WHAT LAW OF TAXATION?

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The Fordham Law Review offers WHAT LAW OF TAXATION? as a timely appraisal of present juristic thought in the fertile field of Taxation. Professor Nash’s article is also enlightening as to current trends in the judicial process—developments of major importance to readers who are interested in the science of law.—EDITORIAL NOTE.

Not even those who at the time heeded the air raid warning of Mr. Justice Frankfurter’s announcement that “an important shift in constitutional doctrine” was on its way, anticipated the devastating thoroughness of the ensuing barrage which, from all indications, has only begun. For the most part the hits have served to clear the legal landscape of some earlier construction work which from the outset had been poorly conceived and feebly supported, or which, sound enough when first erected, had long since outlived its usefulness. While in other quarters the demolition has had some bruising effects, as yet the principal damage complained of seems to consist in wear and tear on the nerves of those who fear that future sorties may leave them completely without shelter.

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2. For example, Mr. Justice Frankfurter’s opinion for the Court in O’Malley v. Woodrough, 307 U. S. 277 (1939), expressly overruling Miles v. Graham, 268 U. S. 591 (1925), and, by unmistakable implication, Evans v. Gore, 253 U. S. 245 (1920).
3. For example, Mr. Justice Frankfurter’s opinion for the Court in Rochester Telephone Co. v. United States, 307 U. S. 125 (1939), eliminating the debris of the “negative order” doctrine.
4. The following newspaper report is interesting in this connection: “South Bend, Ind., Oct. 26.—Federal Judge Walter C. Lindley of Danville, Ill., had under advisement today a motion to dismiss charges against the 17 individual defendants in the General Motors anti-trust case being tried here. . . . Judge Lindley agreed the case probably was without precedent, but remarked that a recent United States Supreme Court decision implied that ‘precedents may be of little avail, and their lack may be no bar.’ . . . Judge Lindley, attributing the Supreme Court opinion to ‘one of the recent appointees,’ told lawyers: ‘I must confess, gentlemen, at the end of 17 years upon the bench, at the end of 35 years engaged as lawyer and as judge, I find less certainty in law today than at any time in that period.” Washington Evening Star, October 26, 1939, p. A-12, col. 4. Compare the views of Circuit Judge Sibley: “The principle of stare decisis in constitutional interpretations
Such at least seems to be the basis of the protest registered by Mr. Justice Roberts on the occasion of the concentrated attack on January 29th. When on that day, in Helvering v. Hallock,\(^5\) there took place "the judicial miracle of the loaves and fishes, four becoming five,"\(^6\) he remonstrated against the action of the majority in overruling the two St. Louis Union Trust Co. cases\(^7\) with the warning that "to upset these precedents now, must necessarily shake the confidence of the bar and the public\(^8\) in the stability of the rulings of the courts and make it impossible for inferior tribunals\(^9\) to adjudicate controversies in reliance has recently received shattering blows in the Supreme Court, and especially in the field of immunities from general taxation. . . . The recent re-examination of the basis for such immunities has resulted in an upheaval. The current of authority has been turned. For the judicial navigator the cases are no longer the beacons marking out a fixed if tortuous channel. He must for awhile fix his eyes anew upon the Constitution as the pole star of his firmament and steer his course rather by principle than by precedent." Stone v. Interstate Natural Gas Co., 103 F. (2d) 544, 549 (C. C. A. 5th, 1939).

5. 60 Sup. Ct. 444 (January 29, 1940).
8. In a recent article, The Court Is Now His, Mr. Wendell Willkie has taken occasion to observe in part as follows: "The precedents of constitutional law, therefore, furnished many limitations on the power of Congress. And these were effectively recognized by the court prior to February, 1937, in holding unconstitutional much of the New Deal legislation. But by a series of sweeping opinions the court has not only nullified many of the precedents of four or five years ago but it has uprooted and overturned some of the oldest guideposts of our constitutional law. Its record reveals an astonishing emancipation of legislative power from judicial restraint, and a corresponding willingness—one might almost say eagerness—to reverse prior decisions. No later than January twenty-ninth the court illustrated graphically this tendency by overruling in one sitting three previous decisions rendered as late as 1935. . . ." SATURDAY EVENING POST, March 9, 1940, pp. 29, 71.
9. The Bailey case in the Court of Claims is illustrative of the point. On March 4, 1940, directly in consequence of Helvering v. Hallock, the Court of Claims rendered its third decision in the case. In its first opinion of May 29, 1939, it held the estate of a decedent liable for federal death taxes on the value of proceeds of insurance policies taken out on the decedent's life. This decision was based on a finding that the insured had paid all premiums on the insurance out of his own funds. It appearing upon the presentation of new evidence that in point of fact the premiums had not been paid by the insured, but by the assignee of the policies, the Court reversed its ruling of May 29, 1939, and on December 4, 1939, entered judgment for refund in favor of the taxpayer. In both rulings it was held that the circumstance that the insured had retained for his estate a reverter interest in the policies was immaterial on the question of taxability, under the decisions of the United States Supreme Court in the two St. Louis Union Trust Co. cases. Following the reversal of those cases in Helvering v. Hallock the Court of Claims (on the Government's motion) reopened the Bailey case, and on March 4, 1940, reversed its holding of December 4, 1939, deciding that the Hallock case compelled a ruling against the taxpayer's claim for refund. 404 CCH 1940 Fed. Tax Serv. ¶ 9289.
on the decisions of this court." In the *New York Sales Tax* case, decided the same day, equally emphatic objections were stated by the Chief Justice in a dissenting opinion in which Mr. Justice Roberts concurred. And in the third precedent-pounding decision of the day, that in *Madden v. Kentucky*, blasting *Colgate v. Harvey* out of existence, the same Justice renewed his exceptions in a dissent whose shortness suggests weariness.

It is not without significance that in each of these cases the immediate victim was a taxpayer. His sufferings at the present Term of the Court have been unusually severe, and yet for most of them he has

10. 60 Sup. Ct. 444, 456 (1940).
12. Mr. Justice McReynolds also concurred in the dissent of the Chief Justice.
15. With Mr. Justice McReynolds concurring. The Chief Justice concurred in the result reached by the majority "upon the ground, as stated by the Court of Appeals of Kentucky, that the classification adopted by the legislature rested upon a reasonable basis." 60 Sup. Ct. 406, 411. Similarly, in the *Hallock* case, the Chief Justice concurred in the result of the majority decision without subscribing to its overruling of the *St. Louis Union Trust Co.* cases, notwithstanding the fact that he was a member of the minority (with Justices Brandeis, Stone and Cardozo) in those cases.
16. To date the work of January 29th, 1940, marks the high concentration point of the campaign's development. Yet search for new victims continues, with pot shots being taken at targets insufficiently exposed for direct hits. Three decisions of March 25th will serve as illustrations. In the case of Tradesmens National Bank v. Oklahoma Tax Commission, 60 Sup. Ct. 688 (March 25, 1940), Mr. Justice Murphy, in his first written opinion for the Court, observes: "We do not now decide just what circumstances, if any, would bring a situation within the precise scope of the Macallen case ([Macallen v. Massachusetts, 279 U. S. 620](https://www.law.cornell.edu/cases/ilc/279US620), assuming that case still has vitality." (Italics inserted). Compare the similarly questioning approach of the Court (through Mr. Justice Frankfurter) in *Whitney v. State Tax Commission of New York*, 60 Sup. Ct. 635 (March 25, 1940): "Acceptance of Binney v. Long, 299 U. S. 280, would not constrain us to hold differently." Mr. Justice Roberts, who had written for the Court in the *Binney* case, dissented, being of the opinion that "the instant case is indistinguishable in principle from Binney v. Long..." And the action of the Court in *Minnesota v. National Tea Company*, 60 Sup. Ct. 676 (March 25, 1940), indicates more than a mere willingness on the part of the majority to reexamine the validity of *Stewart Drygoods Co. v. Lewis*, 294 U. S. 550 (1935).
17. As of April 1, 1940, in twenty-seven cases involving the validity of state taxes, which were disposed of by the Court by written opinion, *per curiam* affirmance, dismissal of appeal, or denial of certiorari, the result of the decision was adverse to the taxpayer in twenty-five. The two cases in which the taxpayer prevailed were *McCarroll v. Dixie Greyhound Lines*, 60 Sup. Ct. 504 (1940), and *McGoldrick v. Gulf Oil Co.*, 60 Sup. Ct. 654 (No. 473, decided March 25, 1940). In twenty-nine cases presenting questions of federal taxation, which were decided by written opinion or *per curiam* affirmance, the taxpayer lost in twenty-four, and prevailed in but five. The five victories were won in *Helvering v. F. & R. Lazarus Co.*, 60 Sup. Ct. 209 (1939); *Helvering v. Johnson*, 60 Sup. Ct. 293 (1939); *Haggar Co. v. Helvering*, 60 Sup. Ct. 337 (1940); *Helvering v. Wood*, 60 Sup. Ct.
been conditioned by his experiences of the past two or three years. In view of the expanding needs for revenue of both federal and state governments, especially under the strain of the past decade, it was inevitable that the bulk of the Court's work in the reexamination of old constitutional concepts and the projection of new ones should fall in the field of taxation. Broad social purposes such as wealth distribution have been accepted as a proper basis for taxation. Immunities from taxation based on presupposed constitutional principle have been shrunk. Exemptions based on statutory provisions have been narrowly construed. Concepts of what constitutes income in the sense of the Sixteenth Amendment have been expanded to bring more numerous situations within the reach of the taxing power. Benevolent attempts

551 (No. 384, decided February 26, 1940); Germantown Trust Co. v. Helvering, 60 Sup. Ct. 566 (No. 462, decided February 26, 1940). And in forty-seven cases involving federal taxes wherein by denial of certiorari the judgment of the lower court was allowed to stand, the denial in every case was against the taxpayer. In one of these, Crane-Johnson v. Helvering, 60 Sup. Ct. 386 (1940), the prior denial of certiorari, 60 Sup. Ct. 386 (January 15, 1940), was set aside and certiorari was granted. 60 Sup. Ct. 708 (No. 584, March 25, 1940).

