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The Influence of the Courts on Tax Policy and Current Trends

By JOEL BARLOW*

Last fall when I had the good fortune to participate in the Commemorative Ceremonies here at the College of William and Mary, I expressed some concern about the attitude of both the Courts and the legal profession toward tax law and tax practice.

My concern with the bar was its persistence in the view that tax practice is only peripheral to law practice—a kind of diversion up a small tributary away from the main current of legal thought. Then, too, I was even more troubled by the impetus given to this attitude toward tax law by the Courts. I quoted a few chapters and verses from Mr. Justice Jackson, Judge Hand and others, where they make plain what might be described as a certain distaste for and even despair with the subject matter of taxation. On that occasion I expressed hope and some confidence, as I do now, that an enlightened emphasis in our law schools like William and Mary on the importance and scope of taxation as a legal study might help bring it into proper focus.

At the risk of a little rehash of the familiar, as Mr. Justice Frankfurter puts it, I want to remind you again of Judge Hand's comment on the tax law:

In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leaving in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the

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most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; . . .¹

Do you wonder at my concern about the attitude of the Courts? If it were not for Judge Hand's evident and delightful sense of humor, one might be apprehensive that "whom the Gods would destroy, they first ridicule."

And then again, Mr. Justice Jackson in the now famous *Dobson*² case looks a little askance at tax law:

[The Tax Court] deals with a subject that is highly specialized and so complex as to be the despair of judges.³

There is, perhaps, an implication here that although the distinguished members of the Tax Court may not yet be considered judges (a related problem to which Judge Turner so ably directed our thoughts this morning), they are, nevertheless, hardier souls not easily discouraged by the formidable complexities of taxation.

Mr. Justice Jackson goes on to say:

But conflicts [in tax cases] are multiplied by treating as questions of *law* what really are disputes over *proper accounting*.⁴

Now *there is* an implication that may well throw some consternation into the Bar Association Committee on Unauthorized Practice as it tilts with all the windmills in the unfortunate controversy with the accountants. By the same token, it should warm the cockles of the heart of the American Institute of Accountants to have a lawyer and a judge furnish grist for some of their mills.

Away back in 1913 at the time of the debates over the Sixteenth Amendment, Elihu Root started, perhaps unwittingly, the libel about what was later to be the tax bar. In writing to a friend who was greatly worried about the vagaries and complexity of the first income tax law, and the prospect of incarceration for non-payment, Root said—and just a little prophetically:

I guess you will have to go to jail. If that is the result of not understanding the income tax law, I shall meet you there. We will have a merry, merry time, for all of our friends will be there. It will be an intellectual center, for no one understands the income tax law except persons who have not sufficient intelligence to understand the questions that arise under it.⁵

This last somewhat paradoxical statement was undoubtedly intended to be *more* than just humorous. It is really and intentionally quite significant. It might well be our point of departure this afternoon.

Root was apprehensive that the proponents of the income tax would

not have intelligence to foresee, let alone understand, all the questions that would arise under it. As a lawyer, he could foresee that basic questions like due process, states rights, the concept of taxable income and many others, would have to be resolved by the Courts. It is the influence the Courts have exerted in resolving these questions which we are to review today. What are these questions?

Usually they are propounded and delineated in heavy prose repetitiously footnoted. I shall subsequently but briefly undertake some of that. But it occurred to me that there is so little poetry in taxation, and so much prosaic accounting, as Mr. Justice Jackson has pointedly pointed out, that our mental pains might be alleviated by following the humorous approach of others, and posing some of these questions in the manner of Phyllis McGinley and Ogden Nash:

Where, may I ask, sir, has due process gone
 With tax rates at 80 and 90 per cent?
 What, sir, has happened to Article One
 And the rights of the States to the money we spent?

I ask you, your honor, just where in the land
 Is a court with the patience to hear a tax case?
 Do all of you sympathize with Jackson and Hand,
 And write of the tax law with "despair" and "distaste?"

