of deferring the taxation of all stock dividends until they were sold by holding that stock dividends, which were constitutionally income, could not be used to reduce the basis of the stock on which such dividends were declared. It expressly reserved the problem, however, of whether such dividends were taxable when they were received under a statute which said that "a stock dividend shall not be subject to tax". If this statute meant only that stock dividends which were not constitutionally taxable were not subject to the tax and that other dividends were, then stock dividends which were constitutionally income were taxable when they were received. On the other hand, if such dividends were not taxable when they were received, that is, if the statute exempted all stock dividends from taxation, then there was the further problem of the proper basis for such dividends when they were sold. The Court eliminated the possibility of using an apportioned basis by the decision in *Koshland v. Helvering*. The possibilities left were that the basis of the stock dividend should be zero or the fair market value of the dividend at the time it was received. A final difficulty, whose answer was perhaps foreshadowed by *Koshland v. Helvering*, was the length of time for which a stockholder should be deemed to have held a stock dividend which was constitutionally income. For the purpose of determining whether the stock dividend constituted a capital asset or the percentage of the gain from its sale which was taxable, did the time of holding start when the dividend was received, or could the taxpayer tack on to this period the period during which he had held the original stock in connection with which the dividend was declared?

There were two cases which go a long way toward clarifying these points at the last term. Both of them presented the same sub-

stantive problems although by an odd procedural twist they reached different results. In *Helvering v. Gowran*¹²² Gowran owned common stock in the Hamilton Manufacturing Corporation, which in 1929 paid him a dividend on this stock in the form of preferred stock. At the time of the preferred stock distribution, the corporation had outstanding both common and preferred stock. Later in 1929, the corporation redeemed Gowran's preferred stock at a price equivalent to the market value of the stock when the dividend was distributed. Gowran treated the redemption as a sale to the corporation and returned part of the money which he received as a capital gain, taking as his basis in computing the gain a proportionate part of the cost of the original common stock allocable to the preferred stock. He also determined the time which he had held the preferred stock by tacking on the period since the distribution of the preferred stock to the prior period during which he had held the common stock. The Commissioner contended that the entire amount received in redemption of the preferred stock was taxable as income in 1929 upon the theory that the distribution and redemption of the preferred stock amounted in substance to the distribution of a taxable cash dividend. Gowran sought a redetermination of the deficiency assessed by the Commissioner before the Board of Tax Appeals. Some idea of the uncertainty created by *Koshland v. Helvering* may be gathered from the fact that Gowran, the Commissioner, the Board of Tax Appeals, the circuit court of appeals, and the Supreme Court of the United States all adopted different theories as to the taxability of the transaction in question. The Board of Tax Appeals upheld the deficiency asserted by the Commissioner, but upon a different theory. The Board held that the distribution of the stock dividend and its redemption in cash were not a taxable cash dividend, but that the stock dividend itself was taxable as income because it resulted in a change in Gowran's proportionate interest in the company. The circuit court of appeals, in reversing the Board, held that the distribution of the stock dividend and its cash redemption did not constitute a taxable cash dividend. Moreover, the Court said that although the stock dividend was income in a constitutional sense, it was not in fact taxed under the applicable revenue act in force at the time which provided that "a stock dividend shall not be subject to tax". Nor, according to the circuit court of appeals, was there taxable gain when the stock was sold back to the corporation because the basis of the stock was not zero but its fair market value at the date of distribution of the dividend. The Supreme Court, in an opinion by Mr. Justice Brandeis, reversed that judgment. The Court accepted the

122. 302 U. S. 238 (1937).

findings of the lower tribunals to the effect that the redemption of the stock did not amount to the distribution of a taxable cash dividend. Moreover, it affirmed the holding of the circuit court of appeals that, although it was constitutionally taxable, the stock dividend was not in fact taxed under the statute in force at the time it was distributed. However, Mr. Justice Brandeis took issue with the circuit court of appeals as to the proper basis for the stock dividend upon its subsequent sale. On the theory that the stock dividend had cost the stockholder nothing,¹²³ the Court held that the proper basis on a subsequent sale was zero. Since, moreover, the stock dividend was income in its nature, rather than capital, the period during which the stock was held started with the distribution of the dividend, not with the date of acquisition of the stock on which the dividend was declared; and it followed that the full amount received from the corporation in redemption of the stock dividend was taxable as income. The Board of Tax Appeals had reached the same result as the Supreme Court although it upheld the deficiency on a different theory. The Court, in reinstating the decision of the Board, held that, since it reached a correct result, its conclusion would not be upset because arrived at by erroneous reasoning.

Laying aside the procedural point for discussion in connection with *Helvering v. Pfeiffer*,¹²⁴ what further light does *Helvering v. Gowran* shed upon *Koshland v. Helvering*? It clears up several points. The Court accepted the original treasury construction of the Acts which exempted stock dividends. The provision that "a stock dividend shall not be subject to tax" covers all stock dividends, not merely those which are beyond the constitutional reach of Congress. Moreover, *Helvering v. Gowran* clarifies the basis which must be used when a stock dividend is sold. If the stock dividend is one which cannot constitutionally be taxed as income, then the proper basis is presumably a proportionate part of the cost of the stock on which the dividend was declared. If the stock dividend is of a type which is constitutionally income, but was received when the applicable revenue acts provided that stock dividends were not taxable, then the basis is zero. Presumably, when a stock dividend is sold which was received under the present practice of taxing all stock dividends as income which are constitutionally so taxable, the proper basis is the fair market value of the stock dividend at the date of distribution. Since the taxpayer is taxed on this amount as income, it should be regarded as his cost.

¹²³. This is obviously untrue. The stock dividend depletes the proportionate share of surplus represented by the original stock. The result, however, may not be unfair, since when the taxpayer sells the original stock he will be entitled to take as his basis the full cost of the original stock, without any allocation to the stock dividend.

¹²⁴. 302 U. S. 247 (1937).

Finally, in connection with the proper basis for the sale of a stock dividend, the period of holding would appear to be determined by whether the dividend was or was not constitutionally income. If it was constitutionally taxable as income, the period of holding runs from the date when the dividend was distributed. If it is not the kind of dividend which is constitutionally taxable as income since it represents merely a capital readjustment, presumably the holding period embraces not only the time which elapsed between the date of distribution and sale but includes the period prior to the date of distribution during which the taxpayer held the original stock.

Although on these points *Helvering v. Gowran* is fairly specific, it still leaves unanswered the question of what stock dividends are and are not constitutionally taxable as income. There are two possible distinctions between taxable and nontaxable stock dividends. It is clear that a stock dividend which gives the stockholder the same kind of interest in the corporation which he had before and effects no change in the preexisting positions of the stockholders is not taxable as income. It is not clear, however, whether both of these conditions must conjoin in order to have a stock dividend which is not taxable. If either element is lacking, will there be a taxable stock dividend?

In *Helvering v. Gowran* (and this was also true of the *Pfeiffer* case), for example, the dividend was a dividend of preferred stock on common, but there was outstanding both common and preferred stock at the time of the distribution. Suppose that there had been only common stock outstanding. Would the preferred stock dividend have been taxable? It would possibly have given the common stockholders a different kind of interest, but it would hardly have given them a different "proportional" interest. Although *Koshland v. Helvering* stressed the idea of a different proportional interest as essential to a taxable stock dividend, this does not seem to have bulked large in Mr. Justice Brandeis' mind in deciding *Helvering v. Gowran*. The dividend was constitutionally taxable, said Mr. Justice Brandeis, ". . . since the dividends in preferred stock gave to Gowran an interest different in character from that which his common stock represented. . . ." ¹²⁵ According to *Helvering v. Gowran*, a stock dividend is apparently taxable if it is a different class of stock than that on which the dividend is declared. It is true that in both *Helvering v. Gowran* and *Helvering v. Pfeiffer* there was outstanding both preferred and common stock at the time the dividends were distributed so that the stockholders may have acquired different proportional interests. But it would appear significant that, while Mr. Justice

125. 302 U. S. at 240.