18. "It is not the decedent's enjoyment of the property—the 'beneficial interest'—which is the occasion of the tax, nor even the acquisition of such enjoyment by the individual beneficiaries. Presumably the policy behind estate tax legislation like that of New York is the diversion to the purposes of a portion of the total current of wealth released by death." Frankfurter, J., writing for the majority of the Court in Whitney v. State Tax Commission of New York, 60 Sup. Ct. 635 (No. 541, decided March 25, 1940). Cf. Stone, J., in Carmichael v. Southern Coal and Coke Co., 301 U. S. 495 (1937): "A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. . . . This Court has repudiated the suggestion, whenever made, that the Constitution requires the benefits derived from the expenditure of public moneys to be apportioned to the burdens of the taxpayer, or that he can resist the payment of the tax because it is not expended for purposes which are peculiarly beneficial to him. . . ." Id. at 522, 523. Broad classifications were sustained in the Carmichael and Whitney cases consistently with the Court's policy in a number of recent decisions, e.g., Great Atlantic & Pacific Tea Co. v. Grosjean, 301 U. S. 412 (1937); New York Rapid Transit Co. v. City of New York, 303 U. S. 573 (1938); Madden v. Kentucky, 60 Sup. Ct. 406 (1940). The principle was stated in the Whitney case as follows: "Differences in circumstances beget appropriate differences in law. The Equal Protection Clause was not designed to compel uniformity in the face of difference. Madden, Jr. v. Kentucky, No. 92, this Term." 60 Sup. Ct. 635, 640.


to eliminate multiple taxation among the states have been abandoned. Interstate commerce has been called upon to "pay its way" to the states to an extent never before dreamed of as possible. Even the retroactive tax has won a tolerance beyond any previously approximated.

Naturally the taxpayer is aggrieved when by a departure from stare decisis the Court withdraws from him the advantage of an immunity from taxation previously thought to be his as a matter of constitutional necessity. In such a case his disappointment is like that of a schoolboy whose allowance has been cut in consequence of his parent's financial reverses. It is like that which follows when a limitation is imposed by the legislature upon some previously enjoyed deduction, or when the rates of existing taxes are elevated, or some entirely new levies are laid. The taxpayer often complains loudly about the uncertainty generated by the Court's departures from stare decisis, but it is usually found to be such stuff as smoke screens are made of. The state employees whose old immunities from federal taxation have been withdrawn are not interested in preserving the integrity of the principle of stare decisis, however much they talk about it. Contractors building dams for the federal government are not primarily concerned with the effect a state tax on their gross receipts may have on the federal sovereignty, if the Court decides upon a departure from stare decisis to sustain the validity of the tax.

More than likely when he made his out-of-the-state bank deposits the taxpayer in *Madden v. Kentucky* had never heard of the decision in *Colgate v. Harvey* to which, in his subsequent resistance of the Kentucky tax, he so strenuously urged the Court to adhere. It even happens that a taxpayer will seek to derive some *ex post facto* protection from a decision rendered by the Court after the consummation of the transaction sought to be taxed, arguing that, in the interests of stare decisis, the Court in deciding his case


27. 60 Sup. Ct. 406 (January 29, 1940).

should hold itself estopped to consider again the soundness of its prior holding.

Such a case was Helvering v. Hallock.\textsuperscript{29} There the settlor established a trust under a separation agreement with his wife, giving her the income for life, and providing further that upon her death the corpus of the trust was to revest in the settlor if then he were living, and if then he were dead the corpus was to be distributed among the settlor's children. In 1919, when the transfer took place, the federal law imposed an estate tax on gifts "intended to take effect in possession or enjoyment at or after death,"\textsuperscript{30} but there had been no authoritative adjudication of the application of these provisions to the situation where the settlor made a gift in trust, retaining for himself only a limited interest in the reversion. No clean cut decision on the point was rendered by the Supreme Court until a year before the settlor's death in 1932 when, in Klein v. United States,\textsuperscript{31} it was held that where a decedent conveyed a life interest in property to his wife, with provision that she should own the fee if she succeeded in outliving him, the decedent's predeceasing his wife brought about an expansion of her interest in the property sufficient to warrant the imposition of a death tax on the decedent's estate. It was not until 1935, in the two St. Louis Union Trust Co. cases,\textsuperscript{32} that the Court definitely (but by a 5-4 decision) drew a distinction between the vesting of a contingent remainder (the situation in the Klein case), and the lapse upon the settlor's death of what it called "a mere possibility of reverter." Nevertheless the taxpayer in Helvering v. Hallock vehemently insisted that the taxability of the transfer in question should be governed by the St. Louis Union Trust Co. cases, decided sixteen years after the transfer took place, and three years after the transferor's death, and that the Court should not re-examine the validity of the technical distinctions drawn in those cases between the situation there presented and that presented in Klein v. United States.

Pointing out how the taxpayer's concern for the principle of \textit{stare decisis} was a wholly impersonal one, the Court said:

"Nor have we in the St. Louis Trust cases rules of decision around which, by the accretion of time and the response of affairs, substantial interests have established themselves. No such conjunction of circumstances requires per-\textsuperscript{33}"

\textsuperscript{29} 60 Sup. Ct. 444 (January 29, 1940).
\textsuperscript{30} Now appearing as § 811 (c) of the Internal Revenue Code.
\textsuperscript{31} 283 U. S. 231 (1931).
petuation of what we must regard as the deviations of the *St. Louis Trust* decisions from the Klein doctrine. We have not before us interests created or maintained in reliance on those cases. . . .

A similar situation was presented in another recent decision of the Supreme Court. In *Higgins v. Smith* the Court held that the taxpayer was not entitled to deduct a loss resulting from his sale of securities to a corporation wholly owned by him. One of the principal arguments urged by the taxpayer in his resistance of the Commissioner's disallowance of the deduction was based upon a fairly well established course of decision in the lower federal courts, and the Board of Tax Appeals, holding in favor of the deduction. In rejecting the argument the Court stressed the circumstance that this course of decision did not begin to develop until 1934, nearly two years after the consummation of the transaction involved in the principal case.

Dissenting in both *Helvering v. Hallock* and *Higgins v. Smith*, Mr. Justice Roberts stressed the possible effects of the majority decisions on taxpayers who, unlike Hallock and Smith, entered into their transactions

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33. Mr. Justice Frankfurter for the Court, 60 Sup. Ct. 444, 451 (1940).
34. 60 Sup. Ct. 355 (January 8, 1940).
38. "Such a conclusion, urges the respondent, is inconsistent with the prior interpretations of the income tax laws and consequently unfair to him. He points to the decisions of four courts of appeals which have held losses determined by sales to controlled corporations allowable and further calls attention to the fact that the Board of Tax Appeals has consistently reached the same conclusion. But this judicial and administrative construction has no significance for the respondent. The Bureau of Internal Revenue has insistently urged since February 18, 1930, the date of the Board of Tax Appeals' decision in *Jones v. Helvering*, that a transfer from a taxpayer to a controlled corporation was ineffective to close a transaction for the determination of loss. Every case cited by respondent in the courts of appeals and before the Board of Tax Appeals found the Government supporting that contention. The Board's ruling in the *Jones* case was standing unreversed at the time of the transaction here involved, December 29, 1932. It was only after the transactions here involved and after the reversal of the Board in the *Jones* case on April 23, 1934, or this Court's refusal of certiorari on October 8, 1934, that the Board of Tax Appeals and the courts of appeals, over Government protests, ruled in line with the opinion of the Court of Appeals of the District of Columbia in the *Jones* case." Mr. Justice Reed for the majority, 60 Sup. Ct. 355, 358 (1940).
after the establishment of the courses of decision reversed in those cases. "I am of opinion," he said in Higgins v. Smith, "that the courts should not disappoint the well-founded expectation of citizens that, until Congress speaks to the contrary, they may, with confidence, rely upon the uniform judicial interpretation of a statute. The action taken in this case seems to me to make it impossible for a citizen safely to conduct his affairs in reliance upon any settled body of court decisions." And in the Hallock case:

"If there ever was an instance in which the doctrine of stare decisis should govern, this is it. Aside from the obvious hardship involved in treating the taxpayers in the present cases differently from many others whose cases have been decided or closed in accordance with the settled rule, there are the weightier considerations that the judgments now rendered disappoint the just expectations of those who have acted in reliance upon the uniform construction of the statute by this and all other federal tribunals. . . ."