Are deductions a sop, sir, just Congressional grace?
 Can we now tax gross income in place of the net?
 Can gambling be banished with quite a straight face, sir
 By a tax imposition on placing a bet?

Do we come to a rate, sir, of 100 per cent
 With wealth all divided; is this your intendment?
 Would this not offend, sir, your justiciable bent?
 Can we rely on the *Fifth*, not the *Sixteenth Amendment*?

Earth-bound again with prose, we can set down in plainer terms areas of decision in which the Courts have exerted their influence on tax policy:

First, we have already noted the evident impatience of the Courts with the snowballing volume of tax cases, as well as their announced distaste for the subject matter. In another passage of his opinion in the *Dobson* case, Mr. Justice Jackson complained that:

The mere number of such [tax] questions and the mass of decisions they call forth become a menace to the certainty and good administration of the law.⁶

Second, there is the marked trend toward what may one day amount to abdication of jurisdiction by the established Courts, and the extension of the authority of administrative tribunals and specialized courts in the field of tax law.

In another passage in the *Dobson* case, Mr. Justice Jackson points out that "the volume of tax matters flowing through the Tax Court keeps its members abreast of changing statutes, regulations, and Bureau practices," and that "tested by every theoretical and practical reason for administrative finality, no administrative decisions are entitled to higher credit in the courts." He complained that "[tax] appeals fan out into the courts of appeal of ten circuits and the District of Columbia."⁷ In a footnote he emphasized that 99 courts of the country are forced to concern themselves with tax cases. It may not be too presumptuous to add another footnote to the effect that many times 99 courts in the land are called upon to decide other no more important questions of law, both civil and criminal.

At a very early date in the development of our tax law, we were confronted with the decision in *Anniston Manufacturing Company*,⁸ holding that a taxpayer has no constitutional right to go into court at all in a tax case if an administrative remedy is provided. If the courts one day are not to be available, and if the power to tax has the ingredients of the power to destroy, the taxpayer can get only cold comfort from the assurance of Mr. Justice Holmes that the power to tax is not the power to destroy while the Court sits. There is the bleak prospect in the present trend that the Court may not be sitting in tax cases.

Next, we come to the expanding concept originally expressed in the *Brushaber*⁹ case, that there is nothing repugnant to due process in the progressive character of the income tax or the exemptions based on relative wealth; that the Fifth Amendment may very well create no barrier at all to the taxation of gross income without regard to losses, deductions being entirely a matter of legislative grace. Just the other day, this doctrine gained momentum in the Supreme Court's decision in the *Glenshaw*¹⁰ case, expanding the definition of gross income to include punitive damages, and dissolving some lingering doubts as to whether the Sixteenth Amendment is winning its race with the Fifth.

One might have the temerity to suggest that this decision may not make too much of a contribution toward balancing the budget or the enforcement of the antitrust laws. Treble damage seekers, like the rest

of us, will now have to think in terms of income after taxes instead of a tax exempt windfall.

Not too many years ago, Mr. Justice Marshall recognized the transitory nature of our Constitution if one amendment can be so superimposed on another as to in effect nullify it. In a letter to Mr. Justice Storey, which is here in the Library of the College of William and Mary, he said:

I begin to fear that our Constitution is not to be so long-lived as its real friends have hoped. What may follow sets conjecture at defiance. I shall not live to see and bewail the consequences of these furious passions which are breaking loose upon us.

The great Chief Justice might well have been even more apprehensive had he known there was to be a Sixteenth Amendment which would rewrite Article One and be quite oblivious to limitations of the Fifth Amendment.

The great Sir William Blackstone once said in his commentaries that:

When properly taxed, a citizen contributes only, as was before observed, some part of his property in order to enjoy the rest.