Brandeis mentioned this fact in *Helvering v. Gowran*, he did not stress it, and in *Helvering v. Pfeiffer* he did not mention it at all.

Helvering v. Pfeiffer involved the same substantive problems as *Helvering v. Gowran*, but reached a different result, due to a procedural peculiarity. A detailed review of the case shows the difficulties which the courts are having with these stock dividend cases. In 1928 Annie M. Pfeiffer received a dividend in preferred stock on common stock which she owned in William R. Warner Corporation. In 1931 she received a similar dividend. In that year, moreover, the preferred stock distributed in 1928 was redeemed by the corporation in cash. Pfeiffer did not return the stock dividend received in 1928. In her return for 1931 she returned the difference between the cash received in redemption of the 1928 dividend and part of the basis of the stock on which the dividend had been declared allocable to the stock dividend. The Commissioner assessed a deficiency for 1931 for the value of the stock dividend distributed in 1931, upon the theory that this was taxable income when it was received; and for the cash received in the redemption of the stock distributed in 1928, upon the theory that the stock distribution plus the redemption in cash was really a taxable cash dividend. The taxpayer appealed to the Board of Tax Appeals, which held that the stock distributed in 1931 was taxable as income in that year, but that the redemption of the stock distributed in 1928 was not a taxable cash dividend but a sale to the corporation. Furthermore, the Board held that the basis of the redeemed stock was its market value at the time it was distributed, which was equal to the redemption price, so that there was no taxable gain on this transaction. The Commissioner did not appeal from the decision of the Board of Tax Appeals although the taxpayer did. The circuit court of appeals reversed the Board's decision insofar as it held that the stock dividend distributed in 1931 was taxable as income when it was distributed, and the Commissioner petitioned the Supreme Court for a review of the circuit court of appeals' decision. The Supreme Court affirmed the judgment of the circuit court of appeals. Although under the *Gowran* case the basis of the stock which was redeemed in 1931 was zero, so there really was a deficiency in the taxpayer's return for that year, the majority of the Court said that, since the Board of Tax Appeals had held that there was no deficiency in connection with this transaction, and the Commissioner had not appealed from the Board's decision, they would not disturb its holding upon this point. The Court drew a distinction between a situation where a deficiency is found by the Board for an erroneous reason where the Court may uphold the deficiency for a proper reason, and a situation where the Board

holds that there is no deficiency and the Commissioner does not appeal. At this juncture, Justices Stone and Cardozo dissented. They pointed out that as a matter of fact the Board had assessed a deficiency in an amount larger than the deficiency actually due because it regarded the stock dividend distributed in 1931 as taxable. Instead of regarding the decision of the Board as really two separate decisions, one with respect to the stock which was redeemed in 1931 and one with respect to the stock which was distributed in that year, as the majority of the Court apparently did, the dissenters wished to regard the decision as a unit. Since the Board assessed a deficiency and this was greater than that actually due, the dissenting justices felt that the Court should sustain the finding of a deficiency in the amount actually owing.

The last case on the taxation of dividends will, perhaps, be clarified by a preliminary word of explanation. Congress possesses the constitutional power to tax dividends, other than distributions in liquidation, from surplus accumulated prior to March 1, 1913, the effective date of the first federal income tax after the ratification of the Sixteenth Amendment. However, it has seen fit to treat such distributions as a return of capital rather than taxable dividends. It follows that it is of the utmost importance to determine the source of a corporate distribution, and this was the problem presented by *Foster v. United States*.¹²⁶ The Foster Lumber Company which was organized in 1892 with a capital stock of \$200,000 was worth \$3,725,000 on March 1, 1913. On October 10, 1929 it redeemed 500 shares of its stock for \$1,025,000, which represented \$2,025 a share, the agreed value per share as of March 1, 1913. On February 11, 1930, the company declared a \$225,000 dividend. The accumulated earnings of the company between March 1, 1913 and October 10, 1929 amounted to \$330,578.98. Between October 10, 1929 and February 11, 1930, the company's earnings amounted to \$82,758.17. The petitioners were executors of a deceased stockholder in the Foster Lumber Company. They contended that, of the \$225,000 dividend paid in 1930, only \$82,758.17 represented a taxable distribution, the theory being that under the 1928 Act dividends were presumed to be paid from the latest earnings and the distribution in 1929 exhausted all the earnings between that date and March 1, 1913. The Court held, however, in an opinion by Mr. Justice Black,¹²⁷ that the entire \$225,000 was taxable on the ground that the 1929 distribution was a distribution in partial liquidation, chargeable to capital account, rather than to earnings accumulated since March 1, 1913.

126. 303 U. S. 118 (1938).

127. Mr. Justice Cardozo did not participate in this decision.

Although as a matter of constitutional power Congress could treat the gains from many exchanges in connection with reorganizations as taxable income, for reasons of fairness and policy it has chosen generally to exempt such exchanges from the federal income tax. The statutory provisions conferring this immunity are, however, technical and complex. Every term sees a number of cases in which an authoritative ruling upon some aspect is sought. The 1937 term was no exception.

In *Groman v. Commissioner*,¹²⁸ the stockholders of Metals Refining Company, in pursuance of a contract between that company and Glidden Company, transferred their stock to an Ohio corporation organized by Glidden, in return for prior preference stock of Glidden, the preferred stock of the new Ohio corporation, and cash. The Ohio corporation, all of whose common stock was held by Glidden, caused a conveyance to it of Metals' assets and Metals was dissolved. The petitioner was one of the shareholders in the Metals corporation. He returned the cash which he received from the reorganization as income but none of the stock. The Commissioner assessed a deficiency contending that the Glidden stock was taxable income on the ground that Glidden was not a party to a reorganization under the 1928 Act which governed the transaction in question. The Board of Tax Appeals reversed the Commissioner, and the circuit court of appeals reversed the Board of Tax Appeals. The Supreme Court in an opinion by Mr. Justice Roberts¹²⁹ affirmed the judgment of the circuit court of appeals. Mr. Justice Roberts said that Section 112 (i) 2 of the 1928 Act which says that a party to a reorganization "includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation"¹³⁰ obviously did not cover Glidden's position in the transaction, but that this definition was not exclusive. He then undertook to decide on general principles whether Glidden was a party to a reorganization and held that it was not. Since Glidden received nothing from the shareholders in Metals Company and transferred nothing to them, Mr. Justice Roberts said that it was not a party to the reorganization, but stood rather in the position of a broker effectuating the reorganization. Mr. Justice Roberts further refused to countenance the argument that Glidden was really a party to the reorganization because the Ohio corporation was simply its alter ego or the agent of a principal. The

128. 302 U. S. 82 (1937).

129. Mr. Justice Black did not participate in this decision.

130. 302 U. S. at 85.

purpose of the reorganization provisions "is that where, pursuant to a plan, the interest of the stockholders of a corporation continues to be definitely represented in substantial measure in a new or different one, then to the extent, but only to the extent, of that continuity of interest, the exchange is to be treated as one not giving rise to present gain or loss."¹³¹ Since by acquisition of the Glidden stock, the shareholders of Metals corporation did not acquire a "continued substantial interest" in the assets of the Metals company in the ownership of the Ohio corporation, but "an interest in the assets of Glidden a part of which was the common stock of Ohio," the Glidden stock constituted "other property" received in connection with a reorganization, which was subject to the tax.