Notwithstanding the Court's care in the Hallock and Smith cases to point out how the taxpayers' concern for stare decisis in those cases was a vicarious one, it is not likely that a better fortune awaits one who can show that he entered upon an arrangement of his affairs after and, perhaps, in reliance upon the St. Louis Trust Co. cases. After emphasizing how the taxpayer in the Hallock case had no standing to argue that the St. Louis Union Trust Co. cases should not be overruled because of any reliance that had been placed on them in the transaction in question, Mr. Justice Frankfurter acted quickly to chill the hopes of any one able to show such reliance, by adding a curt caveat:

"We do not mean to imply that the inevitably empiric process of construing tax legislation should give rise to an estoppel against the responsible exercise of the judicial process. . . ."

Quite possibly it may be argued by the taxpayer who can show reliance upon the St. Louis Union Trust Co. cases that the Court should soften

40. 60 Sup. Ct. 444, 456 (1940). Mr. Justice McReynolds concurred in the dissent.
41. The taxpayer whose situation parallels that of the taxpayer in Higgins v. Smith, except in the particular that, unlike the situation there, he is able to show that his sale at a loss to a corporation controlled by him took place after the course of decision permitting such deduction had become established (see notes 36-38, supra), is faced with the insuperable obstacle of § 24(a)(6) of the Revenue Act of 1934 (48 Stat. 680, 691, now appearing as § 24(b)(1)(B) of the Internal Revenue Code), providing that no deduction shall be allowed for a loss resulting from the sale or exchange of property "between an individual and a corporation in which such individual owns, directly or indirectly, more than 50 per centum in value of the outstanding stock. . . ."
42. 60 Sup. Ct. 444, 451 (1940).
its reversal of those decisions in *Helvering v. Hallock* by limiting the scope of its ruling in that case to two situations, (1) where the transfer under which the transferor retained a reverter interest was made, and the transferor died, prior to the *St. Louis Trust Co.* cases in 1935, or (2) where, without regard for the time when the transfer was made, the transferor died after the decision in *Helvering v. Hallock*. Such a course was followed by the Montana Supreme Court in *Montana Horse Products Co. v. Great Northern Railway Co.* where, in reversing a prior decision, it announced that its reversal was to have no retroactive effect, but that situations arising before the prior decision's reversal would continue to be governed by its principles. By thus giving its overruling decision an operation similar to that of a statutory change with prospective effect only, the Montana court removed the sting of its departure from stare decisis. The United States Supreme Court gave its unanimous approval to this practical compromise in *Great Northern Railway Co. v. Sunburst Oil & Refining Co.* On the strength of this approval an attempt was made to persuade the Court to give similarly limited effect to its decision in *Helvering v. Gerhardt*, holding the salaries of officials of the New York Port Authority subject to the federal income tax. Possibly because the Court felt that any unfairness that might result from retroactive application of its ruling in the *Gerhardt* case could be avoided by the exercise of a power already possessed by the administrative authorities or by

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43. As was the case in *Helvering v. Hallock*.

44. In the situation where the transfer was made prior to the decision in *Helvering v. Hallock*, but the transferor was still living at the time of the decision, the effect of the ruling would still remain avoidable by a surrender of the transferor's reversion interest. A gift tax might be incurred upon such a surrender, but there would remain nothing that could be subjected to the death tax unless, of course, it could be shown that the surrender had been made in contemplation of death.

45. 91 Mont. 194, 7 P. (2d) 919 (1932).

46. 287 U. S. 358 (1932). Compare the recent decision of the Court of Appeals of Kentucky, following the example of the Montana Supreme Court, in *Payne v. City of Covington*, 123 S. W. (2d) 1045 (Ky., 1938), where the Court said at 1051:

"We conceive . . . it to be competent for a court, in overruling a prior adopted principle, to preserve in the overruling opinion all rights accrued under the prior declaration, the same as if they had been created or arose out of a former existing statute which was later repealed by the legislature. . . . Therefore in overruling our prior opinions and in declaring our disapproval of such erroneous interpretations herein dealt with, we do so with the express reservation that all rights heretofore created and accrued in favor of all persons interested in any manner whatsoever shall be preserved and the principles of this opinion will not apply to any transaction begun, or in the course of completion, or finished before this opinion becomes final. . . ."

47. 304 U. S. 405 (1938).

48. Section 605 of the Revenue Act of 1928 provided that "In case a regulation or
legislative interposition, the attempt was unsuccessful.

In view of the Court's past antipathy towards legislative attempts to indulge in retroactive death taxation, and its recently emphasized concern for preserving the stability of administrative rulings by denying the validity of an amendment of a Treasury Regulation sought to be given retroactive effect, it would seem necessary in the interest of consistency that similar limitations should accompany the Court's alterations of its own rulings, particularly in a period of extensive readjustment like the present. Nevertheless it is likely that the Court will leave to the legislators and the administrators the softening of any unfairness resulting from its reversal of earlier tax decisions. This seems especially probable in a case like Helvering v. Hallock where the period between the prior decision and its subsequent reversal was a short one—but a little over four years.

Thus what has been the usual practise is now reversed—where before in cases calling for a more or less strained construction of the taxing statute in order that the tax might be sustained, the taxpayer has by and large been given the benefit of the doubt, and the legislature has

Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect." (45 Stat. 874). Somewhat similar provisions appeared in the Revenue Act of 1926 (44 Stat. 114, § 1108(a)), and the Revenue Act of 1921 (42 Stat. 314, § 1314). The corresponding provisions of the present law appear as section 3791 of the Internal Revenue Code, providing in part as follows: "Sec. 3791. Rules and Regulations. (a) Authorization—(1) . . . the Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations. . . . (2) . . . The Commissioner may make all such regulations, not otherwise provided for, as may have become necessary by reason of any alteration of law in relation to internal revenue. (b) . . . The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury decision, relating to the internal revenue laws, shall be applied without retroactive effect."

53. As it did in Helvering v. Gerhardt (notes 47-49, supra).
54. The St. Louis Union Trust Co. cases were decided on November 11, 1935; the Hallock case was decided on January 29, 1940.
55. Gould v. Gould, 245 U. S. 151 (1917); Shwab v. Doyle, 258 U. S. 529 (1922); United States v. Merriam, 263 U. S. 179 (1923); Hecht v. Malley, 265 U. S. 144 (1924);
been obliged to step in to clarify what theretofore to the Court had seemed uncertain, or to supply what theretofore had been held to be missing completely, the tendency now is to resolve the doubt in favor of the validity of the tax, leaving the taxpayer at the mercy of Congress to relieve what seems to be an unusually severe burden. This phenomenon is strikingly demonstrated by the Hallock case. In 1935 the statutory phrase "gifts intended to take effect in possession and enjoyment at or after death" was held not to include a transfer where the transferor retained a reverter interest which lapsed upon his death. Similarly in 1930-1931 the phrase had been held to be too indefinite to indicate clearly the congressional intent to tax gifts with a reservation of a life interest in the donor. But where the latter situation was taken care of by Congress with an amendment of breath-taking swiftness, the former was left untouched until the Court in 1940 took it upon


57. For example, section 305 of the Revenue Act of 1936 [now appearing as § 811(d)(1) of the Internal Revenue Code], to fill the gap in the estate taxing law found to exist by the Court in its decision in White v. Poor, 286 U. S. 93 (1935).

58. Cf. United States v. Jacobs, 305 U. S. 363 (1939), where the Court, through Mr. Justice Black, said, at 371: "It is immaterial that Congress chose to measure the amount of the tax by a percentage of the total value of the property, rather than by a part, or by a set sum for each such change. The wisdom both of the tax and of its measurement was for Congress to determine."

59. Now appearing as § 811(c) of the Internal Revenue Code.


61. See cases cited in note 56, supra.

62. The Northern Trust Co., Morsman, and McCormick cases (cited in note 56, supra) were all decided by the Supreme Court on March 2, 1931. The Joint Resolution (see note 56, supra) became law when it had been passed by both Houses of Congress and
itself to find in the language of the statute a meaning which five years before had been found lacking. The taxpayer in the *Hallock* case argued with some force that a departure from *stare decisis* was wholly unwarranted when undertaken to correct a prior interpretation of a statute, subsequently felt to have been an erroneous one, where the situation was susceptible of legislative correction. Reliance was placed upon the frequently quoted statement of Mr. Justice Brandeis in his dissenting opinion in *Burnet v. Coronado Oil & Gas Co.*:

"*Stare decisis* is not, like the rule of *res adjudicata*, a universal, inexorable command. 'The rule of *stare decisis*, though one tending to consistency and uniformity of decision is not inflexible. Whether it shall be followed or departed from is a question entirely within the discretion of the court, which is again called upon to consider a question once decided.' *Hertz v. Woodman*, 218 U. S. 205, 212. *Stare decisis* is usually the wise policy, because in most matters it is more important that the applicable rule of law be settled than that it be settled right. Compare *National Bank v. Whitney*, 103 U. S. 99, 102. This is commonly true even where the error is a matter of serious concern provided correction can be had by legislation. But in cases involving the Federal Constitution, where correction through legislative action is practically impossible, this court has often overruled its earlier decisions. The court bows to the lessons of experience and the force of better reasoning, recognizing that the process of trial and error, so fruitful in the physical sciences, is appropriate also in the judicial function.