A taxpayer today in the 91% tax bracket might well wonder under this test whether he is properly or fairly taxed when he contributes 91% in order to enjoy 9%. Sometimes when lawyers have a few leisure moments and are not confusing activity with accomplishment, they indulge in the speculation whether the Fifth Amendment and due process would come into play if the tax rate were increased to 100%.

It was Mr. Justice Holmes who once wisely remarked that taxes are the price we pay for civilization. Today, it is truly better things for better living through higher taxation. We all recognize the necessity for a heavy burden of taxation in the world situation which confronts us. But do we recognize the dangers inherent in a continuation of pyramided confiscatory taxes beyond emergency needs and, perhaps, beyond the strength of the free enterprise system to bear them? Is it possible that a continuing state of emergency, as real as it has been and is, has been utilized by those who have ulterior political motives to continue the present inequitable tax structure?

Memories are short and comparisons are interesting. Under the first corporation tax measured by income, the rate was 2% in 1909. A few short months ago, it was as high as 82%. The decision in the *Brushaber* case might conceivably have been a little different, having in mind the temper of the times, if the Court had been confronted with

a tax rate of 80% or 90% instead of the maximum surtax rate of 6% in 1913.

In that year, the staid old *New York Times* was editorializing, in chorus with distinguished gentlemen like Charles Evans Hughes and Elihu Root, that the income tax was a "frank project of confiscation."

Also in 1913, in a challenge thrown down to the advocates of the income tax, Senator John Sharp Williams of Mississippi uttered a few well-chosen words that sound both a little strange and a little familiar today:

No honest man can make war upon great fortunes *per se*. The Democratic Party has never done it, and when the Democratic Party begins to do it, it will cease to be the Democratic Party and become the Socialist Party of the United States, or better expressed, the Communist Party of the United States.

We have the good fortune today to be guests in a great Commonwealth which was one of the two States of the Union which gazed clearly into the crystal ball—or shall we say Pandora's box—and refused to take any action on a Sixteenth Amendment couched as it was in the broadest and most general terms, without safeguarding limitations that could readily have been included. Without apology, and even with understandable pride, I can say to you that I have the good fortune to hail from the other State that took no action—the great Commonwealth of Pennsylvania. We do not have to be oblivious to the benefits which have inured to the national welfare from the Federal income taxing power, to agree with the many thoughtful people who have proposed constitutional limitations on this power which were overlooked in the adoption of the Sixteenth Amendment.

There are signs on the horizon that the "project of confiscation," as Charles Evans Hughes described it, has slowed down a little. The devotees of Karl Marx, who advocated confiscatory income and inheritance taxes to redistribute the wealth, may yet suffer the slings and arrows of outraged fortunes. Enlightened and unenlightened proposals have been made for superimposing an amendment on the Sixteenth Amendment to put a ceiling on rates. Actually, there is very little wrong with the income tax that could not be cured by a reduction in what can quite objectively and adjectively be described as the inequitable, discriminatory, confiscatory, and steeply graduated rate structure. Perhaps the Twenty-Third Amendment will limit the Sixteenth as the Twenty-First repealed the Eighteenth. A confiscatory income tax is just about as popular as prohibition, and almost as contrary to the mores of the people. Unless this movement toward limitation gains credence and support, Senator Williams' dire prediction about a change in the form

and philosophy of our government may conceivably come true. Probably the taxing power, more than any other, has made possible government in Washington instead of government in the States, and the transition from a republic to the democratic welfare state.

A reduction in rates would mean a corresponding reduction in the hundreds of pages and thousands of provisions of the Revenue Code. It would obviate the necessity for most of the so-called "loophole plugging," and certainly the conversation about it, which in the mouths of demagogues piles up so much political hay.

In the next area of the Courts' influence in the tax field, we must take note of the five to four decision of the Supreme Court in 1953 in *United States v. Kabriger*,¹¹ upholding an occupational tax levied in 1951 on persons engaged in accepting wagers. It takes some temerity for a humble officer of the Court to suggest, even with the support of the dissenting four, that this is another uncertain landmark in the long line of cases trying to resolve the question whether the taxing power may be used to accomplish a social or economic purpose beyond the direct legislative power of Congress.