*Helvering v. Bashford*¹³² was a case very similar to *Groman v. Commissioner*. The one factual distinction between the two cases was not felt sufficiently significant to justify a difference in result. Atlas Powder Company wanted to eliminate the competition of Peerless Explosives Company, Union Explosives Company and Black Diamond Powder Company. It induced the stockholders of these companies to transfer their stock to Atlas in return for cash, Atlas stock, and stock in a new corporation which Atlas organized and to which it transferred the stock of Peerless, Union and Black Diamond in order to enable it to take over the assets of these companies. Atlas held a majority of the common stock of the new corporation. Bashford, one of the stockholders of Peerless, returned the cash as income, but none of the stock. The Commissioner admitted that the stock of the new corporation was not taxable, but contended that the Atlas stock was. The Board of Tax Appeals and the circuit court of appeals agreed with Bashford that the Atlas stock was stock of a party to a reorganization and was not, therefore, taxable. The Supreme Court, however, reversed their holdings on the strength of the *Groman* case. The Court in an opinion by Mr. Justice Brandeis, in which Mr. Justice Roberts did not participate and from which Mr. Justice McReynolds, Mr. Justice Sutherland, and Mr. Justice Butler dissented, said that the Atlas stock did not represent a continuance of the interests of the stockholders in Peerless, Union and Black Diamond, but a different interest in another corporation; and therefore was to be regarded as "other property", which was taxable. The petitioner urged that there was a distinction between the case at hand and the *Groman* case, in that Atlas here exchanged its stock directly with the stockholders in Peerless, Union and Black Diamond for their stock, so that it was a party to all the ex-

131. 302 U. S. at 89.

132. 302 U. S. 454 (1938).

changes, which was not true of the Glidden Company in the *Groman* case. Mr. Justice Brandeis replied, however, that "Any direct ownership by Atlas of Peerless, Black Diamond and Union was transitory and without real substance; it was part of a plan which contemplated the immediate transfer of the stock or the assets or both of the three reorganized companies to the new Atlas subsidiary. Hence, under the rule stated, the above distinctions are not of legal significance. . . . The continuity of interest required by the rule is lacking." ¹³³

In an earlier decision involving the Minnesota Tea Company,¹³⁴ the Supreme Court held that it had participated in a reorganization, and that certain cash and stock received by the corporation were received in connection with a reorganization. *Minnesota Tea Company v. Helvering* ¹³⁵ involved the further question whether part of the cash which had been immediately distributed to the stockholders in pursuance of their agreement to satisfy the corporate debts was taxable as income to the Tea Company. Mr. Justice Sutherland,¹³⁶ delivering the opinion of the Court, said that the corporation had realized taxable income. Although money received by a corporation in the course of a reorganization which is at once distributed to the stockholders is not taxable to the corporation, the money in the case at hand was not in reality distributed to the stockholders but was used by the corporation to pay its own debts, and was, therefore, taxable to the corporation just as though it had paid the debts directly, rather than through the medium of a preliminary distribution to the stockholders.

United States v. Hendler,¹³⁷ involving a somewhat similar point, was decided upon the authority of *Minnesota Tea Company v. Helvering*. One of the corporate parties to a reorganization agreed to assume and pay the bonded indebtedness of the other. The problem was whether the latter realized taxable income by virtue of this transaction. In an opinion by Mr. Justice Black ¹³⁸ the Supreme Court, reversing the circuit court of appeals, held that it did. Section 112 of the 1928 Act exempts only the receipt of "stock or securities" or cash which is immediately distributed to stockholders. The assumption of bonded indebtedness is not the receipt of stock or securities. It is tantamount to the receipt of cash, which is not distributed to stockholders, but used to pay creditors.

133. *Id.* at 458.

134. *Helvering v. Minnesota Tea Co.*, 296 U. S. 378 (1935).

135. 302 U. S. 609 (1938).

136. Mr. Justice Cardozo did not participate in this decision.

137. 303 U. S. 564 (1938).

138. Justices Cardozo and Reed did not participate in this decision.

(b) *Classes of Taxpayers*

There were several interesting points passed upon at the last term in connection with the taxation of partnerships. When a partner and a partnership return their income on the basis of different years—usually a calendar year for the partner and a fiscal year for the partnership, the prevailing statutory rule requires the partner to include his share of the partnership income for the partnership tax year ending in his tax year. For example, if *A*, who returns his income on the basis of a calendar year, is a member of a partnership accounting on a fiscal year ending July 31, in making out his return for 1938, *A* would include his share of the partnership income for the partnership's fiscal year ending July 31, 1938. An interesting problem which has perplexed the inferior federal tribunals is what happens where a partner dies. Suppose in the hypothetical case that *A* dies on December 16, 1938. In making out his return will his executor include his share of the partnership income for the fiscal year ending on July 31, 1938, or will he include his share of the partnership profits accruing up to the date of his death? In *Guaranty Trust Co. v. Commissioner*,¹³⁹ the Supreme Court held that in this situation the partner's share of partnership profits accruing up to his death must be included in his return. Justices McReynolds and Roberts dissented; Justices Cardozo and Reed did not participate in the decision.

*Heiner v. Mellon*¹⁴⁰ raised the problem of what is meant by a partner's distributive share of the partnership income, as well as a number of subsidiary points. A. W. Mellon, R. B. Mellon, and H. C. Frick each owned one-third of the capital stock of two distilling corporations. In 1918 they formed two partnerships in which each was to have a one-third interest; and in 1919 they caused the transfer of the assets of each of the distilling corporations to the partnerships of the same names. The purpose of these partnerships was to liquidate the business of the corporations, and this continued until 1925 when all the assets of the partnerships were finally sold and the proceeds distributed. Frick died in 1919, but the other partners carried on the partnerships after his death in the same manner in which the business had been conducted before his death. In 1920 the partnerships made profits from the sale of whiskey, which the Mellons failed to include in their individual returns. This litigation turned about those profits. Mr. Justice Brandeis, who delivered the opinion for the Court,¹⁴¹ held that the fact that the profits were made in the course of liquidation did not prevent their being taxed in the year when they were made. The federal in-

139. 303 U. S. 493 (1938).

140. 304 U. S. 271 (1938).

141. Justices Cardozo and Reed did not participate in this decision.

come tax is an annual tax and annual income must be returned. When a business is being liquidated, the owners of the business cannot wait until it is finally closed out and then cast up their profits and losses to determine whether there is any income. If profits are made in one year they must be returned in that year. Losses in a later year are to be accounted for in that year. Secondly, Mr. Justice Brandeis said that the fact that Frick died in 1919 and his death dissolved the partnerships did not affect the liability of the Mellons as surviving partners for income taxes on the profits made in 1920. Since they continued the business after Frick's death, they were liable for a tax upon the profits which they earned. This conclusion was fortified by the fact that under the Pennsylvania Uniform Partnership Act it was provided that "On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed."¹⁴² Thirdly, Mr. Justice Brandeis held that the partners' interests in the partnerships were not capitalized upon dissolution, so that until the liquidation returned to them the cost of their interests no taxable income was received, but that current earnings after Frick's death were income taxable to the partners. Fourthly, the Mellons had contended that upon the death of Frick, they became liquidating trustees and that the income earned by their operations in 1920 accrued to them in a fiduciary capacity and was taxable to the trust estate, not to them individually as partners. Mr. Justice Brandeis disposed of this contention by pointing out that, while under the Pennsylvania law they might be liquidating trustees, under the federal law for purposes of the federal income tax they were partners carrying on a business and taxable as such. Possibly the most interesting point was the contention of the Mellons that, since under the law of Pennsylvania they could not have distributed any of the partnership profits in 1920 because as liquidating trustees no distributions could be made until all the debts and liabilities of the partnership had been satisfied, they had no distributive shares in the partnership income on which they could be taxed. The Court held, however, that "distributive" does not mean "currently distributable under state law" but proportionate, and, therefore, they were taxable upon their proportionate shares of the partnership earnings even though these were not distributable. Finally, the Court held that the fact that the Commissioner had determined that no profit was realized until the liquidation of the partnerships in 1925 and that income taxes had been collected upon that theory did not bar the petitioners' liabilities for the 1920 deficiencies. It was not clear whether the Court felt that this was unimportant because it was not shown that

142. PA. STAT. ANN. (Purdon, 1930) tit. 59, § 92.

the recovery of the taxes paid for 1925 was barred, or because it was just unimportant.