The *Coronado Oil & Gas Co.* case involved a question of constitutional power, namely, whether the federal income tax could be applied to a lessee of state school lands on the income derived by him from the leased property. Because the matter was one beyond the scope of legislative correction, Mr. Justice Brandeis argued that the Court would be justified in departing from the precedent of *Gillespie v. Oklahoma* (in which it was held that a state lacked the power to tax the income of a *signed by the President by ten-thirty P.M. on March 3, 1931. The validity of the provisions of the Joint Resolution [as reenacted in section 803(a) of the Revenue Act of 1932, 47 Stat. 279 (1932), 26 U. S. C. § 411(c) (1934)] were sustained, so far as they were given prospective application, in *Helvering v. Bullard*, 303 U. S. 297 (1938). In *Hassett v. Welch*, 303 U. S. 303 (1938), it was held that, properly construed, the provisions were not intended by Congress to be applied retroactively.

64. 285 U. S. 393 (1932).
65. Id. at 405. See Moschzisker, *Stare Decisis in Courts of Last Resort* (1924) 37 Harv. L. Rev. 409; Freeman, *The Protection Afforded Against the Retroactive Operation of an Overruling Decision* (1918) 18 Col. L. Rev. 230.
lessee of Indian lands), where more justification would be necessary to warrant the abandonment of *stare decisis* in a matter susceptible of legislative adaptation. It is by no means clear that the decisions in the *St. Louis Union Trust Co.* cases turned on a mere question of statutory interpretation, so that their result might be circumvented by congressional action. Mr. Justice Sutherland seemed to be talking about a matter of constitutional power when, in *Helvering v. St. Louis Union Trust Co.*, he said:

"If, therefore, no interest in the property involved in a given case pass 'from the possession, enjoyment, or control of the donor at his death,' there is no interest with respect to which the decedent has created a trust intended to take effect in possession or enjoyment at or after his death. The grantor here, by the trust instrument, left in himself no power to resume ownership, possession, or enjoyment, except upon a contingency in the nature of a condition subsequent, the occurrence of which was entirely fortuitous so far as any control, design, or volition on his part was concerned. *After the execution of the trust he held no right in the trust estate which in any sense was the subject of testamentary disposition. His death passed no interest to any of the beneficiaries of the trust, and enlarged none beyond what was conveyed by the indenture.* His death simply put an end to what, at best, was a mere possibility of reverter by extinguishing it; that is to say, by converting what was merely possible into an utter impossibility. . . ."  

If, therefore, the cases were intended to hold that it was beyond the constitutional power of Congress to levy a death tax on the estate of one who during his lifetime made a transfer of property reserving to himself "a mere possibility of reverter" which lapsed upon his death, it was not a matter which could be taken care of by the process of legislative amendment. In such a situation the only way in which Congress could be given the power, short of constitutional amendment, was by an overruling of the *St. Louis Union Trust Co.* cases.

As a matter of fact, however, neither the Government in its brief nor the Court (majority or minority) in *Helvering v. Hallock* challenged the assumption of the taxpayer that the *St. Louis Union Trust Co.* cases were holdings in respect of a matter of mere statutory construction,

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67. Mr. Justice Brandeis, argument, unsuccessful in the *Coronado Oil & Gas Co. case*, became majority law when that case, along with *Gillette v. Oklahoma*, 257 U. S. 591 (1922), was expressly overruled in *Helvering v. Mountain Producers Corp.*, 303 U. S. 376 (1938).


70. *Id.* at 43. Italics inserted.
rather than a holding based on constitutional principle. Accepting the assumption as though it were a necessary one, the Government argued that the problem resulting from the Court's decisions in the _St. Louis Union Trust Co._ cases was one "which cannot readily be dealt with by amendatory legislation," because it "would be unsatisfactory, if not almost impossible, to attempt to describe in the statute the numerous limitations of estates by which transfers are made to take effect in possession or enjoyment at or after death..." This argument was found unpersuasive by the taxpayer and also by Mr. Justice Roberts who, in his dissenting opinion, merely observed in answer to it that, "Little weight can be given to the argument of the Government that the Treasury has not applied to Congress for alteration of the section because of the difficulty of wording a satisfactory amendment. A moment's reflection will show that it would be easy to phrase such an amendment..." 

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72. _Ibid._

73. "... If Congress should desire to tax all transfers in which there exists a possibility of reverter, Congress may do so quite simply. All that is required is an additional sentence in Section 302 (c) stating in appropriate language that if a transfer is otherwise taxable under that section, the fact that the transferor may have retained a possibility of reverter shall not render the transfer nontaxable; or perhaps that in enforcing the section no distinction shall be drawn between vested interests transferred subject to divestiture by condition subsequent and contingent interests to come into being upon condition precedent; or that a retention by the transferor of any reversionary interest, however denominated, shall require inclusion in the gross estate. To be realistic about it, if the _St. Louis Trust Company_ cases had been decided differently the Commissioner would have had no trouble in laying down clear regulations sufficient to enable him to collect his taxes.

"Congress may very well decide to keep the law as declared in the _St. Louis Trust Company_ cases. Whether in that respect Congress is acting wisely is for Congress to determine. It is not essential that reasons be ascribed for the contentment of Congress. One possible reason however is apparent. As heretofore pointed out Congress may well have reasoned that adequate revenue will be produced through gift taxation and that estate taxation related to the same subject is not important." Brief of the Respondent In _Helvering v. Hallock_, pp. 48-49.

74. _Helvering v. Hallock_, 60 Sup. Ct. 444, at 457. The easiest phrasing of such an amendment might be one making the death tax applicable to "any interest, however small, remote, or contingent, remaining in the grantor after the transfer and lapsing upon his death." Congress has had an interesting experience in its use of the seemingly categorical imperative "any" in connection with its attempts to make the estate tax operate retroactively. In _Shwab v. Doyle_, 258 U. S. 529 (1922), the Court held that when the first federal estate taxing act, that of September 8, 1916 (39 Stat. 756) was by its terms made applicable to "any interest of which the decedent has at any time made a transfer, or with respect to which he has created a trust in contemplation of death, or intended to take effect in possession or enjoyment at or after death..." (italics inserted), there was (to the Court) an ambiguity whether the statute was intended to apply to a transfer which had been made in contemplation of death (admittedly) in 1915, and that the doubt
And for the majority Mr. Justice Frankfurter, accepting the taxpayer's premise, answered the contentions built upon it by saying:

"Nor does want of specific Congressional repudiations of the St. Louis Trust cases serve as an implied instruction by Congress to us not to reconsider, in the light of new experience, whether those decisions, in conjunction with the Klein case, make for dissonance of doctrine. It would require very persuasive circumstances enveloping Congressional silence to debar this Court from re-examining its own doctrines. To explain the cause of non-action by Congress when Congress itself sheds no light is to venture into speculative unrealities. Congress may not have had its attention directed to an undesirable decision; and there is no indication that as to the St. Louis Trust cases it had, even by any bill that found its way into a committee pigeon-hole. Congress may not have had its attention so directed for any number of reasons that may have moved the Treasury to stay its hand. But certainly such inaction by the Treasury can hardly operate as a controlling administrative practice, through acquiescence, tantamount to an estoppel barring reexamination by this Court of distinctions which it had drawn. Various considerations of parliamentary tactics and strategy might be suggested as reasons for the inaction of the Treasury and of Congress, but they would only be sufficient to indicate that

should be resolved in the taxpayer's favor. To convince it, said the Court, that a retroactive application was intended for the tax, clear and unmistakable language was called for. The Congress accepted the challenge and in 1924 enacted for the first time the general retroactive provisions now found in § 811(h) of the Internal Revenue Code, providing as follows:

"Except as otherwise specifically provided therein, subsections (b), (c), (d), (e), (f), and (g) shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after February 26, 1926."

These provisions were before the Court in Industrial Trust Co. v. United States, 296 U. S. 220 (1935), where it was sought to apply them to insurance taken out by the decedent prior to 1916, under the terms of which the decedent's wife was irrevocably named as beneficiary, and, if she should predecease her husband, their children were to succeed to the interest. Only in the event that the decedent outlived his wife and children were the insurance proceeds to go to his estate. Of the application of the retroactive provisions, the Court said:

"Subdivision (b) of the 1926 Act . . . provides that subdivisions (b), (c), (d), (e), (f), and (g) shall apply to 'transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after the enactment of this Act (February 26, 1926).' Whether any of these terms apply to an amount receivable by a beneficiary, under a policy such as we have here, is fairly debatable. . . . If any of them do apply, the provision is open to grave doubt as to its constitutionality, and the rule of the Frick case controls."