The majority held that although Congress could not directly regulate gambling (that insidious power and pastime being the province of the States), it could accomplish this indirectly. Stripped of some verbiage, the majority decision simply states that Congress, pursuant to the power to tax in disguise, may force a taxpayer to confess to violations of State law.

Mr. Justice Frankfurter, in dissenting gave us, as usual, the metaphors and similes to understand the error:

However, when oblique use is made of the taxing power as to matters which substantively are not within the powers delegated to Congress, the court cannot shut its eyes to what is obviously, because designedly, an attempt to control conduct which the Constitution left to the responsibility of the States, merely because Congress wrapped the legislation in the verbal cellophane of a revenue measure.¹²

Mr. Justice Black was justifiably impatient in these words:

Whether or not this Act has this effect, I am sure that it creates a squeezing device contrived to put a man in federal prison if he refuses to confess himself into a state prison as a violator of state gambling laws. The coercion of confessions is a common but justly criticized practice of many countries that do not have or live up to a Bill of Rights.¹³

The decision in the *Kabriger* case is not surprising, but is more than a little disappointing to the school of tax thought which had hoped that revenue measures would be used more and more and principally for the collection of revenue. True, tax measures must inevitably have

incidental effects—sometimes very important—beyond the economic impact of the levy. But it was to be hoped that these effects might become more and more incidental. The wolf of social, economic and political change should come less often in the sheep's clothing of a tax measure. Regulatory laws, disguised even in beautiful, useful and transparent cellophane, partake of the nature of the questionable and fraudulent practices they seek to control.

Perhaps you may detect just a note of rebuttal to the views expressed earlier today by my distinguished colleague of the Washington tax bar. I can agree with him that in evolving tax policy we cannot be indifferent to its far-reaching effects beyond revenue collection. But I cannot agree with the dominant role and utility he would give it to accomplish social and economic reforms. Proud as we are of our constitutional heritage, and concerned as we are with the preservation of the Bill of Rights, states rights, and due process, we do not find a very proud heritage, or much peace of mind, in the decisions upholding laws disguised as tax measures but designed to accomplish unconstitutional purposes in other areas.

Perhaps we can go a step further. Even tax provisions with the ulterior motive of requiring the distribution of corporate earnings or the liquidation of so-called undesirables, such as holding companies, are suspect. Names are only labels for our ignorance; but a question might be raised about dressing up an inequitable tax with the misleading title "excess profits tax," primarily for the purpose of getting the support of the taxpayers who do not have to pay it.

We might next explore another area of judicial influence, which can be referred to as the preoccupation, beginning in the 1930's, with substance versus form; also, the new recognition which was accorded legislative intent and legislative history because of the complexity of statutory language and the lack of judicial precedents.

Pyramiding tax rates resulting from the New Deal determination to tax and spend the nation out of the Depression, prompted taxpayers to be more ingenious in the area of avoidance and evasion. Getting and spending, the New Deal did not lay waste its powers to tax, or relax its efforts to plug up the so-called "loopholes." Statutory loophole plugging, however, could not keep pace with the ingenuity of tax experts. The result was that first the Executive Branch and then the Courts felt compelled, because of the exigencies of the revenue and the apparent need for social and economic reform, to go beyond the imperfect language in which the impositions were framed. We are just emerging from an era of judicial and administrative legislation, of government by men and not laws.