(c) *Deductions and Credits*

In order to claim a deduction for depletion, the taxpayer must have a capital investment in the depletable property. Several cases involved the problem of when such an interest exists. In *Helvering v. O'Donnell*¹⁴³ O'Donnell sold his third of the capital stock of the San Gabriel Petroleum Company to Petroleum Midway Company, Limited, in return for the latter's agreement to pay him one-third of the net profits from the development and operation of the oil and gas properties of the San Gabriel Company, which the Midway Company was to acquire. In denying O'Donnell's claim for a depletion allowance with respect to the payments made to him by the Midway Company, Chief Justice Hughes¹⁴⁴ said that O'Donnell lacked a capital interest in the oil and gas in place. "As a mere owner of shares in the San Gabriel Company, respondent had no such interest. . . . The agreement to pay respondent one-third of the net profits derived from the development and operation of the properties was a personal covenant and did not purport to grant respondent an interest in the properties themselves."¹⁴⁵

The Court stressed the same point again in *Helvering v. Elbe Oil Land Development Company*,¹⁴⁶ where the Elbe Oil Land Development Company had sold certain properties consisting of oil and gas prospecting permits, drilling agreements, leases and equipment to Honolulu Consolidated Oil Company. In turn, the latter agreed to pay \$350,000 upon the execution of the agreement, and further sums of \$400,000 in each of the years 1928, 1929, 1930, and 1931, with the further promise that, when the Honolulu Company had been reimbursed for its expenditures in connection with the properties, it would pay the vendor one-third of the net profits realized from them. The Elbe Company received the first payment of \$350,000 in 1927. This exceeded the cost to it of the properties so it returned the difference between the cost basis and \$350,000 as income for 1927. In its returns for 1928 and 1929, the Elbe Company reported the \$400,000 payments as gross income, but claimed a depletion allowance with respect to these sums. In denying the deduction, Chief Justice Hughes¹⁴⁷ said: "The words 'gross income from the property,' as used in the statute governing the allowance for depletion, mean gross income received from the opera-

143. 303 U. S. 370 (1938).

144. Justices Cardozo and Reed did not participate in this decision.

145. 303 U. S. at 371.

146. 303 U. S. 372 (1938).

147. Justices Cardozo and Reed did not participate in this decision.

tion of the oil and gas wells by one who has a capital investment therein—not income from the sale of the oil and gas properties themselves.”¹⁴⁸

*Helvering v. Bankline Oil Company*¹⁴⁹ also denied an allowance for depletion. The Court held¹⁵⁰ that a taxpayer which had contracted which it was to keep two-thirds of the gross proceeds from the sale of the gasoline so extracted was a mere processor, and not a producer having a capital investment in the gas, and was not entitled to a deduction for depletion.

The last case on depletion involved the problem of the gross income on which a depletion allowance should be computed. In *Helvering v. Mountain Producers Corporation*¹⁵¹ Wyoming Associated Oil Company (a subsidiary of Mountain Producers Corporation) entered into an agreement to sell the oil from certain leases to the Midwest Refining Company. The Midwest Company agreed to pay for the oil at a sliding scale of prices based upon the average price received by the Midwest Company for gasoline and kerosene. It further agreed to develop and operate the leased wells and to bear the cost of such operation and development. The Wyoming Company, in view of this proviso, claimed that for the purpose of computing its allowance for depletion it was entitled to include in the gross income on which the allowance was based the cost of producing the oil. The principal basis for this contention was that if it produced the oil itself and sold it, the price, which would constitute the gross income, would include the cost of production. Therefore, the company argued that when it sold the oil for a figure which discounted the cost of production, production costs should be added to the cash payments to arrive at the gross income by which depletion was to be reckoned. The Court, again speaking through the Chief Justice,¹⁵² held, however, that gross income for the purpose of depletion was limited to cash payments. “We do not think,” said the Court, “that we are at liberty to construct a theoretical gross income by recourse to the expenses of production operations.”¹⁵³

*Biddle v. Commissioner*¹⁵⁴ presents an interesting problem with respect to the credit and deduction of foreign income taxes. Under the British income tax, the “standard” tax (which corresponds to our normal tax) on corporate dividends is paid by the corporation. In

148. 303 U. S. at 375.

149. 303 U. S. 362 (1938).

150. The Chief Justice delivered the opinion. Justices McReynolds and Butler concurred in the result. Justices Cardozo and Reed did not participate in the decision.

151. 303 U. S. 376 (1938).

152. Justices Cardozo and Reed did not participate in this decision. Justices McReynolds and Butler dissented on the ground that income of a lessee of state school lands is not subject to the federal income tax, a point discussed in connection with the section on Intergovernmental Immunities, *supra* pp. 7, 8.

153. 303 U. S. at 382.

154. 302 U. S. 573 (1938).

computing his surtax, however, the stockholder adds the appropriate standard tax to the net amount received from the corporation. Moreover, although the corporation rather than the stockholder is legally liable for the standard tax, if the stockholder's income is exempt or less than the minimum amount subject to tax, he is allowed a refund of the tax paid by the corporation. In *Biddle v. Commissioner*, a citizen reported as gross income the net dividends received from British corporations in 1929 and 1931 and the proportionate part of the standard tax paid by the corporations in her United States income tax returns for those years. Up to the limit set by Section 131 (a) (1) of the Revenue Act of 1928, she claimed as credits against the American tax, the British surtax and standard tax on the dividends, and as deductions under Section 23 (c) (2) of the 1928 Act, the excess of the British taxes above the limit allowed for credits. The credits and deductions were allowed with respect to the British surtaxes, but the Commissioner denied the credits and deductions for the standard taxes on the theory that they were paid by the corporations, rather than the taxpayer. The Board of Tax Appeals reversed the decision of the Commissioner and held that the standard tax was paid by the stockholder. The Circuit Court of Appeals for the Third Circuit affirmed the decision of the Board of Tax Appeals. *Helvering v. Elkins*,¹⁵⁵ which was decided with the *Biddle* case, raised the same question. Here again the Board of Tax Appeals overruled the Commissioner and held that the taxpayer was entitled to credit and deduction for the British standard tax. In the *Elkins* case, however, the Circuit Court of Appeals for the First Circuit reversed the decision of the Board of Tax Appeals. To resolve this conflict the Supreme Court agreed to review the cases. The decision in the *Elkins* case was affirmed and that in the *Biddle* case reversed in an opinion delivered by Mr. Justice Stone,¹⁵⁶ who held that the standard tax on dividends was paid by the corporations rather than the taxpayers so that they were not entitled to the credits and deductions. Mr. Justice Stone said that whether the standard tax was paid by the corporation or the stockholders was to be determined not by what the British law regards as payment, but by what Congress regards as payment as that term is used in the federal statute. Starting from this premise he found that the British standard tax on dividends was similar to the tax imposed under American law upon corporate income. This similarity was, of course, more striking under the 1928 Act than under the present federal law since under the 1928 Act there was no normal tax on dividends—the theory being that the normal

155. *Ibid.*

156. Justices McReynolds, Sutherland and Butler dissented.

tax was compensated for by the tax on corporate income. Mr. Justice Stone's view that the British standard tax is really paid by the corporation was fortified by the fact that the legal liability for the tax rests upon the corporation. He admitted that the inclusion of the amount of tax paid by the corporation in the stockholder's gross income for the purpose of computing the surtax and the allowance of a refund of the standard tax, where the stockholder was not subject to the income tax, looked as though the tax was paid by the stockholder. He disposed of this objection, however, by harking back to the initial premise that who pays the tax is to be determined by the federal rather than the British law. Said Mr. Justice Stone, ". . . our statutes afford no scope for saying that the stockholder of a British corporation pays the tax which is laid upon and collected from the corporation, and no basis for a decision that section 131 extends to such a stockholder a credit for a tax paid by the corporation—a privilege not granted to stockholders in our own corporations."¹⁵⁷

There was another interesting point in the *Biddle* case. The taxpayers urged that the departmental rulings sustaining credits and deductions of the British standard tax by stockholders in British corporations had acquired the force of law by virtue of the reenactment of the deduction and credit sections by Congress in view of those rulings. Mr. Justice Stone rejected this argument on the ground that, although Congress in reenacting a statute may be presumed to accept the administrative construction of the statute, it cannot be presumed to accept the administrative interpretation of statutes of other countries. The departmental rulings were an interpretation of the British law in that they held that the stockholder under the British law paid the tax, rather than an interpretation of what the federal statute meant by taxes paid to a foreign government; and, therefore, they were not sanctioned by the reenactment of the provisions for crediting and deducting foreign income taxes.

