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TAX DECISIONS OF THE SUPREME COURT, 1937 TERM

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TO BE PRESENTED AT THE THIRTY-FIRST NATIONAL TAX CONFERENCE
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NATIONAL TAX ASSOCIATION
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COLUMBIA, S. C.
Nearly one third of the cases upon which the Supreme Court rendered written opinions in its 1937 term involved controversies over taxes. They constituted by long odds the largest single group of cases to have travelled the long road of litigation culminating in the deliberations of the highest court. The result has been not only a substantial addition to the already ponderous mass of tax law but the clarification of certain problems left open by previous decisions. There remain to be solved, however, not only many old problems but also a number of new ones growing out of the latest opinions. The difficulties ahead, together with the present maze of tax decisions, warrant taking an inventory of what the court has accomplished in the past year and charting whatever trends seem definite enough to play a part in the consideration of future problems.

Those cases dealing with intergovernmental tax immunity will not be discussed here, as they constitute a separate problem to be dealt with by Mr. Rottschaefer. Apart from them, decisions of great importance have been made on the restrictive effect of the commerce clause, the Fourteenth Amendment and the impairment of contracts clause upon state taxation, the implications of the Sixteenth Amendment, and the construction and application of various provisions of the federal revenue laws.

**Commerce Clause**

Although not abandoning the usual and frequently formalistic methods of approach the court in several opinions has used language that may well presage the future abandonment of old rules and the application of a new test to determine whether or not a state tax violates the commerce clause. Under this test certain elements which have in the past been regarded as part of the pattern if not the fabric of interstate commerce will not be entitled to exemption from a non-discriminatory state tax even though their taxation admittedly increases the cost of carrying on interstate commerce so long as sustaining the tax will not lead to multiple state taxation.¹

*Western Livestock v. Bureau of Revenue* ² is probably the most important case of the last term pointing in this new direction. The New Mexico tax before the court in that case was imposed upon the business of publishing newspapers and magazines and was measured by gross receipts from advertising. The advertising contracts were

¹ As early as 1867 in Steamship Company v. Portwardens, 6 Wall. (73 U. S.) 31, the court recognized that a forbidden burden on interstate commerce might result if a fee were imposed upon every ship entering the port of New Orleans, as a similar fee might then be exacted at every port of call.

made with advertisers in other states and necessitated the interstate transmission of advertising materials from advertiser to publisher and the gross receipts from advertising were greater by reason of the publisher's maintenance of an interstate circulation of the magazine containing the advertisements. The court assumed in favor of the taxpayer that the advertising contracts required the publisher to maintain this interstate circulation.

The tax was upheld, the first ground being that "providing and selling advertising space in a publication," was a local business distinct from the business of circulating the publication. The court found sufficient authority for its holding in American Manufacturing Company v. St. Louis, which sustained a state tax upon manufacturing measured by total sales most of which were in interstate commerce. The court also upheld the tax on the ground that, unlike the tax sustained in the American Manufacturing Company case, it did not include in its measure the gross receipts from goods

3 It was held "the tax . . . is not forbidden either because the contract, apart from its performance, is within the protection of the commerce clause, or because as an incident preliminary to printing and publishing the advertisements the advertisers send cuts, copy and the like to appellants." It is well established that the mere formation of a contract between persons in different states is not within the protection of the commerce clause. See Paul v. Virginia (1868) 8 Wall. 75 (U. S.) 168, and other cases cited by the court. A more difficult problem arises when articles must be transported preliminary to performing a contract, such interstate movement from buyer to seller being necessary to the performance of the contract.

4 It has been suggested that as the business taxed was printing and publishing and as publishing included notification of persons outside the taxing state, the case was governed by Fisher's Blend Station v. Tax Commissioner (1936) 297 U. S. 650. See 86 U. of Pa. L. Rev. 787. The court, however, viewed the tax as "conditioned on the carrying on of a local business, that of providing and selling advertising space in a published journal." If this view, which is not clearly apparent from the language of the taxing statute set forth in a footnote to the opinion, is tenable, the tax can be distinguished from the tax on radio broadcasting invalidated in the Fisher's Blend case.


6 Once a local privilege has been defined there remains the problem of measuring its value. Where the privilege is that of producing something, its value may be measured by the number of things produced over a given period of time. Utah Power & Light Co. v. Pfost (1932) 280 U. S. 165, production of electricity measured by amount generated; Coverdale v. Arkansas-Louisiana Pipe Line Co. (1938) 58 Sup. Ct. 736, production of power measured by horse-power of producing engine. The privilege may also be measured by the value of the things produced over that period. Oliver Iron Mining Co. v. Lord (1923) 262 U. S. 172, production of ore measured by value of the ore mined. Amongst the criteria of the value of a thing is its sale price. Thus gross sales, reflecting as they do the value of that which is sold, are an appropriate measure of the value of the privilege of producing that which is sold. Hope Natural Gas Co. v. Hall (1926) 274 U. S. 284, production of gas, measured by gross receipts from sales of the gas produced; American Mfg. Co. v. St. Louis (1919) 250 U. S. 459, production of goods measured by gross receipts from sales of the goods produced.
sold in interstate commerce. The burden on interstate commerce resulting from taxing receipts from advertising even though augmented by interstate circulation, was considered too remote to affect the validity of the tax, the inference being that gross receipts from advertising are taxable independently of a local privilege.

Perhaps the greatest interest attaches to the court's "added reason" for sustaining the New Mexico tax, namely, that in so far as the additional value of gross advertising receipts resulting from interstate circulation is taxed by New Mexico "it cannot again be taxed elsewhere any more than the value of railroad property taxed locally." Whatever interstate commerce might be involved in the business taxed, therefore, could not be jeopardized by cumulative burdens.

This added reason coupled with the court's emphasis on the fact that interstate commerce is not wholly exempt from state taxation but must pay its way, together with the court's striking declaration that the reason for invalidating state taxes on gross receipts from interstate commerce and other interstate values is to prevent discrimination against interstate commerce resulting from multi-state taxation of the same values, suggests that it is no longer necessary to find a local privilege to uphold a tax on gross receipts from interstate commerce where multi-state taxation of these gross receipts is impossible.

This suggestion is fortified by the decision in Adams Manufacturing Co. v. Storen. This case involved the Indiana gross income tax as applied to gross receipts from interstate sales. The tax on such receipts was invalidated, not on the grounds that they are immune from state taxation except where the tax is merely the equivalent of a tax on property or some other subject within the jurisdiction of the state, but on the ground that such receipts were taxed without apportionment. Such a tax if upheld would result in

5 "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business. 'Even interstate commerce must pay its way.'" 58 Sup. Ct. at 548.

8 "The vice characteristic of those which have been held invalid is that they have placed on commerce burdens of such a nature as to be capable in point of substance of being imposed or added to with equal right by every state which the commerce touches merely because interstate commerce is being done, ... It is for these reasons that a state may not lay a tax measured by the amount of merchandise carried in interstate commerce, or upon the freight earned by its carriage." 58 Sup. Ct. at 548-9.

9 (1938) 58 Sup. Ct. 913. The probable bearing of the Western Livestock case upon the decision in this case is discussed in (1938) 13 Indiana L. J. 560.

10 "The vice of the statute as applied to receipts from interstate sales is that the tax includes in its measure, without apportionment, receipts derived from activities in interstate commerce." 58 Sup. Ct. 913, 916.

"It is because the tax, forbidden as to interstate commerce, reaches indis-
discrimination against interstate commerce as other states in which the commerce is carried on could with equal right tax the same gross receipts. The plain inference to be drawn from the case, in line with the Western Livestock case, is that if the tax had been so apportioned as to avoid the possibility of a cumulative burden resulting from multi-state taxation of the same gross receipts, it would have been valid. Thus, just as a state may tax net income from interstate commerce fairly attributable to the state so may it tax gross receipts fairly attributable thereto even though the tax is not on a local privilege or in lieu of a property tax.