In the early part of the century, Mr. Justice Holmes had thrown out the guidelines for statutory construction:

We recognize that courts have been disinclined to extend statutes modifying the common law beyond the direct operation of the words used, and that at times this disinclination has been carried very far. But it seems to us that there may be statutes that need a different treatment. A statute may indicate or require as its justification a change in the policy of the law, although it expresses that change only in the specific cases most likely to occur to the mind. The legislature has the power to decide what the policy of the law shall be, and after it has intimated its will, however indirectly, that will should be recognized and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an adequate discharge of duty for courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before.¹⁴

It was not surprising then that the nice and precise three-dimensional world of the tax law was upset with the decision in *Gregory v. Helvering*¹⁵ in 1935. This decision set off a chain reaction of judicial legislation, particularly in tax cases, which prompted Mr. Justice Cardozo to raise a warning about liberality of construction "running riot."¹⁶ The trend has slowed, perhaps because of the growing body of judicial precedents and better utilization of our imperfect English tools in drafting tax laws. But this period of judicial legislation will always recall to mind such names as *Clifford*,¹⁷ *Hallock*,¹⁸ *Church*,¹⁹ *Spiegel*,²⁰ *Bazely*,²¹ and *Tower*.²²

Concurrently, tax-writing committees of Congress, being concerned about the inadequacy of their handiwork in preventing avoidance and evasion, and the criticism by the Courts of its complexity and ambiguity, started off on a legislative lark of their own to plug up the loopholes and cast out a bigger net.

Their efforts came to fruition in the inclusion and tightening of tax provisions with subjective tests like old Section 102 and Section 129. These created tax liability in terms of what is the taxpayer's purpose and what goes on in his mind. With seeming vindictiveness, they imposed impossible burdens of proof—usually the entire burden of proof—on the taxpayer. Contrary to the basic principles of the common law, any determination by the accusing Commissioner was considered presumptively correct, and he was not required to produce any evidence to support it. It is in this area, particularly, that some improvement has come in the 1954 Internal Revenue Code. It might well have come through the Courts.

Not only was the taxpayer at a disadvantage with the Treasury, but it was not until Congress reversed the ruling of the *Dobson* case that

there was any assurance that Tax Court decisions would not be affirmed simply because the decisions had been made.

Not always does Congress pull out such legislative plums so as to be able to say, "What a good boy am I!" On the contrary, it has been most remiss in continually taking advantage of the Supreme Court's early ruling that income tax laws may be retroactive and still be constitutional. Nearly every year Congress has been imposing income taxes *nunc pro tunc*—if not in disregard of the taxpayer's legal rights, at least to his consternation and inconvenience.

In passing we should note that because of the permissive encroachment of the Federal taxing power through the Sixteenth Amendment upon the traditional authority and autonomy of the States, the well-springs of State revenue have either been drying up or forced into double duty, to provide the requisite sustenance for the insatiable maw of both the State and Federal governments.

We should not pass this way, and wander somewhat aimlessly through this maze of trends, without a word about the sharper line which is being drawn between human and personal rights on the one hand, and what are commonly referred to as "less sacred" property rights on the other.

In *Thomas v. Collins*,²³ Mr. Justice Roberts rejected the argument that "under the Constitutional guarantees, there is a sharp distinction between business rights and civil rights, . . ." ²⁴ It may be just a little significant in terms of the present trend that this was nothing but *dictum* in a *dissenting opinion*—a voice crying in the wilderness.

It seems to me that the inference can too often be drawn from the decisions of the Courts, as for example the opinion in the *Dobson* case, that property rights, particularly in the realm of taxation, are of a very low order, that there is no longer anything sacred about them, and like Lucifer, they have fallen entirely from grace. Perhaps this accounts for the thinking that tax cases one day may not have an equal hearing before the common law courts, either initially or on appeal, but may be relegated to the limbo of administrative decision or, at best, to a small body of discerning specialists who, Charon-like, are equipped to ferry them across the Styx. Then, perchance, the disillusioned taxpayer may imagine he sees on the facade of every courthouse the paraphrase: "Abandon hope, ye may not enter here."

Conceivably, there may be some of this thinking in the Courts and even among members of the bar themselves. There was a feeling among the lawyers of another generation, after the principal constitutional aspects of tax law were settled, that tax law was really not law at all, and that the practice of this segment of the profession required only a

knowledge of arithmetic and accounting and a penchant for horse trading.