A similar treatment was given the Government's attempt to apply the provisions of the Joint Resolution of March 3, 1931 (note 56, supra) retroactively. Hassett v. Welch, 303 U. S. 303 (1938).
we walk on quicksand when we try to find in the absence of corrective legislation a controlling legal principle.

The most convincing proof that the Court regarded the *St. Louis Union Trust Co.* cases as involving no more than an interpretation of the statute is found in the position of Mr. Justice Roberts. For his was the fifth voice that made the majority in those cases, and in *Helvering v. Hallock* he gives unmistakable indication that had Congress amended the statute so as to cover the situation by express provision, he would have voted to sustain the amendment (at least so far as it might be given prospective application). In his view, therefore, the *St. Louis Union Trust Co.* cases closely paralleled the Court’s holding in *May v. Heiner* (and its three companion decisions), in that there also the Court refused to find in the broad and general terms of the statute an intention on the part of Congress to cover the gift with a reservation of a life interest, but where Congress made its intent plain, its power was sustained. There was this difference, however, that in one of the three cases decided in 1931, following *May v. Heiner*, the Court invited a statutory amendment by expressly, and quite gratuitously, conceding the congressional power to tax the situation. No-where in the *St. Louis Trust Co.* cases, or in any case following soon thereafter, was Congress given a similar hint as to the taxability of the lapse of a reverter interest.

It seems a fair appraisal of the majority’s position in the *Hallock* case

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75. 60 Sup. Ct. 444, 451-452.

76. Compare the position taken by Mr. Justice Roberts in *Hassett v. Welch*, 303 U. S. 303 (1938), and *Helvering v. Bullard*, 303 U. S. 297 (1938), involving the validity of the Joint Resolution of March 3, 1931 (see notes 56 and 62, supra), as applied retroactively in the former case, and prospectively in the latter.

77. 281 U. S. 238 (1930).


79. Section 402 (c) of the Revenue Act of 1918, taxing gifts “intended to take effect in possession or enjoyment at or after death.” (40 Stat. 1057, 1097.) For the present provisions see § 811 (c) of the Internal Revenue Code.


81. In its *per curiam* opinion in *Burnet v. Northern Trust Co.*, 283 U. S. 782 (1931), the Court said:

“The question in this case is that of the construction of sec. 402 (c) of the Revenue Act of 1921 . . . a provision similar to sec. 402 (c) of the Revenue Act of 1918 . . . which has already been construed by this Court, and, in this view, there being no question of the constitutional authority of the Congress to impose prospectively a tax with respect to transfers or trusts of the sort here involved, the judgment of the Circuit Court of Appeals for the Seventh Circuit is affirmed upon the authority of *May v. Heiner*, 281 U. S. 238. . . .” *(Italics inserted.)*

to say they recognized that in their overruling of the St. Louis Union Trust Co. cases they were meeting a situation which Congress might have met by an amendment to the statute, but that they felt their action was none the less warranted on this account.83 This same attitude was reflected even more emphatically by their decision in Higgins v. Smith.84 There Congress had beaten the Court to the punch in plugging the loophole existing (or, more strictly, thought to exist) in the revenue laws, whereby a taxpayer could, by manipulation of a controlled corporation, manufacture a loss deduction for purposes of the income tax. By an amendment in the Revenue Act of 1934 losses were declared non-deductible when arising from sales consummated between a corporation and a person owning more than fifty per cent of the corporation's outstanding stock.85 Unlike some other amendments wrought by the '34 Act86 this one apparently was not regarded by Congress as merely clarifying something already implicit in the statute.87 Consequently

83. Thus Mr. Justice Frankfurter, for the majority, said:
"This Court, unlike the House of Lords, has from the beginning rejected a doctrine of disability at self-correction. Whatever else may be said about want of Congressional action to modify by legislation the result in the St. Louis Trust cases, it will hardly be urged that the reason was Congressional approval of those distinctions between the St. Louis Trust and the Klein cases to which four members of this Court could not give assent. By imputing to Congress a hypothetical recognition of coherence between the Klein and the St. Louis Trust cases, we cannot evade our own responsibility for reconsidering, in the light of further experience, the validity of distinctions which this Court has itself created." 60 Sup. Ct. 444, 452-453.

84. 60 Sup. Ct. 355 (January 8, 1940).


86. For example, section 113 (a) (13) of the Revenue Act of 1934, requiring that a partnership hold property transferred to it by one of the partners with the same cost basis which attached to the property in the hands of the contributing partner. Of this change the Ways and Means Committee in its Report to the House stated:
"The result of the provisions of section 113 (a) (13) is that if property is purchased by a partnership the basis of such property shall be its cost; but if the property is paid in by a partner then the basis to the partnership shall be the cost or other basis to the partner. The committee believes that this provision singly makes specific the correct interpretation of the general provisions of the present law." H. R. Rep. No. 704, 73d Cong., 2d Sess., p. 28. (Italics inserted.) A similar statement appeared in the Report of the Senate Finance Committee. (S. Rep. No. 558, 73d Cong., 2d Sess., p. 18 et seq.)


87. Referring to section 24(a)(6), the Report of the House Ways and Means Committee said:
"The bill adds to existing law a paragraph which will deny losses to be taken in the
the taxpayer was able to argue, and argue cogently, that for the Court
to supply in the Revenue Act of 1932 (under which Higgins v. Smith
arose) a statutory deficiency which Congress had felt obliged to remedy
by express action in the Revenue Act of 1934, would be for the Court
to indulge in a purely legislative function. The Court was no stranger
to this argument; on the contrary it had frequently employed it as a
basis of decision. Less than a year before, in Fairbanks v. United
States, the Government argued that the redemption of bonds before
maturity by the issuing corporation was to be treated as tantamount to
a sale or exchange of capital assets, and as such was subject to tax
under the capital gains provisions of the statute. This contention was
put forward in connection with the Revenue Acts of 1926 and 1928, and
flew in the face of an amendment in the Revenue Act of 1934, expressly
requiring treatment of such a redemption as the equivalent of a sale or
exchange of capital assets. Through Mr. Justice McReynolds the
Court unanimously declared that, "The Circuit Court of Appeals below
was right in holding that by the Act of 1934 Congress did not attempt
to construe the prior Acts and purposely made a material addition there-
to. . . ." Moreover, in Higgins v. Smith, the circumstances that six
years previously Congress had acted to prevent a recurrence of the
situation made it much less a matter of vital necessity for the Court to

case of sales or exchanges of property between members of a family, or between a share-
holder and a corporation in which such shareholder holds a majority of the voting stock . . .

"Experience shows that the practice of creating losses through transactions between
members of a family and close corporations has been frequently utilized for avoiding the
income tax. It is believed that the proposed change will operate to close this loophole of
Similar statements are found in the Report of the Finance Committee of the Senate. (Snr.
Rep. No. 558, 73d Cong., 2d Sess., p. 27.)
88. 47 Stat. 179, 26 U. S. C. A. § 23 (e)
89. 59 Sup. Ct. 607 (March 27, 1939)
90. Id. at 609. Cf. Helvering v. Gowran, 302 U. S. 238 (1937), and compare Mr.

"In the more recent Income Tax Acts, provisions have been inserted for the purpose
of excluding from the effect of the tax any dividends declared out of earnings or profits
that accrued prior to March 1, 1913. This originated with the Act of September 8,
1916, and has been continued in the Act of October 3, 1917. We are referred to the legis-
lative history of the Act of 1916, which it is contended indicates that the new definition
of the term 'dividends' was intended to be declaratory of the meaning of the term as
used in the 1913 Act. We cannot accept this suggestion, deeming it more reasonable to
regard the change as a concession to the equity of stockholders granted in the 1916 Act, in
view of constitutional questions that had been raised in this case, in the companion case
of Lynch v. Turrish, and perhaps in other cases. These two cases were commenced in
October, 1915; and decisions adverse to the tax were rendered in the District Court In
January, 1916, and in the Circuit Court of Appeals September 4, 1916." Id. at 345-6.
interfere than might otherwise have been the case had the door of tax avoidance still remained open.

The painful artificiality of the Government's answers to these arguments is the best demonstration of their strength. In an attempt to offset the significance of the 1934 amendment, the Government urged that, notwithstanding contrary indications in its legislative history, the change was intended to be declaratory of existing law:

"An intention to close loopholes is equally consistent with uncertainty as to existing law and a sense of caution, as with an alleged recognition of the law's shortcomings. Indeed, it would be most ironical if the solicitude of Congress in meeting an evil with particularity should be taken to have foreclosed the consideration of doubts under existing law which might be resolved in accord with the law as enacted for the future. . . . Further, Section 24 (a) (6) is operative even where the individual owns only 50% of the stock. . . . Thus, in speaking of closing up 'loopholes', the Congressional Committees were doubtless referring to those instances in which the new provisions plainly went beyond existing law. But in their broad sweep these new provisions undoubtedly embraced some situations which could be regarded as already covered by existing law, and we submit that the instant case presents such a situation."