(d) *Surtax on Improper Accumulation of Surplus*

One of the methods devised by Congress to discourage "incorporated pocketbooks" is a heavy penalty or surtax on a corporation "formed or availed of for the purpose of preventing the imposition of surtax on its shareholders through the medium of permitting its gains and profits to accumulate instead of being divided or distributed."¹⁵⁸ In *Helvering v. National Grocery Company*,¹⁵⁹ the constitutionality, as well as the construction, of this provision was in issue.

¹⁵⁷ 302 U. S. at 581.

¹⁵⁸ 45 STAT. 814 (1928), 26 U. S. C. A. § 104 (1934).

¹⁵⁹ 304 U. S. 282 (1938). Justices Cardozo and Reed did not participate in this decision.

The National Grocery Company was a New Jersey corporation which operated chain stores. Since 1911 its capital stock of \$200,000 had been owned beneficially by Henry Kohl. In the year ending January 31, 1931, the corporation earned a net profit of \$682,850.38 after paying \$104,000 to Kohl as salary and the federal corporation income tax of 12 per cent.; and its surplus increased \$693,141.28, or from \$7,245,824.26 to \$7,938,965.54. The Commissioner found that the corporation had been availed of for the purpose of avoiding the imposition of surtax upon Kohl and assessed a deficiency tax of 50 per cent. under Section 104 of the 1928 Act. The corporation petitioned for a redetermination to the Board of Tax Appeals, which affirmed the deficiency. The circuit court of appeals reversed the Board of Tax Appeals; and the Supreme Court, over the dissent of Justices McReynolds and Butler, reversed the judgment of the circuit court of appeals. Mr. Justice Brandeis, for the majority, first discussed the constitutionality of the statute. He rejected the argument of the taxpayer that the tax violates the Tenth Amendment because it interferes with the power to declare or withhold dividends conferred by the state upon the corporation. He pointed out that the federal statute does not prevent a corporation from declaring dividends; it simply imposes a tax if dividends are not declared in order to prevent the imposition of surtaxes on stockholders in the corporation. Moreover, even this tax can be avoided if the stockholders elect to return their proportionate share of the corporate earnings in their individual returns. Nor was Mr. Justice Brandeis impressed by the argument that the tax was not a tax upon income but a penalty designed to force corporations to distribute earnings in order to create a basis for taxation against the stockholders: "Kohl, the sole owner of the business, could not by conducting it as a corporation, prevent Congress, if it chose to do so, from laying on him individually the tax on the year's profits. If it preferred, Congress could lay the tax upon the corporation, as was done by Section 104. The penal nature of the imposition does not prevent its being valid, as the tax was otherwise permissible under the Constitution."¹⁶⁰ The taxpayer also argued that the tax was unconstitutional because it was a direct tax upon the state of mind of preventing the imposition of surtaxes upon the shareholders of corporations subject to the tax. Mr. Justice Brandeis replied that the tax was not laid upon a state of mind but upon the net income of the corporation, and the fact that the existence of a certain purpose was a prerequisite to the imposition of the tax was not fatal, citing a number of situations under the income tax in which purpose or state of mind determines tax lia-

160. 304 U. S. at 288.

bility. The Court refused to consider the effect of the tax upon the rights of minority stockholders since this was not in issue in the case before it. It held, however, that the tax was not lacking in due process of law because no standard was laid down to guide the Commissioner in assessing it, or because it was assessed retroactively. The standard prescribed by the statute takes the form of a *prima facie* presumption that earnings accumulated beyond the "reasonable needs" of the business are accumulated to prevent imposition of individual surtaxes. With respect to retroactive assessment, he said that this was no more objectionable here than in the case of penalties for fraud or negligence. Finally, the Court said with respect to the constitutionality of the tax that it involved no delegation of legislative power to the Commissioner since "No power is delegated to the Commissioner save that of finding facts upon evidence."¹⁶¹

In addition to contesting the constitutionality of the tax, the taxpayer contended that there had in fact been no improper accumulation of surplus. One argument under this head was that the tax was not applicable because there had been no "gains or profits" by the corporation during the tax year since the earnings of the corporation were more than offset by depreciation in the securities it held. The taxpayer contended that "gains" was not synonymous with "profits", but meant increases in net worth since prudent directors would take depreciation of assets as well as earnings into consideration in declaring dividends. Mr. Justice Brandeis, without discussing this objection in detail, merely said that depreciation in a company's assets is a factor to be taken into consideration in determining whether the accumulation of profits was in excess of the reasonable needs of the business, but is not as a matter of law conclusive. Mr. Justice Brandeis also examined the evidence upon which the Board had based its finding that there was an unreasonable accumulation of profits and found there ample support for its decision.

(e) *Administration*

*Helvering v. Mitchell*¹⁶² stimulated an interesting analysis of the legal quality of the *penalty* which the various Revenue Acts have empowered the Commissioner to assess against a taxpayer who fraudulently tries to evade his income tax. Mitchell was acquitted on an indictment which charged him with "unlawfully, wilfully, knowingly, feloniously, and fraudulently" attempting to "defeat and evade an income tax of, to wit, \$728,709.84". Later, however, the Commissioner made a deficiency assessment against him for this sum, to which

¹⁶¹. *Ibid.*

¹⁶². 303 U. S. 391 (1938).

he added a fraud penalty of 50 per cent. Mitchell appealed to the Board of Tax Appeals, which upheld the Commissioner. The circuit court of appeals upheld the Board's decision as to the deficiency, but reversed its determination sustaining the fraud penalty. The Supreme Court held that the penalty was improperly disallowed and reversed the circuit court of appeals. Mr. Justice Brandeis delivered the opinion of the Court,¹⁶³ from which Mr. Justice McReynolds dissented. The objection that the action for the fraud penalty was barred by *res judicata* was disposed of on the ground that the burden of proof in the criminal action differed from that in the civil suit. Mr. Justice Brandeis also concluded that there was no double jeopardy inasmuch as the fraud penalty was in the nature of indemnity for the loss which the government sustained in being hindered in collecting its taxes, and was thus a civil rather than a criminal sanction.

There were a number of cases involving the statute of limitations. *United States v. Wurts*¹⁶⁴ held that under Section 610 of the 1928 Act, which requires suits to recover erroneous refunds to be instituted within "two years after the making of such refund", an action commenced within two years from the date the refund was paid to the taxpayer, but more than two years after the Commissioner had signed the schedule of over-assessments containing the refund, was timely. Mr. Justice Black, who delivered the opinion of the Court,¹⁶⁵ said that the proper construction of "the making of such refund" was that this phrase indicated the date when the refund was paid to the taxpayer, rather than the date when it was approved by the Commissioner.

Bates Manufacturing Co. v. United States,¹⁶⁶ another decision by Mr. Justice Black,¹⁶⁷ held that a suit for refund is "begun" in a district court when the petition is filed, rather than when copies of the petition are served upon the District Attorney and mailed to the Attorney General. The Court held that Congress, by the Tucker Act, intended to provide uniform procedure for both the Court of Claims and the district courts in suits for refunds and that, since the suit would have been begun in the Court of Claims by filing the petition alone, this sufficed to initiate the action in the district courts.