A discussion of the above cases would not be complete without some mention of the vigorous dissenting opinion of Mr. Justice Black in the Storen case. He protested the “unfair and discriminatory burden” which in his view was imposed by the court’s decision upon those engaged in local commerce, and contrasted the cases upholding taxes nominally imposed upon a local subject or property but measured by gross receipts from interstate commerce. He reasoned that as Congress had the exclusive power to regulate interstate commerce and, therefore, could protect such commerce from undue and unfair burdens, the court went beyond its province in invalidating a state tax because it might in some hypothetical future have resulted in multiple burdens on interstate commerce.

Puget Sound Stevedoring Co. v. Tax Commission involved the validity of a Washington occupation tax measured by gross receipts, as applied to a domestic corporation engaged in a general stevedoring business but serving only vessels engaged exclusively in interstate and foreign commerce. The great mass of the taxpayer’s business consisted of loading and unloading vessels by longshoremen working under the taxpayer’s direction and control. In a few instances the taxpayer simply supplied longshoremen to shipowners without directing or controlling their work. Although the business here taxed was a “general stevedoring business,” the court treated it as a business of two kinds. The business of loading and unload-

discriminately and without apportionment, the gross compensation for both interstate commerce and intrastate activity that it must fail in its entirety so far as applied to receipts from sales interstate.” 58 Sup. Ct. 913, 917.

11 This inference raises the question as to what sort of an apportionment would have satisfied the court. See Hump Hairpin Mfg. Co. v. Emmerson (1922) 298 U. S. 290 and Western Cartridge Co. v. Emmerson (1930) 281 U. S. 511, where under an allocation formula based upon property and business, interstate sales were attributable to the state of manufacture. From the language of the court in the Storen case it seems apparent that it would insist upon an allocation between the state of origin and the state of destination for it called attention to the fact that the tax if sustained could be imposed with equal right by the state of origin and the state of destination thus exposing the same gross receipts to double taxation.

12 (1937) 58 Sup. Ct. 72.

13 Compare Ficklen v. Shelby County Taxing District (1892) 145 U. S. 1, cited with approval in the Western Livestock v. Bureau of Revenue (1938)
ing interstate and foreign vessels was held to be interstate and foreign commerce which the state could not "tax the privilege of doing by exacting in return therefor a percentage of the gross receipts." The business of supplying longshoremen to shipowners without directing or controlling their work was held to be a local business subject to a tax measured by gross receipts.

The decision invalidating the tax based on gross receipts from interstate commerce even though the business was of such a character that multi-state taxation was impossible can be reconciled with the implications in the *Western Livestock and Storen* cases on the ground that the tax involved was a privilege tax. Thus the decision is in line with the cases like *Alpha Portland Cement Co. v. Massachusetts* holding that a state may not exact a tax for the privilege of carrying on interstate commerce, a privilege which it does not grant, regardless of the measure.

Thus, legalistic reasoning is still employed to justify on the one hand, a tax even though cumulative burdens are possible provided the tax is called a privilege tax and is imposed upon a local privilege, and to invalidate on the other hand, taxes which are imposed upon the privilege of engaging in interstate commerce although there is no possibility of a cumulative burden on that commerce.

The Louisiana tax before the court in *Coverdale v. Arkansas Louisiana Pipe Line Company* was not imposed upon gross receipts, but upon the privilege of producing power measured by the horse power of the "prime mover" or power-producing machine. In order to get natural gas to the pressure necessary to transport it through interstate pipe lines a company used compressors operated by engines. The court upheld a tax on the company for the privilege of producing power by these engines. It stated that the production of power was a local activity just as generation of electrical energy was in *Utah Power & Light Co. v. Pfost*.

§8 Sup. Ct. 546. There a tax of $50.00 plus two and one-half percent of gross commissions was upheld as applied to merchants engaged in a general commission business, with the bulk of their commissions resulting from interstate sales. This case has been criticized and distinguished, but never overruled. See Brennan v. Titusville (1894) 153 U. S. 289; Crew Levick v. Pennsylvania (1917) 245 U. S. 292 and Stockard v. Morgan (1902) 185 U. S. 27. See also Raley and Bros. v. Richardson (1924) 264 U. S. 157, where a flat tax on commission merchants was held inapplicable to merchants doing wholly interstate business, but properly applicable to those doing both intrastate and interstate business. The court remarked that "one cannot avoid a tax upon a taxable business by also engaging in a non-taxable business."

14 The gross receipts from loading and unloading interstate vessels would not be taxable by any other state nor does it seem that they would constitute the measure of a tax that might be imposed by the state of origin or destination of the cargo unloaded or loaded.

15 (1925) 268 U. S. 203.
16 (1938) 58 Sup. Ct. 736.
17 (1932) 286 U. S. 165.
In this respect the case is striking in contrast with *Helson v. Kentucky*,\(^{18}\) holding invalid a state tax as applied to the use of gasoline in operating a ferry boat running between two states. The *Helson* case and others were distinguished on the ground that they involved, in the words of the court, “taxes on interstate commerce and its instrumentalities rather than on operations closely connected with but distinct from that commerce.” The tenuous nature of this distinction may indicate a reluctance on the part of the court to apply the rule of the *Helson* case. As in the *Western Livestock* case, the court was not content to dispose of the case solely on precedent but pointed out that the tax could be imposed by only one state, namely, the state in which the engines were located. It recognized that two states might tax the production of power, if engines connected with the same pipe line were located in several states, but stated that such multiple state taxation would result from “length of line, not interstate commerce.”

**FOURTEENTH AMENDMENT**

Concerned as the court has been in the recent cases just discussed to protect interstate commerce from the possibilities of multiple state taxation, it has shown no comparable anxiety over similar possibilities presented by the ad valorem taxation of intangibles. The court, for example, in *Schuylkill Trust Co. v. Commonwealth of Pennsylvania*\(^{19}\) sanctioned the ad valorem taxation of corporate shares held by a non-resident, even though the same stock might also be taxed in another state. In accord with previous decisions,\(^{20}\) it also held that the state need not allow any exemption equivalent to the value of the shares attributable to the corporation’s ownership of federal securities, other than national bank shares, so long as it did not discriminate against such securities in computing the tax base.\(^{21}\) Relying on *Corry v. Baltimore*,\(^{22}\) the court rejected the suggested distinction that in the instant case the act declaring the liability of the shares of non-residents, did not antedate the charter of the corporation nor provide that the situs of the shares should be in the state of the corporate domicile. It pointed out that for many years before the granting of the charter the state constitution contained a reserved right to alter and amend, so that every stockholder acquired his shares with full knowledge that they could be

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\(^{18}\) (1929) 279 U. S. 245.

\(^{19}\) (1938) 58 Sup. Ct. 295.


\(^{21}\) See the decision rendered on the previous appeal of this case (1935) 296 U. S. 113.

\(^{22}\) (1905) 196 U. S. 466.
subjected to regulation and taxation. The court reasoned that as a
share of stock represents an aliquot proportion of corporate assets and depended on the law of the corporation's state of domicile for protection and preservation, it was within the taxing jurisdiction of that state, even though the ownership of the stock might also be a taxable subject in another state under the doctrine of *First Bank Corporation v. Minnesota.*

The case apparently supports the proposition that nothing in the Fourteenth Amendment prohibits multiple ad valorem taxation of intangibles. While not over-ruling either *Farmers Loan & Trust Co. v. Minnesota* or *First National Bank v. Maine,* it strips those cases of implications respecting property taxation and limits them to the field of death taxation. The dictum of Mr. Justice Stone in *First Bank Stock Corp. v. Minnesota,* that intangibles can have no location in space and that the fiction of *mobilia sequuntur personam* cannot be used to exempt an owner of intangibles from contribution to costs of government in return for benefits bestowed by a state, becomes the elegy of a doctrine long regarded as far-reaching in scope even after it had been excluded from income taxation in *Cohn v. Graves* and *Whitney v. Graves.*

The rule against multi-state taxation of intangibles is not inexorable even in the field of death taxation to which it is now restricted, as the well-known *Dorrance* litigation graphically demonstrates. While domicile in legal theory exists in but one jurisdiction, it may in legal fact exist in several. A year ago the committee of the National Tax Association on double domicile in inheritance taxation looked for some solution of the dilemma in the settlement of certain cases then pending before the United States Supreme Court. The court's recent decision in one of those cases, *Worcester County Trust Co. v. Riley,* rejected a practical solution which would have

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24 (1937) 301 U. S. 234.
26 (1932) 284 U. S. 312, 77 A. L. R. 1401.
27 Supra note 24, at 241.
28 (1937) 300 U. S. 308.
29 (1937) 299 U. S. 366.
31 In addition to the Riley case the Committee called attention to Texas v. New York et al., wherein the Supreme Court appointed a master to take testimony and report.
32 (1937) 58 Sup. Ct. 185.
made possible determination of the disputed fact of domicile by the independent federal judiciary.