Nevertheless the Court found the Government's argument the more persuasive, though Mr. Justice Reed's opinion does little to buttress the argument's saggings:

"Respondent makes the further point that the passage of Section 24 (a) (6) of the Revenue Act of 1934 which explicitly forbids any deduction for losses determined by sales to corporations controlled by the taxpayer is convincing proof that the law was formerly otherwise. This does not follow. At most it is evidence that a later Congress construed the 1932 Act to recognize separate taxable identities between the taxpayer and his wholly owned corporation. As the new provision goes much farther than the former decisions in disregarding transfers between members of the family it may well have been passed to extend as well as clarify the existing rule. The suggestion is not sufficiently persuasive to give vitality to a futile transfer."

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91. Brief for the Petitioner, pp. 31, 32.
92. 60 Sup. Ct. 355, 359. The Court's failure to refer to the legislative history of the provisions of the 1934 Act is typical of the cavalier treatment usually accorded this particular extrinsic aid of statutory interpretation. While reports of the congressional committees may not be resorted to in aid of interpretation of a statute lacking in ambiguity, since, ambiguity lacking, there is no need of interpretation and hence no need of aids, intrinsic or extrinsic, [United States v. Shreveport Grain & Elevator Co., 287 U. S. 77 (1935)], it would seem that the appearance of an express provision in a later statute to deal with a situation as to which the earlier statute is silent would raise doubt as to
Nor is the Court's conclusion helped any by the result reached in its decision a month previously in the case of Helvering v. Johnson. Like Higgins v. Smith, the Johnson case involved the question of deductibility, under the Revenue Act of 1932, of a loss resulting from the sale of stock to a corporation controlled by the vendor. The case differs from the Smith case in that the taxpayer, Smith, was the sole owner of the corporation to which he sold his stock, whereas the taxpayer in the Johnson case was not the only stockholder in the corporation there involved. There were countervailing circumstances, however. In the Smith case there was a long record of dealings extending over a period of six years (from the formation of the corporation in 1926), many of which were sales between the taxpayer and the corporation, but a number of which involved transactions between the corporation and strangers. Among the latter were sales of stock on the open market resulting in heavy losses of which the taxpayer made no attempt to avail himself. In the Johnson case, on the other hand, the corporation was formed in 1932. It appeared that the taxpayer desired to sell some stock belonging to him which had greatly depreciated in value, in order to secure a loss deduction on his 1932 income tax return. He also wished to make a gift to his wife. Accordingly, in 1932, after consultation with tax attorneys, the scope of the latter sufficient to bring into play whatever interpretative aids might be available. If at this late date proof be needed for the proposition that the legislative history of a statute is employed when and precisely as the Court pleases to employ it, ample evidence is to be found in the almost fantastic jugglings of committee reports and congressional debates in Helvering v. City Bank Farmers' Trust Co., 296 U. S. 85 (1935), and Hassett v. Welch, 303 U. S. 303 (1938). 93. 60 Sup. Ct. 293 (December 11, 1939).
95. In Burnet v. Commonwealth Improvement Co., 287 U. S. 415 (1932), a corporation sold stock to its sole stockholder for a book profit on which, notwithstanding its close identification with the vendee, the corporation was held taxable. Arguing that the same strictness with which the Court in the Commonwealth case regarded the separateness of the corporate entity from its sole stockholder should be followed in his case, the taxpayer in Higgins v. Smith sought to justify his deduction for the loss resulting from his sale of stock to the corporation wholly owned by him. But the Court rejected the argument, holding that in such cases it was "heads" the Government wins, and "tails" the taxpayer loses, by saying:
"... A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages. On the other hand, the Government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The Government may look at actualities [but the taxpayer may not] and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute. . . ." 60 Sup. Ct. 355, 358. (Italics inserted.)
96. Before the Board of Tax Appeals the taxpayer conceded that he was motivated in part by interests of tax avoidance in arranging the transaction.
and acting on a plan developed by them, the taxpayer borrowed $100,000 from a bank, taking the proceeds of the loan in three checks, one payable to himself in the amount of $49,900, one for a like sum payable to his wife, and the third, representing the remaining $200, payable to one Childress. Thereupon the three check-holders organized a corporation authorized to deal in stocks, bonds, securities, and real estate. Its capital stock of $100,000 was divided into 10,000 shares at $10 each, of which the taxpayer acquired 4990, his wife an equal number, and Childress the remaining 20. Each paid for the shares by endorsing the checks received through the bank loan. The next step in the plan called for a sale to the corporation by the taxpayer of 10,000 shares of stock for which the taxpayer had paid $620,000. The sale price of $240,000 was paid by the corporation's turning over to the taxpayer $99,000 of the $100,000 which it had received upon cashing the checks received for its capital stock, and its note for the difference of $141,000, secured by a pledge of the stock it had just bought. Immediately upon receipt of the $99,000 the taxpayer applied it on his indebtedness to the bank. The stock continued to be held by the corporation, the dividends paid on it being applied to retire its $141,000 note to the taxpayer. The corporation engaged in no other activity, and held no other property until 1935 when it acquired a small amount of stock in another company. The taxpayer's wife retained her holdings in the corporation and so, apparently, did Childress. Resisting the Commissioner's disallowance of his deduction for the "loss" resulting from his sale to the corporation in 1932, the taxpayer prevailed in the Board of Tax Appeals, and in the Circuit Court of Appeals for the Second Circuit."
had indicated his willingness to settle for the full amount. Desirous of avoiding the high surtaxes imposable upon his receipt of the lump sum (its nature being such as to make it subject to the federal income tax), the taxpayer on January 10, 1933, formed a corporation, paying $1,000 for the entire issue of its capital stock. On the same day the corporation was brought into existence the taxpayer entered into a written agreement with it, under whose terms the $100,000 claim was sold to the corporation, the purchase price to be paid in installments of $2,500 each year. On January 11 the taxpayer, purporting now to be acting as the corporation's agent, made final settlement with the third party (who knew nothing of the corporation's existence), and immediately endorsed over to his corporation the $100,000 check received upon surrender of the claim. In his income tax return for 1933 the taxpayer included only the amounts paid to him by his corporation in that year. The Commissioner ruled that the provisions of the Revenue Act of 1932 permitting vendors of property under contracts providing for payment of the purchase price on an installment basis to report for purposes of the income tax only that part of the purchase price paid in the taxable year, were inapplicable to the taxpayer's situation, and included the entire settlement sum in the taxpayer's income for 1933. The resulting deficiency assessment was successfully resisted by the taxpayer before the Board of Tax Appeals, but its decision was reversed by the Circuit Court of Appeals for the Seventh Circuit, and this reversal was affirmed by the Supreme Court.

Speaking for the unanimous Court Mr. Justice Frankfurter characterized the taxpayer's manipulations as "technically elegant" in their conception and execution, but held them abortive in their result, saying:

"Legislative words are not inert, and derive vitality from the obvious purposes at which they are aimed, particularly in the provisions of a tax law like those governing installment sales in § 44 of the Revenue Act of 1932. Taxes cannot be escaped 'by anticipatory arrangements and contracts however skilfully devised... by which the fruits are attributed to a different tree from that on which they grew.' Lucas v. Earl, 281 U. S. 111..."
Griffiths v. Helvering, Helvering v. Johnson, and Higgins v. Smith were all argued together. All three involved attempts by the taxpayer to avoid taxes through the medium of the "incorporated pocketbook." In all three the Government urged the Court to frustrate the attempts on the principle of Gregory v. Helvering—that where the statute grants deductions or exemptions, the taxpayer who seeks to avail himself of them must show himself to be uberrima facies. The results in the Griffiths and Smith cases are consistent enough, but Helvering v. Johnson is a piece from another puzzle. Since the Court merely noted that its 4-4 division resulted in affirmance of the holding below, neither stating reasons nor citing cases for the result, it is mere guesswork to fathom what lay beneath the surface of its decision. The obvious distinction between the facts of the Smith and Johnson cases is derived from the circumstance that the corporation in the former case was wholly owned by the taxpayer, where the control of the Johnson corporation was divided between the taxpayer and his wife (with a one five-hundredth participation by a third party who appears to have been brought into the picture in the capacity of a straw man to accomplish a superficial division of controlling interests). Had it arisen after the passage of the Revenue Act of 1934 the situation in the Johnson case, like that in the Smith case, would have fallen under the express prohibition of

110. That is to say, the transaction out of which arises the loss or exemption claimed must be shown to have been entered into for some purpose other than, or in addition to, mere tax avoidance. Cf. Chisholm v. Helvering, 79 F. (2d) 14 (C. C. A. 2d, 1935), cert. denied, 296 U. S. 641 (1935); Minnesota Tea Co. v. Helvering, 302 U. S. 609 (1937).