*United States v. Andrews*¹⁶⁸ and *United States v. Garbutt Oil Company*¹⁶⁹ held that an amendment to a claim for refund, which is filed after the lapse of the statutory period of limitation, comes too

163. Justices Cardozo and Reed did not participate in this decision.

164. 303 U. S. 414 (1938).

165. Justices Cardozo and Reed did not participate in this decision.

166. 303 U. S. 567 (1938).

167. Justices Cardozo and Reed did not participate in this decision.

168. 302 U. S. 517 (1938).

169. 302 U. S. 528 (1938).

late where the original claim was on a specific ground and the amendment shifts to another ground. In the *Andrews* case the original claim was based upon an alleged loss sustained in connection with worthless stock in two corporations. The amendment, which the Court held to have been filed too late, was based upon the theory that certain corporate distributions had been improperly reported as taxable dividends. In the *Garbutt Oil Company* case the original claim rested upon an alleged deduction for amortization of a drilling contract; the amendment, which again was held too late, was based upon the theory that the taxpayer had had no taxable income at all in the year in question. Mr. Justice Roberts delivered the unanimous opinion of the Court in both cases. The gist of his reasoning was that where a general claim for refund has been filed, the Commissioner is put on notice of any overpayments for the period covered by the claim, and an amendment setting forth a specific ground for recovery may, therefore, be filed after the lapse of the statutory period. On the other hand, a specific claim for refund gives notice only that the taxpayer claims an overpayment in that respect, and an amendment setting out a different ground after the statutory period has elapsed is not permissible.

McEachern v. Rose,¹⁷⁰ another case on the statute of limitations, presented the perplexing problem of whether in a suit by a taxpayer to recover an overpayment, the Government may offset unpaid taxes for earlier years, the collection of which is barred by the statutory limitation. The petitioner sued to recover for overpayments in the years 1929, 1930 and 1931 with respect to an installment contract. The tax with respect to the gains from the contract should have been paid in 1928, and the amount of the unpaid tax in 1928 exceeded the overpayments in the later years. The Court, in a unanimous opinion by Mr. Justice Stone, refused to allow the defendant to offset the unpaid tax for 1928. Mr. Justice Stone pointed out that, when the overpayments for 1930 and 1931 were made, collection of the 1928 tax was barred. If the 1928 tax had been paid then, it would have been an overpayment under Section 607. Consequently, under Section 609 (a), crediting the overpayments for 1930 and 1931 against the tax for 1928 was forbidden.

When the overpayment for 1929 was made, the collection of the 1928 tax was not barred. However, since the Commissioner could not credit the overpayment against the 1928 tax, until the amount of the overpayment was ascertained, and at this time the collection of the 1928 tax was barred, Mr. Justice Stone said that the overpayment for 1929 stood on the same footing as those for 1930 and 1931.

170. 302 U. S. 56 (1937).

McEachern v. Rose seems straightforward enough until it is projected against the background of *Stone v. White*,¹⁷¹ although perhaps a fairer statement would be that *Stone v. White* is still more troublesome when it is read in the light of *McEachern v. Rose*. What Mr. Justice Stone said about *Stone v. White* may be worth noting in detail: "Sections 607 and 609 do not apply in the circumstances disclosed in *Stone v. White*, *supra*. There testamentary trustees had paid from income a tax upon it which should have been paid by the beneficiary, and it was held that they were not equitably entitled to recover the tax after the statute had barred collection from the beneficiary. The assessment of a deficiency against the trustees and the payment of it by them were not barred by limitation. Hence section 607 did not compel a recovery. Section 609 did not require it. The commissioner neither sought, nor did section 322, regardless of any period of limitation, permit him to credit the amount which one taxpayer had paid against the tax which another should have paid. Equitable considerations not within the reach of the statutes denied a recovery. It was enough, in the peculiar facts of the case, that the trustees had suffered no burden and that the Government was not unjustly enriched."¹⁷²

There were four more cases on the federal income tax which dealt with some phase of the taxpayer's remedies. *Phillips-Jones Corporation v. Parmley*¹⁷³ involved the right of a transferee against whom a tax had been assessed to demand contribution from other transferees who had not been called upon to pay the tax. After a corporation had distributed its assets among its eleven stockholders, the Commissioner assessed additional income and profits taxes against it, and then made an assessment for this amount against one of the stockholders, Phillips. Phillips was dead. His executors made an unsuccessful attempt to contest the assessment, which was finally paid by the Phillips-Jones corporation, the real owner of the stock standing in his name. The Phillips-Jones corporation then sought contribution from the other stockholders for their proportionate shares of the tax. The district court held that the only liability for taxes on the part of the stockholders arose in virtue of an assessment made under Section 280 of the 1926 Act; and since no assessment had been made against the defendants, they were not liable. The circuit court of appeals affirmed this judgment,¹⁷⁴ which was unanimously reversed by the Supreme Court. Mr. Justice Brandeis said that the liability of the stockholders for taxes originated independently of Section 280 in the trust fund

171. 301 U. S. 532 (1937).

172. 302 U. S. at 62.

173. 302 U. S. 233 (1937).

174. 88 F. (2d) 958 (C. C. A. 3d, 1937).

doctrine, according to which, if the assets of a corporation are distributed to its stockholders before all its debts are paid, each stockholder is liable severally to creditors to the extent of the amount which he received from the corporation, and between stockholders similarly situated the burden of paying debts must be borne ratably. Consequently, there was a duty to contribute, apart from Section 280, which could be enforced in this action.

*Lowe Brothers Company v. United States*¹⁷⁵ dealt with the jurisdiction of a district court to entertain a suit against the United States for an overpayment in excess of \$10,000. The taxpayer overpaid income and excess profits taxes in 1918. In 1924 the Commissioner acknowledged the overpayment, which was in excess of \$10,000, and credited it against a 1917 deficiency, which was barred by the statute of limitations. The collector in office when the credit was entered retired, and the petitioner sued the United States in a district court to recover the amount of the credit, basing his action upon an alleged overpayment of the 1917 tax by reason of the credit, rather than any claim for refund of the 1918 tax, which apparently was barred by the statute of limitations. The district court dismissed the petition on the theory that the credit of the 1918 overpayment was not an overpayment of the 1917 tax since the credit was void under Sections 607 and 609 of the 1928 Act, which forbid crediting an overpayment against a barred deficiency.¹⁷⁶ The circuit court of appeals affirmed the judgment of the district court upon the ground that the lower court lacked jurisdiction to entertain the suit.¹⁷⁷ The Supreme Court affirmed the decision of the circuit court of appeals, limiting its review to the jurisdictional point. Mr. Justice Stone, who delivered the opinion of a unanimous Court,¹⁷⁸ pointed out that Section 24 (20) of the Judicial Code, which confers jurisdiction on the district courts to entertain suits to recover taxes against the United States even though the claim exceeds \$10,000, if the collector who collected the tax is out of office or dead, requires that the collector must have collected the tax. In the case at hand, if the tax was collected at all, it was collected, not by the collector, but by the action of the Commissioner in crediting the 1918 overpayment against the 1917 deficiency.

*Pacific National Co. v. Welch*¹⁷⁹ and *United States v. Kaplan*¹⁸⁰ involved election. In both cases taxpayers sold property, the gains from which could have been returned on the installment basis, although

175. 304 U. S. 302 (1938).

176. *Lowe Bros. Co. v. United States*, 8 F. Supp. 1016 (S. D. Ohio, 1934).

177. *Lowe Bros. Co. v. United States*, 92 F. (2d) 905 (C. C. A. 6th, 1937).

178. Mr. Justice Cardozo did not participate in this decision.

179. 304 U. S. 191 (1938).