The Federal Interpleader Act gives the Federal District Court original jurisdiction in interpleader petitions "filed by any person . . . having . . . money or property . . . if two or more adverse claimants, citizens of different states are claiming to be entitled to such money or property." The executor of a decedent attempted under this act to interplead the tax officials of Massachusetts and California, as both states were claiming death transfer taxes upon the transfer of the same intangibles.

The court held that the suit was in substance one against the State of California and hence forbidden by the Eleventh Amendment. The court distinguished between suits against state officials enforcing unconstitutional state statutes, to which the federal judicial power extends notwithstanding the Eleventh Amendment, and suits against state officials, enforcing state statutes constitutional on their face which are in effect suits against "one of the United States" and beyond the federal judicial power. It pointed out that under the California statutes the tax would be imposed only if it were judicially determined that the decedent had been domiciled in California and it was not contended that the California officials were taxing independently of the judgment of a court. Even if both Massachusetts and California courts had found the decedent domiciled in their respective states there would in the court's opinion have been no violation of due process as the Fourteenth Amendment does not protect against inconsistent or erroneous state court decisions.

Earlier in First National Bank of Boston v. Maine, the court took the position that "intangibles constitutionally can be subjected to a death tax by one state only." It has been forced to deviate

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34 Ibid.
35 "The judicial power . . . shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state."
36 The court recognized that under Ex parte Young (1908) 209 U. S. 123, the Eleventh Amendment is no bar to a suit against a state official acting without legal authority. This was not the situation in the instant case, where the state official's acts did not involve any breach of state law or of the United States Constitution.
37 The fact that the state statutes did not impose death taxes on a nondomiciliary basis as they did in First National Bank v. Maine (1932) 284 U. S. 312, and Farmers Loan and Trust Co. v. Minn. (1930) 280 U. S. 204, cleared them of any unconstitutionality. The California Act afforded opportunity for a judicial determination of the question of domicile, so that at most there could be a conflict of court decisions only on the fact-question of domicile, a conflict not "forestalled" by the United States Constitution.
38 (1932) 284 U. S. 312.
39 Ibid. at 328.
from this position by the recognition that multiple state death transfer taxation of intangibles in the double domicile cases is beyond the reach of federal constitutional prohibitions. The eventual solution may lie, as suggested in the Third Report of the Committee of the National Tax Association, in interstate compacts or reciprocal legislation between states.

The due process clause has been involved as well as the commerce clause in the cases turning on the distinction between a privilege fee and a tax. *Atlantic Refining Co. v. Virginia* calls attention to the distinction between the two in their application to foreign corporations. The state exacted from a foreign corporation an entrance fee for the privilege of doing intrastate business, varying according to the authorized capital stock of the corporation but not to exceed $5,000 for corporations having an authorized capital of more than $90,000,000. The appellant corporation paid the maximum fee. The court held it constitutional, relying on two previous decisions involving the constitutionality of the same statutes. Its intervening decision in *Cudahy Packing Company v. Hinkle*, however, made necessary an extended discussion of the reasons for distinguishing that case.

The court assumed at the outset that the doctrine of unconstitutional conditions might be invoked for conditions to be fulfilled wholly before admission. It pointed out, however, that an entrance fee, as the sale price of the privilege of doing local business, constitutes a non-recurring charge, analogous to the charter or incorporation fee of a domestic corporation, which may be fixed in any manner the state sees fit to adopt. It went on to state that "even if the United States Constitution conferred 'upon every corporation the right to enter any State and carry on there a local business upon paying a reasonable fee, there is nothing in the record to show that the $5,000 charged is more than reasonable compensation for the privilege granted.'" As the amount of the fee bore no relation either to the volume of interstate business or the amount of

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40 The court seems to recognize that double domicile cases result from conflicting decisions of the courts of different states "upon the same issues of fact," and that differences in proof and the latitude necessarily allowed to the trier of fact in each case to weigh and draw inferences from evidence and to pass upon the credibility of witnesses, might lead an appellate court to conclude that in none is the judgment erroneous." 58 Sup. Ct. at 188.


42 (1937) 58 Sup. Ct. 75. See comment (1938) 24 Va. L. Rev. 326.


44 (1929) 278 U. S. 460.

property outside the state and was not arbitrarily fixed, the fee was held not to violate either the commerce clause or the due process clause.

The same considerations with respect to the commerce and due process clauses were disregarded in *Cudahy Packing Co. v. Hinkle*, but the court distinguished that case on the ground that there the corporation had previously entered the state with permission to do local business, and pursuant to that permission had acquired property and made expenditures. Whatever was imposed after the admission of the corporation was regarded by the court as a tax rather than a filing fee. The distinction is theoretical, for a filing fee measured by total authorized stock imposes the same literal "burden" as does a tax measured in the same manner. The burden in the *Atlantic Refining* case was legitimatized by being anticipated, while the burden in the *Cudahy* case, being a sequel rather than a prelude to admission, violated not only the commerce but the due process clause. The burden remained the same regardless of its name, but its validity was materially affected by the time at which it was imposed. The court found no discrimination between appellant corporation and domestic corporations. Citing *Hanover Fire Insurance Co. v. Harding*, it states that the appellant in any event could not invoke the equal protection clause as it had not yet been admitted to do business in the state.

The case of *Connecticut General Life Ins. Co. v. Johnson* illustrates that the measure of an excise tax, as distinguished from an admission fee, must bear some integral relation to the activities carried on by a foreign corporation within the taxing state. California imposed a tax upon the gross premiums received by insurance companies on contracts entered into outside the state with other insurance companies authorized to do business in California, reinsuring the latter companies against loss on policies of life insurance executed by them in California. The state contended that the reinsurance transactions were so related to business carried on by the company in California as to be a part of it, and that in any event no injustice was done as the state could have exacted a tax from the original insurers instead of allowing them to deduct from the measure of their tax liability the amount of reinsurance premiums paid by them to companies authorized to do business in the state.

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46 The court pointed out that the value of the privilege was dependent upon the financial resources of the corporation, of which the authorized capital stock was some indication. *Cf. Airway Electric Appliance Corp. v. Day* (1924) 266 U. S. 71.
47 (1929) 278 U. S. 460.
48 (1926) 272 U. S. 494, 49 A. L. R. 713.
50 Following the court's decision in the instant case the California Legislature proposed a constitutional amendment to be voted upon by the people.
The court denied the validity of these contentions, pointing out that "the reinsurance involved no transactions or relationship between [the company] and those originally insured, and called for no act in California." The decisive factor was said to be the state's power to control the objects of the tax. Had the contracts of reinsurance involved any action in California, such as the settlement and adjustment of claims, the inclusion of the reinsurance premiums in the measure of the tax might have been valid. 51

In Breedlove v. Suttles 52 the court sustained a Georgia Poll Tax 53 against the claim that it violated the Fourteenth Amendment in favoring persons under twenty-one years of age, over sixty years of age and women not desiring to vote. 54 The fact that the state constitution made payment of poll taxes a prerequisite to voting, 55 and the fact that women desiring to vote are required to pay current taxes only, 56 were held not to constitute a violation of the Nineteenth Amendment. The court found a reasonable basis for the exemption accorded to the several classes, even implying that failure to classify might render the tax invalid. 57

Hale v. Iowa State Board of Assessment and Review 58 added another page to the story of taxation of non-taxables. The case at the general election in November under which the taxes on insurance companies will be measured by the gross premiums "other than premiums for reinsurance" received from business done within the state. As no deduction will be allowed for premiums paid for reinsurance in other companies, the net result will be to include in the measure of the tax premiums upon all direct writings with respect to California business regardless of reinsurance contracts.