In Smith v. Higgins the Government was not so much interested in having the Court plug the loophole there involved (since for the future Congress had taken care of the situation in the Revenue Act of 1934), as it was in securing an elaboration or clearer articulation of the doctrine laid down in Gregory v. Helvering. But of that case Mr. Justice Reed, speaking for the majority in Higgins v. Smith, merely remarked:

"The Government urges that the principle underlying Gregory v. Helvering finds expression in the rule calling for a realistic approach to tax situations. As so broad and unchallenged a principle furnishes only a general direction, it is of little value in the solution of tax problems. If, on the other hand, the Gregory case is viewed as a precedent for the disregard of a transfer of assets without a business purpose but solely to reduce tax liability, it gives support to the natural conclusion that transactions, which do not vary control or change the flow of economic benefits, are to be dismissed from consideration. There is no illusion about the payment of a tax exaction. Each tax, according to a legislative plan, raises funds to carry on government. The purpose here is to tax earnings and profits less expenses and losses. If one or the other factor in any calculation is unreal, it distorts the liability of the particular taxpayer to the detriment or advantage of the entire taxpaying group." 60 Sup. Ct. 355, 357.
the statute. But quite apart from any legislative assistance, the Court at the present Term has taken what may prove to be a tremendous step toward the frustration of family dealings as a means of tax saving. In *Helvering v. Clifford* the Court held the income of a trust taxable to the settlor where it appeared that the trust transfer, while irrevocable, had been made to the settlor himself as trustee (with broad powers of management and control), named the settlor's wife as beneficiary, and was destined to terminate not later than five years after its establishment, whereupon the principal was to revest in the settlor. In holding that the settlor had not sufficiently divested himself of interest in and control over the property to make possible the taxing of the trust income to persons other than himself, the Court emphasized three factors: (1) The shortness of the trust's term; (2) The control retained by the settlor *qua* trustee; (3) The close relationship between the settlor and the holder of the beneficial interest. Of the three the circumstances most strongly stressed was the last.

111. Thus section 24 of the Revenue Act of 1934 (48 Stat. 680, 691) provided:

"(a) General Rule.—In computing net income no deduction shall in any case be allowed in respect of—(6) Loss from sales or exchanges of property, directly or indirectly, (A) between members of a family, or (B) except in the case of distributions in liquidation, between an individual and a corporation in which such individual owns, *directly or indirectly*, more than 50 per centum in value of the outstanding stock. For the purpose of this paragraph—(C) an individual shall be considered as owning the stock owned, *directly or indirectly*, by his family; and (D) the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), *spouse, ancestors, and lineal descendants*.” (Italics inserted.) For the corresponding provisions of the present law see § 24(b) of the Internal Revenue Code.

112. 60 Sup. Ct. 554 (February 26, 1940).

113. Mr. Justice Douglas, speaking for the majority of the Court (Mr. Justice Roberts dissented in an opinion in which Mr. Justice McReynolds concurred), said:

"... We have at best a temporary reallocation of income within an intimate family group. Since the income remains in the family and since the husband retains control over the investment, he has rather complete assurance that the trust will not effect any substantial change in his economic position. It is hard to imagine that respondent felt himself the poorer after this trust had been executed or, if he did, that it had any rational foundation in fact. For as a result of the terms of the trust and the intimacy of the familial relationship respondent retained the substance of full enjoyment of all the rights which previously he had in the property. That might not be true if only strictly legal rights were considered. But when the benefits flowing to him indirectly through the wife are added to the legal rights he retained, the aggregate may be said to be a fair equivalent of what he previously had. To exclude from the aggregate those indirect benefits would be to deprive § 22 (a) of considerable vitality and to treat as immaterial what may be highly relevant considerations in the creation of such family trusts. For where the head of the household has income in excess of normal needs, it may well make but little difference to him (except income-tax-wise) where portions of that income are routed—so long as it stays in the family group. In those circumstances the all-important factor might be
When the *Johnson* case is projected against the screen of the Court's reasoning in *Helvering v. Clifford*, the circumstance differentiating it from *Higgins v. Smith* becomes little more than a makeweight. In the *Smith* case all that the Court had to say concerning shams and unreali-ties must have struck an especially sour note in the ears of the taxpayer after he had witnessed the result of *Helvering v. Johnson*. The upshot of the *Griffiths*, *Johnson* and *Smith* cases is that three fish of pretty equal elusiveness were caught in the Commissioner's nets, but only two were landed when the courts finally finished hauling the nets in.

The unequal treatment of the taxpayers in the *Johnson* and *Smith* cases was repeated in *Helvering v. Clifford* and its companion case, *Helvering v. Wood*. As in the *Clifford* case, a five year trust with the settlor in control of the property as trustee, and his wife enjoying the beneficial interest, was involved in the *Wood* case. But where the settlor, Clifford, was held taxable on the trust income, his fellow-settlor, Wood, escaped, simply because the Government chose to rest the former's liability on section 22 (a) of the Revenue Act of 1934, where the latter's was based on section 166 of the same statute. If, as Judge...
Learned Hand has suggested, the meaning of a statute is to be looked for in something beyond the words used, even as the melody of a song is something transcending the notes,\(^{120}\) the Court is finding in section 22 (a) hidden significances\(^{121}\) surpassing those discovered in, say, Beethoven's *Pastoral*.

It would be frivolous to suggest that the taxpayers in the *Griffiths, Smith* and *Clifford* cases should have been allowed to go free simply because the taxpayers in the *Johnson* and *Wood* cases were fortunate enough to get away. When one trims sails closely to the wind one must at all times be prepared for an upset, and the warning is none the less to be heeded because occasionally some one whose luck matches his intrepidity happens to skin by.

More valid is the suggestion that in its jettison of mouldy precedents, and its desertion of leaky "principles" of statutory interpretation, the Court is running the risk of getting far off its prescribed course and dangerously near the reefs. Heretofore the principal part of taxation has been the statute, the judicial function being limited to an appraisal of the legislative power to do what it has clearly indicated its intention of doing, and, occasionally, a determination that the legislative intent, though clear enough, has fallen short of completely adequate expression in the statute. There is more than an indication in the decisions of the present Term that the Court is itself willing to supply deficiencies in the statute,\(^{122}\) indeed, that in at least some circumstances it believes the judicial method to be better adapted to cope with the situation than the legislative.\(^{123}\) It may come to pass that a legislature eager to rid

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120. "It is quite true, as the Board has very well said, that as the articulation of a statute increases, the room for interpretation must contract; but the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create." Helvering v. Gregory, 69 F. (2d) 809, 810-811 (C. C. A. 2d, 1934).

121. The interpretative gymnastics of the *Clifford* and *Wood* cases do things to supposedly traditional methods of statutory construction wondrous to behold. Less involved but similar in result was the technique followed by the Court in *Douglas v. Willcuts*, 296 U. S. 1 (1935); *Helvering v. Schweitzer*, 296 U. S. 551 (1935); *Helvering v. Stokes*, 296 U. S. 551 (1935); *Helvering v. Blumenthal*, 296 U. S. 552 (1935).

122. As, for example, in *Higgins v. Smith*, 60 Sup. Ct. 355 (January 8, 1940).

123. In *Helvering v. Clifford*, for example, where Mr. Justice Douglas suggested that by its rejection of the Treasury recommendation that the Revenue Act of 1934 carry an express provision taxing the short term trust Congress indicated its belief that "a specific statutory formula", such as that in the British taxing statutes, would be disadvantageous as compared with a "more generalized treatment." 60 Sup. Ct. 554, 557. Compare *Helvering v. Hallock*, 60 Sup. Ct. 444 (January 29, 1940), notes 71-75, *supra*, and the accompanying text.
itself of the laborious task of attempting to write an air-tight taxing statute will abandon the job to the courts, contenting itself with a simple declaration of policy that it wishes to tax incomes of certain individuals at certain rates. It has done as much with the taxing of stock dividends. Should the executive and judicial administration of the statute result in something deemed impolitic or involving too great a hardship, the legislature may then step in to relieve the situation with an amendment. This has already happened at least twice with the judicial treatment of the tax consequences of corporate reorganizations.

"The inevitably empiric" nature of the judicial process may be superior to legislative methods in dealing with cases like *Griffiths v. Helvering*, but what in such cases appears to be an advantage must in most situations prove to be an insurmountable handicap. The outcome of the *Clifford* case may in time prove the fact of this proposition, but the proof, if any be required, need not be left to the future. Sufficient unto the end are the Court's recent decisions in *Le Tulle v. Scofield*, and its companion cases, *Helvering v. Tyng*, and *Helvering v. Buchsbaum*.

In the *Le Tulle* case the Court for the first time in any clearly defined way decided that the transfer of assets of, or stock-holdings in, one corporation for long term bonds of another did not satisfy the requirements of the statutory definition of a tax-free reorganization.

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124. Following the Court's decision in *Eisner v. Macomber*, 252 U. S. 189 (1920), Congress exempted all stock dividends from income taxation. (Section 201 (d) of the Revenue Act of 1921, 42 Stat. 227, 228.) Similar provisions were carried in subsequent Acts up to 1936 when, in *Koshland v. Helvering*, 293 U. S. 441 (1936), the Court declared that its decision in the *Macomber* case was not intended to compel the exemption of all stock dividends. Shortly thereafter Congress amended the law so as to tax stock dividends to the extent that they "constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution." Section 115 (f) of the Revenue Act of 1936, now appearing as § 115 (f) of the Internal Revenue Code.