180. 304 U. S. 195 (1938).

they reported the sales as completed transactions in the years in which they were made. Later they filed claims for refunds claiming that they were entitled to have their income from these transactions computed by the installment method. Mr. Justice Butler, who delivered the opinions of a unanimous Court,¹⁸¹ in both cases, pointed out that the 1928 Act allowed a taxpayer to return the profits from installment sales on the ordinary cash or accrual basis or on the installment basis, but when once he has elected one method and filed on that basis, the election is final, at least, after the time for filing the original return has expired.

VIII. FEDERAL ESTATE TAX

In *May v. Heiner*¹⁸² and a series of memorandum decisions¹⁸³ stemming from that case, the Supreme Court held that a transfer with a reservation of a life estate was not a transfer intended to take effect at or after death, so as to be taxable as part of a decedent's gross estate under Section 302 (c) of the Revenue Act of 1926.¹⁸⁴ The last of these decisions was rendered on March 2, 1931. By a joint resolution¹⁸⁵ passed and approved the next day Congress amended Section 302 (c) of the 1926 Act to explicitly extend the federal estate tax to such a situation. This amendment was subsequently reenacted with minor alterations as Section 803 (a) of the Revenue Act of 1932.¹⁸⁶

The amendments taxing transfers with a reservation of a life estate raised several interesting problems. Were they constitutional? Did they apply retroactively to transfers made before the adoption of the amendments? If they did apply retroactively, was this retroactive application constitutional? In *Helvering v. Bullard*¹⁸⁷ and *Hassett v. Welch*,¹⁸⁸ the Supreme Court undertook to expound the answers to these problems. The opinions in both cases were written by Mr. Justice Roberts.¹⁸⁹

In *Helvering v. Bullard* the Court held that it was constitutional to include transfers with a reservation of a life estate, in the gross estate of the grantor for purposes of the federal estate tax. Doubts as to the constitutionality of the tax sprang largely from the dicta of two earlier cases. In *May v. Heiner* the Court intimated that a transfer with a reservation of a life estate was not a testamentary transfer. In

181. Justices Cardozo and Reed did not participate in either of these decisions.

182. 281 U. S. 238 (1930).

183. *Burnet v. Northern Trust Co.*, 283 U. S. 782 (1931); *Morsman v. Burnet*, 283 U. S. 783 (1931); *McCormick v. Burnet*, 283 U. S. 784 (1931).

184. 44 STAT. 70 (1926).

185. 46 STAT. 1516 (1931), 26 U. S. C. A. § 411 (c) (1934).

186. 47 STAT. 279 (1932), 26 U. S. C. A. § 411 (c) (1934).

187. 303 U. S. 297 (1938).

188. 303 U. S. 303 (1938).

189. Justices Cardozo and Reed did not participate in either of these decisions.

*Heiner v. Donnan*¹⁹⁰ the Court said that Congress lacked constitutional power to tax transfers which were not testamentary under the federal estate tax. Without explicit reference to either *May v. Heiner* or *Heiner v. Donnan*, Mr. Justice Roberts sustained the constitutionality of the tax by the test laid down by *Helvering v. City Bank*:¹⁹¹ that it was a reasonable method of preventing avoidance of the estate tax.

In another respect, Mr. Justice Roberts' reasoning is so flatly opposed to that of *Heiner v. Donnan* that one wonders how much credence may still be given to that unhappy decision. *Heiner v. Donnan* involved a conclusive presumption that gifts in excess of a certain amount, made by a decedent within two years of his death, were in contemplation of death. One ground upon which the Court held the presumption unconstitutional, which has already been referred to, was that it attempted to extend a death tax to transfers which were not necessarily testamentary. The government in attempting to save the statute, however, had argued that even if the tax could not be upheld as a death tax, it could be sustained as a gift tax. The Court in reply declared that viewing the tax as a gift tax it established an arbitrary classification which violated the due process clause of the Fifth Amendment since it singled out one class of gifts for taxation. Bearing in mind that Mr. Justice Roberts did not mention *Heiner v. Donnan* in deciding *Helvering v. Bullard*, the language he used in the latter case is interesting: "Since Congress may lay an excise upon gifts it is of no significance that the exaction is denominated an estate tax or is found in a statute purporting to levy an estate tax. Moreover, Congress having the right to classify gifts of different sorts might impose an excise at one rate upon a gift without reservation of a life estate and at another rate upon a gift with such reservation. Such a classification would not be arbitrary or unreasonable."¹⁹²

Hassett v. Welch raised the problem of whether the amendments explicitly taxing transfers with a reservation of a life estate could be applied to transfers made before the effective dates of these amendments. By deciding that the amendments properly construed were purely prospective, the Court held that such transfers were not taxable without becoming embroiled with the constitutionality of a retroactive tax. The question of construction here was close and rather interesting. The 1931 amendment was adopted on the last day of the contemporary session of Congress. There was no time to print a committee report, or for that matter, to print the resolution itself, before

190. 285 U. S. 312 (1932).

191. 296 U. S. 85 (1935).

192. 303 U. S. at 301.

its adoption. However, in introducing the amendment Mr. Garner and Mr. Hawley¹⁹³ of the House Ways and Means Committee stated that it was not retroactive. Moreover, the contemporaneous construction of the amendment by the Treasury was that it was not retroactive. When the 1931 amendment was reenacted as part of the 1932 Act, nothing was said as to whether it should be retroactive. However, both the 1931 and 1932 amendments were amendments to Section 302 (c) of the 1926 Act. Section 302 (c) provides that the enumerated transfers made "at any time" shall be taxed. Moreover, Section 302 (c) of the 1926 Act is qualified by Section 302 (h) of the same act, which provides that the transfers specified in 302 (c) whether made before or after the enactment of the Act shall be taxable. In *Hassett v. Welch* the Court said that, as far as the language of the amended statute was concerned, it was not clear whether the tax on transfers with a reservation of a life estate was retroactive or not. The phrase, "at any time", in Section 302 (c) did not make it retroactive since it was held in *Shwab v. Doyle*¹⁹⁴ that this merely means at any time after the enactment of the tax in question. Moreover, it was not clear that the provision for retroactivity in Section 302 (h), which modified Section 302 (c), applied to amendments to Section 302 (c) adopted after the enactment of 302 (h). With this opening wedge of ambiguity, the Court was free to consider the legislative utterances at the time the amendments were adopted. It accepted the oral statements of the sponsors of the 1931 amendment on the floor of the House, since there had been no Committee report, to the effect that the 1931 amendment was not intended to be retroactive. Since the 1932 Act simply reenacted the 1931 amendment, Mr. Justice Roberts found that it should be construed in the same way as the 1931 amendment and that it too was not intended to be retroactive.

*Lang v. Commissioner*¹⁹⁵ suggested, without solving, an interesting question in connection with the federal estate tax on insurance. In that case Julius C. Lang, a citizen of Washington, a community property state, took out a number of policies of insurance upon his life. Under some of these policies his wife was made the beneficiary; under others, his children. Some of the premiums on the policies had been paid by Lang from his separate estate before his marriage. Others were paid from community funds. The problem presented by the case was what proportion of the proceeds of the policies should be included in Lang's gross estate upon his death for purposes of the federal estate tax. Mr. Justice McReynolds, writing the opinion of a unanimous

193. 74 CONG. REC. 7198, 7199 (1931).

194. 258 U. S. 529 (1922).

195. 304 U. S. 264 (1938).