52 (1937) 58 Sup. Ct. 205.
53 Georgia Code 1933, sections 92-108.
54 It was pointed out that the tax upon minors would in effect be upon the fathers liable for their support, and that men over sixty are normally relieved of numerous public duties. The exemption of women was justified as a recognition of the special burdens they bear. "Moreover," the court said, "Georgia poll taxes are laid to raise money for educational purposes, and it is the father's duty to provide for education of the children."
55 There is nothing in the United States Constitution that would seem to prohibit the conditioning of the right to vote on the payment of taxes. The court approved of the condition as an aid to tax collection.
56 As women could be exempt from the tax altogether, the requirement that women desirous of voting must pay current taxes makes for equality for voting purposes.
57 In Salt Lake City v. Wilson, 46 Utah 60, 148 Pac. 1104, cited by the court, the hardships that would result from imposing a poll tax upon all inhabitants without classification, were recognized. The court in that case said that "the Legislature must deviate to some extent from any such Procrustean standard of equality as this."
involved the application of the Iowa net income tax to interest from bonds declared by Iowa statutes to be exempt from all taxation. As these statutes had once been part and parcel of the ad valorem tax statutes, the Iowa court held that they exempted the bonds from property taxes only. It went on to hold that the income tax was not a property tax, and could, therefore, properly be applied to interest from bonds.

The Supreme Court, citing the division of authority in the state cases as to whether or not an income tax is a property tax, and also citing its own decisions, including New York ex rel. Cohn v. Graves, on the nature of net income taxes, held that there was nothing unreasonable in the decision of the Iowa court. It pointed out that as Iowa did not have income taxes when its ad valorem tax statutes were passed, the legislature could not have intended to include income taxes in the exemption.

The same point arose in Adams Mfg. Co. v. Storen with respect to the Indiana gross income tax, and the tax was held valid on the authority of the Hale case. Here again the history of the statute lent conviction to the theory that its exemption provision was intended to cover only property taxes and such other taxes as were known when the statute was passed.

**IMPAIRMENT OF CONTRACTS CLAUSE**

Several attempts were made, all unsuccessful, to defeat state taxation by invoking the impairment of contracts clause of the Constitution. In addition to the contention in the Hale case that the state net income tax was a property tax and therefore not applicable to interest on exempt bonds, it was argued in that case that the statute exempting the bonds created a contract between bondholders and the state. On the assumption that a contract did exist, the court held that it did not extend to the interest on the bonds.

In New York Rapid Transit Corporation v. The City of New York, a tax on utilities of 3% of their gross receipts designated for relief purposes was protested by the plaintiff utility which operated rapid transit railroads in the City of New York under contract with the City. The contract provided for a five-cent fare, which could be increased only by a majority vote of the people, and for a

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60 (1937) 300 U. S. 398.

61 (1938) 58 Sup. Ct. 913.

62 *Supra*, note 54.

63 It was decided that even if the state statute exempting bonds from taxation created a contract, the state court's determination that the contract was limited to property taxes was not unreasonable.

64 (1938) 58 Sup. Ct. 721, petition for rehearing denied, 58 Sup. Ct. 939.
pooling of the gross receipts from operation and a division between
the utility and city after the deduction of specific items. The plain-
tiff challenged the validity of the tax on the grounds that it impaired
the obligation of its contract with the city and violated its rights
under the Fourteenth Amendment.

As the contract contained no express exemption from taxes of
any kind, the court held that the tax did not impair the contract,
citing the principle that any surrender of the taxing power must be
made in clear and unmistakable language, and vetoing the suggestion
that the imposition of the tax violated the provision of the
contract as to the allocation of revenue.

In discussing the relevance of the Fourteenth Amendment, the
court, in line with its decisions at the previous term, held that
there need be no relationship between the taxpayer and the purpose
for which the money was spent. United States v. Butler, which
held invalid the tax imposed under the Agricultural Adjustment
Act, was distinguished on the ground that it was part of an un-
constitutional scheme to regulate production through expenditures.

**The Federal Income Taxable Income**

The Supreme Court in its last term added substantially to the
case law on the meaning of income under the Sixteenth Amendment. Helvering v. Gowran, perhaps the most important of these cases, removed much of the uncertainty left by the Koshland case with

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65 58 Sup. Ct. at 730.
67 (1936) 297 U. S. 1.
next step was taken in Koshland v. Helvering (1936) 298 U. S. 441, where the
taxpayer, taking her cue from the reorganization cases, asserted that
when she received a common stock dividend on preferred shares she re-
ceived a different proportionate interest in the corporation, which was in-
come to her on receipt. In sustaining this contention, the court apparently
sentitled the requirement, upon which Eisner v. Maconomer was partly based,
that a stockholder must receive some of the corporate assets before he can
be taxed as having received income. The Koshland case did not decide,
however, just how different the proportions must be before the receipt of
the new interest could be income. The problem is clarified to some extent
by the Gowran case.
69 Supra, note 68.
respect to stock dividends. The court held that a preferred stock dividend, paid to a common stockholder of a corporation with preferred stock outstanding, was constitutionally taxable as income, on the ground that it sufficiently changed the proportionate interest of the common stockholder by giving him new rights to share in the profits, or assets on liquidation, if the corporation were unable to pay the preferred shareholders in full.\(^7\) Congress had provided that "a stock dividend shall not be subject to tax." The court, however, rejected the Government's contention that this exemption was intended, in line with Eisner v. Macomber,\(^7\) to exclude only those stock dividends which could not constitutionally be taxed, and held that it exempted all stock dividends from the tax. The taxpayer sold the stock dividend in the year received. The Act established cost as the basis for the computation of gain or loss on the sale or exchange of property,\(^7\) and as the cost of the preferred stock to the stockholder in this case was zero, the total proceeds were taxable.\(^7\)

It has been suggested\(^7\) that the statute does not distinguish between income which is taxable on receipt and that which is exempt on receipt by statute; that in either case, the cost being zero, the

\(^{70}\) A preferred dividend on preferred stock would seem also to be a taxable dividend as it increases the preference to dividends and to share in the assets of liquidation which the preferred stockholder has over the common. If participating preferred shares are outstanding, a common stock dividend on common stock apparently constitutes income, as the common shareholders have acquired a greater right to share in the earnings after the minimum dividend is paid to the preferred shareholders. In these instances, there is actually some change in proportionate interest. No change would occur, however, if a preferred dividend were paid to common shareholders when no preferred shares were outstanding. The court in the Gowran case laid no emphasis on the existence of outstanding preferred shares, and in Helvering v. Pfeiffer, supra, note 68, disposed of on another issue, did not mention whether or not there were such outstanding stock. It may have considered the point immaterial and the dividend income even though other preferred shares were not outstanding.

\(^{71}\) Supra, note 68.

\(^{72}\) Revenue Act of 1928, Secs. 111 (a), 113.

\(^{73}\) In Koshland v. Helvering, supra, note 68, it was held that the Act did not provide for splitting the basis of the original stock between it and the dividend stock, so that possibility had to be discarded. The Circuit Court of Appeals thought that the rule applied in the case of tax-free legacies and gifts, where no basis was provided by statute, should be followed and concluded that the market value of the dividend on receipt became its basis. See U. S. Treas. Reg. 45 (1918) Art. 1562; Brewster v. Gage (1930) 280 U. S. 327. The act, however, now provides a basis in the case of bequests and gifts, so the analogy cannot be followed. Furthermore, it provides that the basis of property, except where specifically provided for, is cost (Revenue Act of 1928, Sec. 113). As the dividend cost nothing and had been income, it could constitutionally be given a zero basis. See (1938) 38 Col. L. Rev. 363, 368.