127. 60 Sup. Ct. 277 (December 18, 1939).


129. 60 Sup. Ct. 313 (January 2, 1940).

130. 60 Sup. Ct. 378 (January 2, 1940).

131. *Ibid*.

the ten Circuit Courts of Appeal and the Court of Claims had over a period of years arrived at a contrary conclusion, several of them by express reliance on the 1935 decision of the Supreme Court in *Helvering v. Watts*. Mr. Justice Roberts' opinion for the unanimous Court noted this course of decision, but found it unpersuasive. The full force of the holding is not appreciated by a consideration of the *Le Tulle* case alone, for there the result was colored by the circumstance that a solely owned corporation was one of the parties to the transaction involved. But in the *Tyng* and *Buchsbaum* cases there were no such diverting factors. There the Associated Gas & Electric Company in 1929 agreed to purchase the stock of another corporation by paying its twenty-three stockholders the sum of $50,000,000 in cash. Three of the stockholders, desirous of postponing a tax on the gain to be realized by them from the sale, insisted that they be paid in 20 and 40 year bonds of Associated Gas & Electric, and this was done. More than ten years after the completion of the transfer the Supreme Court finally ruled that the transaction did not fall within the provisions of the statute relating to tax-exempt exchanges.

These were not cases like *Gregory v. Helvering* and *Griffiths v. Commissioner*, where the taxpayers attempted to cut round corners in their dealings with the Government. More like *United States v. Hendler*, they were bona fide business transactions thought to be with-

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135. 296 U. S. 387 (1935). In this case the Court said: "The bonds, we think, were securities within the definition, and cannot be regarded as cash, as were the short-term notes referred to in the *Pinellas Ice Co. v. Commissioner*, 287 U. S. 462..." Id. at 389.
136. "In applying our decision in the Pinellas case... the courts have generally held that receipt of long term bonds as distinguished from short term notes constitutes retention of an interest in the purchasing corporation. *There has naturally been some difficulty in classifying the securities involved in various cases.*" (Italics inserted.) 60 Sup. Ct. 313, 316.
138. 60 Sup. Ct. 277 (December 18, 1939).
139. 303 U. S. 564 (1938). To meet the chaos precipitated by this decision in respect of transactions entered into long before the case was decided, and entered into on the assumption that the correct interpretation was just the opposite of that finally hit upon by the Supreme Court, Congress made the 1939 amendment retroactive to 1924. At the same time Congress took care to prevent abuses of the equity conferred by the amend-
in the statute and subsequently so held to be by an authoritative course of decision in the lower courts. Cases of this sort are preeminently of the type where the taxpayer, like the batter stepping up to the plate, is entitled to "know how many strikes he can take before being called out, and . . . that the ruling will not change while he is at bat."\(^{120}\)

Recourse to the legislature in such a situation, heretofore the exceptional expedient, may have to become the rule. Yet however extended the practise may become, by its very nature it must remain a narrowly limited assistance. Moreover it does not touch the real difficulty which is lack of assurance as to what legal consequences are apt to follow the taking of a proposed course of action involving tax matters. If one cannot obtain this assurance from a reading of the statute, the only remaining source of a beforehand answer is the Treasury. The hopefulness of success from this source has been greatly enhanced by the Court's decisions in the \(R. J.\) Reynolds \(Co.\)\(^1\) and \(Wilshire\) Oil \(Co.\)\(^2\) cases. On the other hand shadows of varying length and density have been cast by the Court's later decisions in \(Sanford's\) Estate \(v.\) \(Helvering\)\(^3\) and \(Helvering\) \(v.\) \(Wood\)\(^4\).

Like ants patiently returning to construct anew the bill that has been brushed aside, lawyers insist on pulling from the Court's latest pronouncements what Mr. Justice Frankfurter has recently called "litigation-breeding assumptions."\(^5\) As a consequence the Court may attempt

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\(^{120}\) See Sherman, \textit{Assumption of Debts in Corporate Reorganizations} (1939) 17 Tax Mag. 691.

\(^{1}\) \textit{Willkie, The Court Is Now His}, \textit{Saturday Evening Post}, March 9, 1940, pp. 29, 76. Compare the following excerpt from a statement issued in support of a proposed Act of Congress creating a commission to formulate a permanent and consistent system of federal taxation, by Mr. Walter A. Cooper, Chairman of the Committee on Federal Taxation of the American Institute of Accountants:

". . . Fixed principles of taxation are urgently required to give taxpayers the necessary confidence to face the future. . . . A permanent tax structure should be established, with fixed principles subject only to changes in rates to meet the varying requirements of the Federal budget. Business can adjust itself to changing rates, as long as such rates are non-confiscatory, but staggers under the impact of successive changes in the general scheme and incidence of taxation, a procedure which calls for new interpretations of tax provisions from year to year." Quoted in the \textit{New York Times} on March 5, 1940, p. 30, col. 7.


\(^{2}\) \textit{Helvering v. Wilshire Oil Co.}, 60 Sup. Ct. 18 (November 6, 1939).

\(^{3}\) 60 Sup. Ct. 51 (November 6, 1939).

\(^{4}\) 60 Sup. Ct. 551 (February 26, 1940).

\(^{5}\) "Without elaborating the reasons for this construction and not unmindful of op-
to develop the heretofore unheard of policy of abandoning *dicta* and of saying as little as possible in the decision of the case. Simultaneously the Court's growing willingness to read volumes between the lines of a taxing statute may lead to the legislature's adoption of a technique of statutory draftsmanship less detailed in its explications. Then the law of taxation, if any there is to be, will have to be written by the administrative branch of the government. To give the force and effect of law to what may thus be written it will be necessary either to accord a greater dignity to the administrative interpretation than heretofore it has received, or to develop some means by which the interpretation may be given a quick and final imprimatur by the courts. The only alternative is the abandonment of rules and doctrines of general application, which is law, in favor of completely individualized treatment of taxpayers, which is something else again.

146. Compare all that is left unsaid in Helvering v. Fitch, 60 Sup. Ct. 427 (January 29, 1940), where a confusing course of decision in the state courts was accepted in support of the federal tax, with the queries raised by Morgan v. Helvering, 60 Sup. Ct. 424 (January 29, 1940), where a comparatively clear course of decision in the state courts was ignored because to follow it would have necessitated the invalidation of the federal tax.

147. A striking illustration of what the Treasury is up against in its attempts to concretize the taxing statute by its Regulations is offered in Helvering v. Bruun, 60 Sup. Ct. 631 (March 25, 1940). In 1917 the Treasury ruled that the adjusted value of improvements made on leased property by the lessee is income to the lessor upon the lease's termination. This Regulation was held invalid in Miller v. Gearin, 258 Fed. 225 (C. C. A. 9th, 1919), the Court there suggesting that the gain to the lessor, if taxable at all, was taxable in the year when the improvements were completed. Thereupon the Commissioner issued Regulations putting this suggestion into effect. Fifteen years later these Regulations were held invalid in Hewitt Realty Co. v. Commissioner, 76 F. (2d) 880 (C. C. A. 2d, 1935). Pressing the matter to the Supreme Court the Commissioner in 1938 secured a decision that the lessor could not be taxed on improvements made by the lessee in the year in which the improvements were made. M. E. Blatt Co. v. United States, 305 U. S. 267 (1938). Finally on March 25, 1940, the Court sustained a tax on a lessor who, upon termination of the lease, had entered into possession of property upon which improvements had been made by the lessee during the term of the lease.

148. It is significant that the Bureau of Internal Revenue is one of the departments of the Government to which the Logan-Walter Bill now pending before Congress would not apply.

149. This case method of treatment is precisely what the Government contended for in Helvering v. Clifford, 60 Sup. Ct. 554 (February 26, 1940). In its brief it asserted that "There would, we believe, be no dispute that the respondent would be taxable upon the trust income had the trust been declared for a day-to-day or a month-to-month period. Du Pont v. Commissioner, 289 U. S. 685, 688-689. On the other hand, the income of a
long term irrevocable trust which committed the possession and control of the corpus
to an independent trustee would not likely be taxed to the settlor merely because of a
reversionary interest. The question here, as in many other tax problems, is simply one
of degree. The grantor's liability to tax must depend upon whether he retains so many
of the attributes of ownership as to require that he be treated as the owner for tax pur-
poses, or whether he has given up the substance of his dominion and control over the
trust property.

"Under these circumstances, the question of precisely where the line should be drawn
between those irrevocable trusts which deprive the grantor of command over the trust
property and those which leave in him the practical equivalent of ownership is, in our
view, a matter peculiarly for the judgment of the agency charged with the administration

In this connection compare the expansion of the Commissioner's authority to enter
into closing agreements accomplished by Section 801 of the Revenue Act of 1933,
amending Section 606 (a) of the Revenue Act of 1928. On the scope and effect of the
provisions of the latter Act see Helvering v. Kehoe, 60 Sup. Ct. 549 (February 26, 1940).
For the present provisions of the law see § 3706 and § 3801 of the Internal Revenue Code.