Court,¹⁹⁶ held that that proportion of the proceeds of the policies referable to the premiums paid by Lang out of his separate estate and one-half of the proceeds referable to the premiums paid out of community funds were taxable. The Court found that, under the local law, half of the premiums paid out of community funds were paid by the wife of the assured; and, consequently, it excluded that proportion of the proceeds of the policies from the tax. Unfortunately, the regulations in effect at Lang's death provided explicitly that the proceeds of insurance referable to premiums paid by the beneficiary were not taxable as part of the gross estate of the assured. Although the regulations did not explicitly cover the taxability of the policies payable to Lang's children, the Court held that the proportion of these policies referable to the part of the premiums paid by Lang's widow were not taxable under a proper construction of the regulations. The reason why it was unfortunate that the regulations in effect on the decedent's death excluded insurance payable to a beneficiary other than the assured or his estate, where the premiums had been paid by one other than the assured, was that this prevented a decision as to the validity of the current regulations which undertake to tax policies of insurance where the assured retains "legal incidents of ownership", regardless of who pays the premiums.¹⁹⁷

The last case on the federal estate tax, *Taft v. Commissioner*,¹⁹⁸ reached a result which must be deplored and which should be remedied by amending the tax. During her lifetime, the decedent entered into various engagements to transfer certain sums to charity, which agreements were legally binding upon her and her estate. The Court¹⁹⁹ held that the amounts payable by her executors from her estate in discharge of these obligations were not deductible from the decedent's gross estate, either as claims incurred bona fide and for an adequate and full consideration in money or money's worth under Section 303 (a) (1) of the 1926 Act, or on the theory that they amounted to transfers to charity under Section 303 (a) (3). As a matter of statutory construction, the decision of the Court, which was delivered by Mr. Justice Roberts, is difficult to refute. A charitable subscription can scarcely be said to be incurred for a full and adequate consideration in money or money's worth; and the charitable transfers to which the statute refers are testamentary transfers rather than inter vivos undertakings. The injustice of the law as it is presently written lies in the fact that it makes taxability turn on form rather than substance. If *A*

196. Mr. Justice Cardozo did not participate in this decision.

197. U. S. Treas. Reg. 80, Arts. 25, 27.

198. 304 U. S. 351 (1938).

199. Mr. Justice Cardozo did not participate in this decision.

by his will makes a bequest to charity, this is deductible from his gross estate. If, however, he pledges himself to make a charitable gift during his life, which is paid out of his estate, no deduction is allowable. If there is any substantial policy behind the exemption of charitable donations from the federal estate tax, it should be extended by Congress to cover both situations.²⁰⁰

CONCLUSION

One group of scholars sees the judicial process as a series of legal syllogisms. Another visualizes it as an advanced exercise in psychoanalysis. Both attitudes are extreme. By overemphasizing some factors and suppressing others, however, they offer an appealingly simple solution for a complex problem. It is difficult for the intellectual adolescent, hungering for certainty in an uncertain world, to resist the lure of narrow partisan perspective under which heterogeneous phenomena assume a meretricious homogeneity.

There is no master key to unlock the decisions even in a limited field. There are cases where doctrinal considerations are important—even dominant and controlling. There are others where legalistic conceptions are of minimal moment, serving merely as awkward verbal vehicles to convey a conclusion deriving from more complex processes. There are a vast number of cases compounded of an inextricable admixture of human prejudices and legal scholasticism.

The proper approach in appraising a decision of the Supreme Court lies somewhere between realism and fundamentalism. This is not necessarily, however, midway between the two; there is no constant point between the extremes where one may safely start in every case. Nor is there any uniform formula by which to weigh the sincerity of judicial utterances. Every decision must be scrutinized on its own foundations and appraised as the unique problem which it is. Give diligent heed to the schools of juristic thought! Give unswerving allegiance to none!

Judicial opinions, in addition to telling what has transpired in the past, may with varying shades of clarity indicate what will be done in the future. Save for the cloistered scholar and the immediate litigants, the historical aspect of a case is less interesting than its prophetic overtones. Lawyers eagerly scan even the distant horizons of past performance in the hope of divining the future. This is hazardous work.

200. Two tax cases at the last term have not been noted in text. *White v. Aronson*, 302 U. S. 16 (1937), held that jigsaw puzzles were not games within the purview of the federal tax on games; *Ocean Beach Heights v. Brown-Crummer Investment Co.*, 302 U. S. 614 (1938), held that a Florida statute forbidding the incorporation into a single town of detached tracts of land, prevented a town, which had attempted to incorporate detached land, from taxing the land.

Successful utilization of judicial decisions as tools of prophecy involves constant and skilful adjustment to a rapidly moving social and economic background as well as to changes in personnel and parties litigant. The stage is seldom set twice in precisely the same way. It is so easy to guess wrong. But it is so amusing to guess!

At the 1937 Term, the Court made substantial inroads on the doctrine of intergovernmental immunities. These are permanent. Retreat simply is not in the cards. With rising deficits and expanding governmental activity, elementary principles of self-preservation imperatively demand curtailment of intergovernmental exemptions.

A new test for the validity of a state tax on interstate commerce—whether the tax will lead to multiple taxation—made its appearance at the last term. It is difficult to estimate the vitality of this formula. There is an obvious analogy between this approach and the problem of state jurisdiction to tax under the due process clause of the Fourteenth Amendment. The two problems have characteristics in common. Much the same policy lies behind the protection of interstate traffic from state taxes and the denial of multiple taxation under the due process clause—the need to protect national business from the partisan zeal of the provinces. It is not unlikely that the future will see a sincere effort to assimilate the doctrines developed in connection with state jurisdiction to tax into the law which has grown up under the commerce clause.

Radical developments may fairly be anticipated in connection with state jurisdiction to tax. In view of the changed complexion of the Court, it seems fairly certain that the broad dicta which forbade double taxation of intangibles under the Fourteenth Amendment will either go by the board entirely or be severely restricted to death taxes.

With respect to the federal income tax, probably the most interesting cases at the last Term were those involving the taxation of stock dividends and stock rights. The ghost of *Eisner v. Macomber*, invoked by the decision in *Koshland v. Helvering*, is proving obdurate. The most sensible thing that the Court could do would be to overrule *Eisner v. Macomber* entirely. Whatever merits that case may possess as an exercise in abstract logic, the evil influence which it continues to exert on the day by day administration of the tax laws more than justifies its abrogation. *Eisner v. Macomber* does not relieve a taxpayer who receives a stock dividend from paying a tax; it merely defers the tax. Whatever minor advantage taxpayers may derive from having a tax deferred in some cases is considerably overbalanced by the difficulty in determining when a tax is due and the basis upon which to compute gain or loss upon the sale of a stock dividend, or the original stock, on which the dividend was declared.

Continued progress was recorded at the 1937 term in connection with the federal estate tax, by the Court's affirmance of the rational test for the constitutionality of a tax avoiding tax developed in *Helvering v. City Bank*. Due process will no longer be viewed from the cramped focus of the medieval conveyancer, but as a liberal political canon of convenience and fairness. No longer will the Court seek the constitutionality of a law in the cloudy metaphysics of testamentary transfer, but in the forthright inquiry: Is the tax a reasonable method of preventing tax avoidance?

The outstanding characteristic of the tax work of the Supreme Court at the last term as a whole was the emphasis on the strictly specialized and technical features of taxation. Thirty-five²⁰¹ of the cases decided by the Court dealt with federal taxes. Taxation no longer can be relegated to a subcategory of constitutional law. It is a specialty in its own right. However, one other thing is striking in this connection. Most of the cases before the Supreme Court involving the construction of the federal tax statutes got there because of conflict between the different circuit courts of appeals. In a field where the foundation of the whole system is self-assessment and administrative action, there is imperative need for a method of deciding finally and expeditiously perplexing problems of construction. Much of the alleged complexity in connection with federal taxes is merely the reflection of the diffuse legal system by which these complexities must be resolved. Instead of a horde of coordinate tribunals passing upon tax questions, there should be one central tax court, from whose judgment certiorari would in rare cases be granted by the Supreme Court. The vast number of cases before the Supreme Court in recent years unhappily reflects not only the constantly increasing importance of the law of taxation, but the defective procedural techniques, which have been developed for disposing of these problems.

201. There were twenty-nine cases on the federal income tax; four on the federal estate tax; one on the federal tax on admissions; and, one on the federal tax on games.