\(^{74}\) (1938) 26 Calif. L. Rev. 388; (1938) 5 U. Chi. L. Rev. 512; (1938) 51 Harv. L. Rev. 744.
basis is likewise zero. Thus, under the amendment to Section 115f made in the Revenue Act of 1936 it is possible that a stock dividend may be taxed as income on receipt and, on the authority of the Gowran case, the whole proceeds taxed on its sale. The question has also been raised whether items taxable in the year of receipt but which escaped taxation will acquire a basis other than cost.

With respect to stock dividends from 1932 to 1936, an answer may be found in Sec. 113 (b) (1) (D), first passed in 1932, which provides in part as follows: "Proper adjustment in respect of the property shall in all cases be made in the case of stock . . . for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax free or were applicable in reduction of basis. . . ." For the four years in question, the dividends were tax-free and, accordingly, would reduce the basis of the stock on which the dividend was paid. A necessary implication of such a result is that the amount by which the original stock's basis is reduced should become the basis of the tax-free dividend. The purpose was to treat the dividend as a return of capital and hence to divide the original investment between the two forms by which it is now represented.

That does not answer the problem completely. Where the dividends are taxed on receipt, will they again be taxed? It must be conceded that there is no specific provision which will ascribe to these items a basis other than cost. The aim of the income tax acts, however, is to tax net gain, which would seem to preclude taxing the same income twice to the same recipient, once on receipt and again on redefinition. Gain once taxed should not thereafter be taxed. It is probable that some such theory will find expression in an opinion if the issue is raised. Where the item, for some reason other than statutory exemption escaped taxation in the year of receipt, the outcome is doubtful. Probably the rule of the Gowran case will be followed and the basis will be cost.

75 "A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."


77 See Treasury Decision 3052, 3 Cum. Bull. 38 (Aug. 4, 1920); "... A dividend, paid in stock of another corporation held as a part of the assets of the corporation paying the dividend, is income to the stockholder at the time the same is made available for distribution to the full amount of the then market value of such stock (Peabody v. Eisner, 247 U. S. 347); and if such stock be subsequently sold by the stockholder, the difference between its market value at date of receipt and the price for which it is sold is additional income or loss to him, as the case may be." See John H. Cook, B.T.A. Docket No. 77140 promulgated Sept. 20, 1938.
In another case, Palmer v. Commissioner,\(^{78}\) rights distributed to stockholders to buy stock in another corporation were held not to be taxable dividends, even though they had considerable market value when received,\(^{79}\) on the ground that the receipt of an option does not constitute income. The court quoted the statutory definition of dividend, emphasizing the necessity of a distribution of money or property which diminishes the corporation's net worth,\(^{80}\) and held that the distribution of options to buy its assets was not a diminution of corporate net worth.\(^{81}\) Apparently it regards an option as involving too many contingencies\(^ {82}\) to be considered property in the contemplation of the income tax law.\(^{83}\) It held at the


\(^{79}\) On the cash receipts and disbursements basis a dividend becomes income on receipt. On the accrual basis it becomes income on the ex-dividend date. Sharp v. Commissioner (C. C. A. 2nd 1937) 91 F. (2d) 802, reversed on another point (1938) 58 Sup. Ct. 748.

\(^{80}\) Although this is the "outgo" test of Eisner v. Macomber, it is not inconsistent with the Gowran case, as the former dealt with the nature of income under the Sixteenth Amendment while the latter deals with the statutory requirement for a dividend. Since 1936, Sec. 115 (f) has provided that stock dividends shall be excluded from taxable income only where they do not constitute income under the Sixteenth Amendment. This provision leaves no room for limiting their taxability by an interpretation of the definition of dividends found in Sec. 115 (a).

\(^{81}\) This holding seems to disregard the plain economic facts in cases where rights are issued to purchase property at less than its market value. In such cases there is in every practical sense a decrease in corporate net worth. The option price is the maximum amount at which the property subject to the option can be valued as property of the corporation. Helvering v. Salvage (1936) 297 U. S. 106; Wilson v. Bowers (1932) 57 F. (2d) 682; Lomb v. Sugden (C. C. A. 2d, 1936) 82 F. (2d) 166; (See (1936) 36 Ill. L. Rev. 537, 540, note 11), and the net worth is decreased by the difference between that price and the market value. Furthermore, the stockholder has received something of value, separated from his previous interest in the corporation, represented usually by certificates commonly dealt with on the exchange as is the stock acquired through them. If, however, these options were held to be property, a deductible capital loss would result upon their lapse. See Section 117 (e) (2) of the Revenue Act of 1936, Sec. 117 (g) (2) of the 1938 Act.


\(^{83}\) The court followed Helvering v. San Joaquin Fruit & Investment Co. (1936) 297 U. S. 496, holding that the value of an option owned on March 1, 1913, did not become capital of the taxpayer on that date. It also held that the option was not property, which when exercised, was "exchanged" together with the cash for real property, that the basis of the real property was not the March 1, 1913, value of the option plus the cash, and that income was not realized on the exercise of the option. Had the option been property, the taxpayer would have had income upon its exercise or exchange in an amount equal to the excess of the value of the land over the sum of the cash plus the March 1, 1913 value of the option. The holding in this case is thus inconsistent with any notion that an option is property or an
same time that income was not realized by the exchange of the option plus money for the stock, although the value of the property acquired exceeded the option price. The bargain purchase rule did not apply in the instant case because the value of the stock and the option prices coinciding on the day the option was created, there was no intent to distribute earnings.

The case of Heiner v. Mellon provides the first authoritative decision of the court on two problems concerning the nature of income. Two partnerships were formed under the law of Pennsylvania to liquidate the inventories of certain distilling companies. In 1920, both partnerships showed large profits from the sale of whisky, but Pennsylvania law forbade the distribution of any of these profits until the deceased partner's capital was returned. The court first decided that the partners had taxable income each year even though they had a liquidating business and could not therefore know for several years whether they would regain their capital and make profits. In holding that the basis should be apportioned among the cases of whisky and that the profit on the sale of each was income, the court settled the doubts occasioned by the statement in Burnet v. Logan, that the taxpayer "properly demanded a return asset, although in the course of its opinion the court said, "The option itself was property, and doubtless was valuable." See Merhendo Corporation v. Helvering (C. A. D. C. 1937) 89 F. (2d) 972, certiorari denied 58 Sup. Ct. 33, holding that an option to buy stock given as an inducement to enter a corporation's employ was not property constituting income on receipt or added to the basis of the stock when exercised. See also Bathwell v. Commissioner (C. C. A. 10th 1936) 77 F. (2d) 35, Rossheim v. Commissioner (C. C. A. 3rd 1937) 92 F. (2d) 247.

84 Helvering v. Salvage, supra, note 81.

85 (1938) 58 Sup. Ct. 926. This case also served to clarify certain problems of statutory interpretation in holding that the technical dissolution of a partnership upon the death of a partner does not affect the liability of the surviving partners for taxes on their distributive shares of the partnership income pending final liquidation and distribution. The court specifically denied the contention that because the partners' interests were capitalized upon dissolution, no taxable income resulted until the liquidation returned to the partners the cost of their interest.

A more formidable argument was made that under Pennsylvania law the surviving partners became trustees for liquidation and that the income should therefore be taxed to them as trustees. The court, however, held that the local law was not controlling and that the term "trustees" as used in the revenue act did not include the taxpayers who under that act were more appropriately considered as partners carrying on business.


87 (1931) 283 U. S. 404. The taxpayer sold some stock for cash plus royalties from the operation of a mine. The Commissioner estimated the yearly yield needed to restore the taxpayer's investment, and claimed that any excess yearly royalty was income from the sale of the stock. The court held that the taxpayer could not be held to realize income until her capital was restored.
of her capital investment before assessment of any taxable gain based on conjecture.”