It was only a few years ago that many of the most brilliant and scholarly graduates of our law schools avoided tax practice like the plague, and considered assignment in this area a kind of banishment to Siberia.

In recent years, however, all this has been changing. As you know, there is a general impression in America that everything can be solved by education and a higher standard of living. Perhaps this thought pattern accounts for the developing interest in tax practice. Lawyers became educated to the interesting ramifications of tax law, going as it does down all the highways and byways of the common law and legal practice—wills and probate, corporations and their reorganization, contracts and the commercial law of the business community, real estate and security transactions, and even criminal law, domestic relations, and such rarified regions as conflicts and international law. The bar is gradually becoming educated to the fact that in terms of the daily relations of human beings with each other and with their government, probably no area of the law has a greater impact or plays a more important part. I would not be in the tradition of a public speaker, or what is more important, entirely objective, if I did not look down this afternoon at the bright young faces of the law students before me and take courage.

Human nature being what it is, and it *is* acquisitive, the prospect of a higher standard of living for the lawyer and the taxpayer may have had some appeal. Despite the “will-o’-the-wisp” element in all this, tales were told of the new-found affluence of tax practitioners. The aspect of “salt mines in Siberia” changed to “greener grass over the fence.” The interest of those who would “remake the world” was also stimulated by the fruitful prospects of the taxing power.

Quite seriously, though, there has been a change of attitude and an increasing entry of outstanding lawyers into tax practice, which have given it a new vitality. Much of this is attributable to more enlightened and imaginative teaching in the law schools. It is a tribute to William and Mary that it has recognized and is assuming a greater responsibility in this field.

This recognition on the part of the law schools and the bar has come very late—almost too late to alleviate the pains and burdens of the Courts, and dispel their impatience with the thousands of unnecessary and meaningless controversies in the tax field. But better lawyers will mean better controversies in the better sense of the word. This will mean less trivial litigation and the better presentation of the more

important issues and cases that remain. Every Court is a victim of the briefs it has to read. There will even be fewer meaningless and inconsequential controversies at the administrative level. Lawyers and accountants may even do less haggling over who is to do the haggling in petty cases which should never get into court. Perhaps then the judges will not be faced with the menace of congested dockets and calendars, and have such distaste for tax litigation.

To my mind, if the issue in the *Dobson* case had been presented a few years hence to a court which had not had the misfortune of too close proximity with tax practice and administration in its earlier immature and formative stages, the decision might have been different.

A growing respect for this body of law on the part of both lawyer and judge is inevitable. There is some handwriting on the wall in the legislative reversal of the *Dobson* case that tax litigation is to be considered more important, affecting as it does the daily lives and fortunes of almost everybody; that it cannot be limited or relegated to isolated and special administrative bodies or courts, but must, instead, be reviewed and decided in the main current of judicial thought.

It is difficult to reconcile Mr. Justice Jackson's views in the *Dobson* case with the timely warning he gave us in his great dissenting opinion in the *Kabriger* case. Possibly, he had already come to a fuller realization of the vital role the Courts must play in safeguarding the rights of taxpayers and in keeping their confidence and good will in order to preserve our unique taxing system. This was his warning:

The United States has a system of taxation by confession. That a people so numerous, scattered and individualistic annually assesses itself with a tax liability, often in highly burdensome amounts, is a reassuring sign of the stability and vitality of our system of self-government. What surprised me in once trying to help administer these laws was not to discover examples of recalcitrance, fraud or self-serving mistakes in reporting, but to discover that such derelictions were so few. It will be a sad day for the revenues if the good will of the people toward their taxing system is frittered away in efforts to accomplish by taxation moral reforms that cannot be accomplished by direct legislation.²⁵

These words, better than any phrases of mine, bespeak the necessary influence and responsibility of the Courts in directing us toward a sound tax policy and a more enlightened trend.