The court next decided that the partners were taxable on their distributive shares even though Pennsylvania law prohibited distribution of the profits. Such a tax is similar to taxing a shareholder on his proportionate part of the undistributed profits of the corporation.88

In another partnership case, Guaranty Trust Co. v. Commissioner,89 the decedent’s returns were filed on a calendar year basis, although the partnership of which he was a member reported on a fiscal year basis. The return for the decedent included his share of the partnership profits for the full fiscal year last ending. The executor objected, however, to the inclusion of partnership profits for the portion of its fiscal year closed by decedent’s death on the ground that as income taxation is based on annual accounting periods income for two periods should not be included in one return. He contended that section 182 (a) of the 1932 Act supported this position in providing for the inclusion in a partner’s return of partnership profits “for any taxable year of the partnership ending within his taxable year”, which, he argued, meant “any one taxable year,” thus excluding from taxation a portion of the partnership profits. The court found no Congressional purpose to relieve business income from taxation in the year distributable to a partner and held that the partnership profits for both periods were properly includible in the decedent’s final return. It pointed out that Congress has never undertaken to limit the income taxable in any one year to that derived from the taxpayer’s activities occurring in that or any other single year. It held that the purpose of Section 182 (a) was to make certain that the distributive share of the partnership income included in computing the net income of a partner “shall be based upon the income of the partnership” distributable during the partner’s taxable year, even though an accounting period of the partnership may not be wholly within that year and that the profits accruing to decedent from the two partnership accountings were taxable in that year even though the accounting periods aggregated more than twelve months.

In 1934 the court held that subsection (a) of Section 115 of the Revenue Act of 1928, defining “dividend” for income tax purposes as “any distribution made by a corporation to its shareholders . . . out of earnings or profits accumulated after February 28, 1913,” and subsection (b) providing that for income tax purposes all distributions are paid from “the most recently accumulated earnings or profits”, when construed together, disclosed a legislative purpose that pre-1913 accumulations shall not be distributed “in such fashion

89 (1938) 58 Sup. Ct. 673.
as to permit profits accumulated after that date to escape taxation." 90 This construction was applied in *Foster v. U. S.* 91 to thwart an attempt to charge to post-1913 earnings amounts distributed in partial liquidation of the corporation's stock. The court held that the amounts so distributed were in no part from "the most recently accumulated earnings" but chargeable to capital, leaving the post-1913 accumulations intact.

*Bogardus v. Commissioner* 92 creates new uncertainties regarding the taxability of bonus payments to employees. Shareholders of corporation B, formerly shareholders of Corporation A, without any obligation to do so, voted a bonus to former employees of A in recognition of their valuable and loyal services to A. Finding that the payments were made without consideration and to persons who had never been employed by the disbursing corporation and (as the parties had stipulated) that the payments were not made or intended to be made for any services to that corporation, the court held that they were intended as gifts and not as compensation, the historic fact of past service simply being a reason for the gift. 93 The court's earlier holding, that if the intention is to compensate more completely for past service the payment is taxable income although made voluntarily and without a consideration, 94 it not repudiated. The court's reasoning, however, that a payment cannot be both gift and compensation and the inference that every payment which is in any aspect a gift is perforce not compensation makes the administrative determination of the category into which a bonus payment falls almost impossible to make. Nor is the test suggested by the dissenting Justices satisfactory. They view the question as one of fact, to be determined by the trial court, whether the payment is made to requite more completely for past services or is made to show good will, esteem or kindness to persons who have served but without thought to make a requital for service. Under this test there may be as many different interpretations as there are courts to find the facts. A statutory provision that payments made by reason of past service are compensation regardless of the intention with which made appears to be the most satisfactory solution.

In framing the Civil War Income Tax Act of 1864 and every Revenue Act from 1913 to 1938, Congress has struggled with the problem of preventing the avoidance of taxes on shareholders through the accumulation of corporate surplus. The expedient of

93 Justices Brandeis, Stone, Cardozo and Black, dissenting.
94 Old Colony Trust Co. v. Commissioner (1929) 279 U. S. 716.
taxing corporate profits to the shareholders employed in the Act of 1864 was used in the Revenue Act of 1913 only if the corporation was formed or availed of for the purpose of preventing the imposition of surtaxes upon its shareholders. *Eisner v. Macomber*\(^95\) cast doubt upon the validity of this provision and in 1921 the system was changed to a tax of 25% on the net income of corporations having the defined purpose. This method with various changes, particularly in rates, is found in all subsequent Revenue Acts.\(^96\) The difficulty of proving the requisite purpose has rendered extremely difficult the application of the section. The surtax on personal holding companies imposed by the Revenue Act of 1934 and strengthened by the Revenue Act of 1937, avoids this difficulty with respect to corporations, the greater part of whose income is derived from investment sources, by eliminating the necessity of proving a purpose to avoid surtaxes.

The undistributed profits tax imposed by the Revenue Act of 1936 was perhaps the most complete and effective method of solving the problem. The emasculation of that tax in the Revenue Act of 1938 gives renewed significance to the tax on corporations formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders. The doubts as to the constitutionality of this tax that have existed since its inception were finally removed by the decision in *Helvering v. National Grocery Company*\(^97\). The court held: that the tax in no way limits the powers of the corporation conferred by state law to declare or withhold dividends but is merely imposed upon corporations using their powers to prevent imposition of surtaxes upon their shareholders; that the tax was not laid upon a state of mind but upon net income, the existence of the defined purpose being a condition precedent to liability; that the prescribed standard was not too vague; that the retroactive assessment involved was not objectionable and that an invalid delegation of power was not given the commissioner. In holding that the penal nature of the tax did not render it invalid on the grounds that the taxpayer, the sole owner of the business, could not by conducting it as a corporation prevent Congress from laying on him individually the tax on the year's profits, and by referring to the various provisions in the Revenue Acts from 1913 through 1937, taxing shareholders with respect to corporate income, the court clearly indicates that it no longer considers the corporate entity a bar to the taxation of corporate income to the shareholders.

\(^{95}\) (1920) 252 U. S. 189, by overruling Collector v. Hubbard (1871) 12 Wall. (79 U. S.) 1.

\(^{96}\) See Section 102 of the Revenue Act of 1938.

\(^{97}\) (1938) 58 Sup. Ct. 932.
CORPORATE REORGANIZATIONS

In four cases the scope of the reorganization provisions was considerably limited. In two, Groman v. Commissioner \(^{98}\) and Helvering v. Bashford,\(^ {99}\) these provisions were interpreted to apply only where the securities acquired by a transferor represent a "continuing interest" in the property transferred and not solely an interest in new or different property.\(^ {100}\)

In the Groman case A Company, pursuant to agreement with the shareholders of B Company, organized C Company to which it transferred cash and its preferred stock. The shareholders of B Company transferred their B Company stock to C Company in return for C Company's stock, A Company's stock, and cash. It was admitted that the acquisition of C Company stock was tax-free, as C Company was a party to a reorganization, and the issue was whether the acquisition of A Company's stock was tax-free for the same reason. A Company was not a party to a reorganization as defined in Section 112 (i) (2).\(^ {101}\) The court held that the definition of reorganization in Section 112 (i) (2) was not intended to be all inclusive. Under this definition, A Company was not a party to the reorganization "within the natural meaning of the term," but merely the "efficient agent" in promoting the reorganization. It had been contended that A Company was a party on the ground that the separate entity of C Company, a mere agent of A Company, should be disregarded. The court held that A Company stock received by the B Company shareholders represented an interest in new assets and not a continuing interest in the property transferred and was therefore "other property," giving rise to taxable gain. The test was based on the principle 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."

\(^{98}\) (1937) 58 Sup. Ct. 108.

This interpretation appeared in Courtland Specialty Co. v. Commissioner (C. C. A. 2d, 1932) 60 F. (2d) 937, as an implication of the term "reorganization". It was adopted as conclusive by the Supreme Court in Pinellas Ice & Cold Storage Co. v. Commissioner (1933) 287 U. S. 462, holding that short-term notes were equivalent to cash and not "securities", as they did not represent a continuing interest in the transferred assets. See Helvering v. Minnesota Tea Company (1935) 296 U. S. 378, where the acquisition of common stock of the transferee, John A. Nelson Co. v. Helvering (1935) 296 U. S. 374, where the acquisition of preferred stock of the transferee, and Helvering v. Watts (1935) 296 U. S. 387, where the acquisition of bonds of the transferee, supplied the continuing interest and made the transactions reorganizations rather than sales of assets.

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\(^{101}\) Revenue Act of 1928. Section 112 (g) (2) of the 1938 Act.
In Helvering v. Bashford the court decided that a taxable gain arose on the sole ground that there had been no continuity of interest. A Company bought all the stock of B, C and D corporations, which it transferred to a subsidiary, X Company. The stockholders of B, C and D received from A Company cash, stock of X Company and stock of A Company. A Company retained 57% of the common and all of the preferred in X Company, thus coming within the statutory definition of "a party to a reorganization." The acquisition by A Company of the B, C and D stock also constituted a reorganization to which under the statutory definition, A Company was likewise a party. Despite the fact that A Company was therefore a party to two reorganizations, under the statutory language, the court held that because the shareholders of B, C and D acquired, by receipt of the A Company stock, only an interest in new assets (A Company's) and not a continuing interest in the transferred assets, the A Company stock was "other property" giving rise to taxable gain, and A Company was not therefore a party to a reorganization.

The court answered the contention that A Company was a party to a reorganization as expressly defined in the statute by holding that as the whole purpose of the reorganization plan was to transfer the assets of the three reorganized companies to X Company, the subsidiary of A Company, A Company's ownership of B, C and D was "transitory and without real substance," and unnecessary to the consummation of the plan. Accordingly, there were virtually no differences from the Groman case, and the rule of that case applied.

Supra, note 99.

Sec. 112 (i) (1) — "The term 'reorganization' means ... (c) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders (shareholders) or both are in control of the corporation to which the assets are transferred ...." Under this definition, a reorganization occurred when A Company transferred to X Company assets in the form of stock in three corporations and in return received all the preferred and a majority of the common shares of X Company.

Section 112 (i) (2) — "The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another." Another provision in the same section defining reorganization as "including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of all other classes of stock of another corporation." Under these definitions when X Company acquired properties of A Company, both were parties to a reorganization.

Supra note 103.

In the two other recent corporate reorganization cases, Minnesota Tea Co. v. Helvering and U. S. v. Hendler, debts of the corporations were assumed by the shareholders and by the transferee corporation, respectively. The court held that the assumption of the obligations gave rise to income and as it was not distributed to the shareholders it was not exempted by Section 112 (d) (1) but was taxable under Section 112 (d) (2).

In reorganizations, gain realized on the receipt of securities is not taxed. Gain realized on the receipt of money or property is taxed unless, in the case of a corporation, it is distributed. If it is distributed to shareholders, they will be taxed on it. If the money or property is used to pay creditors, any gain the corporation realized on its receipts will never be taxed. Where the taxation of a gain cannot be postponed or passed on, as in the instant cases, the gain should be taxed when realized.

Depletion

The nature of a depletable interest in oil and gas wells was before the court in three cases. It had previously stated that a taxpayer had a depletable interest if he had an economic interest in the oil and gas. The use of this test led to a great confusion as is evidenced by the reversal of the Circuit Courts of Appeals in each of the three cases. Its latest pronouncement that the taxpayer must have a "capital investment or interest" in the oil or gas in place and that a mere economic interest is insufficient will probably prove no less confusing.

In Helvering v. Bankline Oil Company, the taxpayer had a contract entitling him to possession of the oil at the well after it was pumped to the surface and the right to refine the oil and pay the owner of the well in kind. He was held not to have a depletable interest as he had merely a contractual right against the owner of the oil and no interest therein before it was pumped to the surface. In Helvering v. O'Donnell, a shareholder in a corporation owning oil wells and producing oil and gas was held not to possess any depletable interest. Accordingly, when all the shares were sold to another corporation and the taxpayer received for his share a por-
tion of the net proceeds from the production of the oil wells, he did not have the required depletable interest as he acquired no greater interest in the oil and gas in place after the sale of his shares than he had before their sale.

In Helvering v. Elbe Oil Land Development Company, the taxpayer had sold the property under an agreement entitling the purchaser to abandon the property at any time prior to the middle of the second year, the taxable year in question. The contract stated that the taxpayer retained no interest in the property although during these years there was the possibility of a reversion upon abandonment by the buyer. The purchaser, however, did not abandon the property. The court, ignoring the possible reversion, held that the taxpayer had retained an interest in the oil and the gas in the place, and therefore had no depletable interest.

In another depletion case, Helvering v. Mountain Producer's Corporation, the taxpayer, an owner of oil leases, entered into a contract to sell all the oil produced. The purchaser agreed to conduct all the development and production operations and to pay cash royalties to the taxpayer. The taxpayer's contention that the development and production costs should be considered gross income for the purpose of computing the seller's depletion allowance, was rejected as too theoretical and contrary to the natural sense in which the term "gross income from property" was employed in the statute.

**Miscellaneous**

*Biddle v. Commissioner* held that no credit was permissible under Section 131 of the Federal Revenue Act of 1928, allowing a citizen of the United States a credit for income taxes paid to any foreign country, for the English standard tax on corporate dividends. The English tax is imposed on corporate earnings each year whether or not dividends are paid. If a dividend is paid, the tax is considered as part of the gross dividend. Each recipient of the dividend includes his pro rata share of the tax in his gross income for English super tax purposes, and if by reason of exemptions or deductions his net income is below a certain figure he can get a refund from the government of his pro rata share of the tax paid by the corporation. In England this system is considered as a payment of the tax by the shareholder. The court applying American rather than English tests in holding that the corporation and not the shareholder pays the English tax within the meaning of Section 131, reasoned that the English tax was similar to our

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116 (1938) 58 Sup. Ct. 621.
corporate income tax and that as a shareholder in an American corporation receives no credit for the corporate tax neither should a shareholder in British corporations.

Although the Regulations require claims for refund to state specifically the grounds on which based, claims are sometimes considered notwithstanding they are general. If a general claim is considered, it may be amended to set forth specific grounds even though the time for filing refund claims has elapsed. If a specific claim is filed, it may be amended after the expiration of the statutory period if its effect is merely to set forth with greater particularity the grounds set forth in the original claim but not if its effect is to set forth new and additional grounds for relief.

These rules were applied in U. S. v. Andrews where the taxpayer was denied a right to amend his specific claim and in U. S. v. Garbutt Oil Co. where it was held that the untimeliness of the amendment was not waived by the Commissioner's consideration of the merits of the position taken therein.

In two cases, Pacific National Co. v. Welch and U. S. v. Kaplan the court refused to permit taxpayers to change from the deferred payment basis to the installment basis after the time for filing returns had expired but before the expiration of the period of limitations for claiming refunds. The burdensome uncertainties in the administration of the revenue acts that would otherwise result seem clearly to justify making binding an election between methods of reporting income.

Acquittal of the defendant in a criminal action for “willful evasion of the revenue laws” was held in Helvering v. Mitchell not to bar recovery of an assessment of the 50% addition to the deficiency due to fraud, provided in Section 293 of the Revenue Act of 1928. The court held that the addition was civil and not criminal in nature, and that its purpose was not to punish but to protect the revenue and to reimburse the government for the heavy expenses of the investigation and loss resulting from the taxpayers’ fraud. As the burden of proof is greater in criminal than in civil cases, acquittal in a criminal case is not res judicata in the civil case even though the facts, issues and parties be the same, and as the case is civil no question of double jeopardy can arise.

119 Reg. 94, Art. 322-323.
124 (1938) 58 Sup. Ct. 320.
125 (1938) 58 Sup. Ct. 857.
126 (1938) 58 Sup. Ct. 859.
127 (1938) 58 Supt. Ct. 630.
In Phillips-Jones Corporation v. Parmley, the right of the shareholder, held liable as a transferee in Phillips v. Commissioner to contribution against other shareholders was upheld. The transferee's right to contribution arises from the general law and does not differ from that of any other person who has paid more than his fair share of a common burden. Accordingly, it was of no consequence that the Commissioner had made no assessments against the other shareholders, or that the sections of the Revenue Act imposing transferee liability made no provision for contribution.

Section 607 of the Federal Revenue Act of 1928 provides that any payment of a tax after its collection is barred by limitation is an overpayment and section 609 provides that any credit against a barred liability is void. In McEachern v. Rose the court was called upon to decide whether these provisions prevented the government from relying upon a barred deficiency of income tax for the year of death of a decedent to deny refund of overpayments made by the administrator of decedent's estate for subsequent years. The overpayments and deficiency, respectively, resulted from the error of the administrator in reporting as income for the years following death, gains from an installment sale which should have been included in income for the year of death. The court, applying the literal language of the statute, held the overpayments could not be credited against the barred deficiency and accordingly should be refunded. The case in itself is of little importance particularly since a different result will unquestionably be reached in similar situations under the provisions added by Section 820 of the Revenue Act of 1938 to mitigate the effect of the statute of limitations in cases of this character. It gains significance, however, when considered in relation to previous cases on recoupment.

In Bull v. U. S. a taxpayer was permitted to apply an overpayment of estate tax, recovery of which was barred, against an income tax later imposed on the same item as that on which the estate tax was paid. The decision was based on the application of equitable principles to prevent the government from unjustly retaining two taxes on the same item. The McEachern case presents an almost exact converse situation and, admittedly, a contrary result would have been reached were it not for the specific provisions of sections 607 and 609. The court's refusal to permit the application of the overpayments against the barred deficiency must thus be accepted as a reversal or modification of the statement in Stone v. White, decided at the previous term, to the effect that these sec-

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129 (1931) 283 U. S. 589.
130 (1837) 58 Sup. Ct. 84.
132 (1937) 301 U. S. 532, 538.
tions of the act did not deprive the government of equitable defenses. The decisions in the two cases, however, are entirely consistent.

In the *McEachern* case, recovery of the overpayments could be prevented only by crediting them against the barred deficiency of the taxpayer for an earlier year, a procedure specifically prohibited by the statute. In *Stone v. White*, a different situation existed. The trustees of a trust sought to recover a tax paid by the trust on income which should have been taxed to the beneficiary. Since recovery by the trustees would inure to the benefit of the beneficiary and would result in income escaping taxation, inasmuch as collection from the beneficiary was barred, the government unquestionably had an equitable defense unless prohibited by Sections 607 and 609. Although collection from the beneficiary was barred at the time of payment by the trust, the trust was not paying the beneficiary’s tax but was paying what it erroneously considered was its own, collection of which was not barred by limitation at the time of payment. Thus, the overpayment of tax by the trust existed independently of Section 607 and not by virtue of that section.

Section 609 likewise was not applicable. Although, equitably considered, a beneficiary and a trust may have identical interests, they are separate entities for income tax purposes. Since the only authority in the Act for the crediting of overpayments contemplates that the credit shall be applied against taxes due from the taxpayer, Congress in providing in Section 609 that overpayments shall not be credited against barred liabilities must have had reference to cases where the barred tax and the overpayment both related to the same taxpayer and not to cases like that of *Stone v. White*, where the barred deficiency was owing from one taxpayer and the barred deficiency was made by another. Hence, although these sections deprive the government of equitable defenses in cases falling within their provisions, these sections, not being applicable in *Stone v. White*, did not preclude reliance on the equities presented therein.

In reaching its decision in *McEachern v. Rose*, the court had occasion to consider the actual time when an overpayment was credited against a deficiency. It concluded that since the credit or refund was allowed when the commissioner signed the schedule of overassessments that that was the time when the credit was made. In such cases the credit is merely a bookkeeping entry. In *United States v. Wurts*, the court was required to decide if the date of allowance of the refund, i. e., the signing of the schedule of overassessments, was the date of the making of the refund so that the statute of limitations on recovery of an erroneous refund would start to run when the schedule was signed. The court held that a refund was not “made” at the time it was “allowed.” The use of different terms implies a different meaning, and as the government

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133 Sec. 322 (a) Revenue Act of 1928.
134 (1938) 58 Sup. Ct. 637.
could not sue to recover an erroneously made refund before it had
sent the money to the taxpayer, the statute of limitations should not
commence to run before the cause of action arose.

**The Federal Estate Tax**

Section 302 (c) of the Revenue Act of 1926 as amended by Joint
Resolution of Congress of March 3, 1931, and Section 803 (a) of
the Revenue Act of 1932, which included in the gross estate of a
decedent property irrevocably transferred with a reservation of a
life estate to the transferor,\(^\text{135}\) was interpreted in *Hassett v. Welch*\(^\text{136}\) to be prospective only in operation, and therefore inapplicable to transfers made prior to March 3, 1931. The constitution-
ality of its application to transfers made after that date was upheld
in *Helvering v. Bullard*\(^\text{137}\) on the grounds that the purpose of the
legislation was to prevent avoidance of estate taxes and that “Con-
gress having the right to classify gifts of different sorts, might
impose a tax at one rate upon a gift without reservation of a life
estate, and at another rate upon a gift with such reservation.”\(^\text{138}\)

These reasons were repudiated by the court in 1932 in *Heiner v.
Donnan*,\(^\text{139}\) holding invalid the conclusive presumption in Section
302 (c) of the Revenue Act of 1926 that gifts within two years
of the donor’s death were made in contemplation of death. The
court’s present recognition of Congress’s power to classify gifts inter
vivos with transfers at death not only indicates that *Heiner v.
Donnan* was wrongly decided but goes far in removing the doubts
concerning the validity of proposals to integrate gift and estate
taxes into one tax.\(^\text{140}\)

Another instance of the special tax advantages given residents of
community property states is found in *Lang v. Commissioner*,\(^\text{141}\) in
which only one-half of the proceeds of the decedent’s policies of
life insurance were held includible in the gross estate as the prem-
iums had been paid with community funds.

Amounts paid to charitable institutions by an executor pursuant
to binding promises of the decedent, where the only consideration
was a stipulated application of the amount received, were held not

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\(^{136}\) (1938) 58 Sup. Ct. 559.

\(^{137}\) (1938) 58 Sup. Ct. 595.

\(^{138}\) Ibid. at page 597.

\(^{139}\) (1932) 285 U. S. 312. See also *Schlesinger v. Wisconsin* (1926) 279 U. S. 230.

\(^{140}\) See George T. Altman, *Combining the Gift and Estate Taxes* (1938) 16 Tax Magazine 259.

\(^{141}\) (1938) 58 Sup. Ct. 880.
deductible in *Taft v. Commissioner*\(^{142}\) as "claims . . . incurred . . . for an adequate and full consideration in money or money's worth". As such amounts were not testamentary transfers of the decedent, they were held not deductible as transfers to charitable institutions.

**Federal Excise Taxes**

In *White v. Aronson*,\(^{143}\) the only federal excise tax case reviewed during the last term, it was held that jig-saw puzzles are not subject to tax as "games and parts of games" under Section 609 of the Revenue Act of 1932.

\(^{142}\) (1938) 58 Sup. Ct. 891.

\(^{143}\) (1937) 58 Sup. Ct. 95. The court limited the language of the decision in *Baltimore Talking Board Co. v. Miles* (C. C. A. 1922) 280 Fed. 658, which held a ouija board a game, and distinguished *Mills Novelty Co. v. U. S.* (Ct. Cl. 1931) 50 F.(2d) 476, upholding the tax on a coin-operating gambling machine.