

# THE TAXATION OF FAMILY INCOME

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CONFRONTED with rising taxes and falling profits taxpayers are resorting to every method at their disposal to minimize their mounting tax burdens. The artificial distribution of large incomes among several persons is one of the obvious means of tax avoidance. The courts are thus confronted with an increasing number of cases involving various devices designed to accomplish this result. Roughly, these cases fall into two general groups—those involving the community property system as a means of dividing income between husband and wife, and those dealing with different kinds of agreements whereby the taxpayer assigns his income. Of course, any question of the taxation of community income arises only between husband and wife. Examination reveals, however, that practically all of the assignment cases likewise deal with the distribution of income among members of a family.

## I. *Taxation of Community Income*

The Revenue Act provides that "There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to" a sum specified in the statute.<sup>1</sup> There is no indication as to what shall constitute income of the particular individual taxed, whether it shall be the income to which, according to the courts, he has "legal title," or "equitable title," or simply income which he actually enjoys through his power to dispose of as he pleases. It is safe to say that this matter was never considered by the legislators, but was left to the Treasury officials and the courts to work out as particular cases arose.

The problem was presented first in the community property states,<sup>2</sup> where it was contended that the wife had an interest in community income which was equal to that of the husband and that therefore one-half of such income should be returned by each spouse. In no two states are the community property statutes just alike, but in general it may be said that community

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<sup>1</sup> Revenue Act of 1928, § 11. The wording has been the same since the 1918 act.

<sup>2</sup> The states are: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington.

income consists of the earnings of the husband and of the wife and the income from any investment of such earnings.<sup>3</sup> In some states the income from separate property is included. Community property is under the management and control of the husband. Thus he has complete power over the disposition of community personal property, subject only to the restrictions that he may not will more than one-half of it and cannot make certain gifts of it without his wife's consent.<sup>4</sup> Therefore, whether the income of the husband and the profits from it be regarded as community income or as his separate income makes little difference as far as the power of the husband to control and enjoy it is concerned. It was argued, however, by the taxpayers in the community property states that the Revenue Act taxed income to the person who "owned" it and that the wife, having a "vested interest" in community income, "owned" one-half of it and therefore should be taxed for one-half. This "vested interest" argument was based upon the common law theory of ownership embodied in the conception of legal title. It was a theory which was inept and inadequate to describe community property relations which were developed under an alien jurisprudence. It had no real connection with the tax problem involved which should have been approached from the standpoint of the taxpayer's actual relation to the income for which he was taxed.

No one outside the Treasury Department passed on the question until 1920 and 1921 when the Treasury obtained opinions from Attorney-General Palmer to the effect that spouses in all of the community property states except California could each return one-half of the community income.<sup>5</sup> How completely the Attorney-General accepted the "vested interest" theory is indicated by his reason for excluding California from the list of favored states. The rights and powers of the wife were the same in California as in some of the other community property states<sup>6</sup>

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<sup>3</sup> Unless, of course, the spouses agree otherwise.

<sup>4</sup> For a comparative study of community property systems see Daggett, *The Modern Problem of the Nature of the Wife's Interest in Community Property—A Comparative Study* (1931) 19 CAL. L. REV. 567.

<sup>5</sup> The first opinion considered only Texas. 32 Op. Att'y Gen. 298 (1920). The second opinion dealt with the problem in the other community states. 32 Op. Att'y Gen. 435 (1921).

<sup>6</sup> This can be illustrated by comparing the part of the Attorney-General's opinion relating to Nevada with that concerning California. It was stated that in each of these states the husband had the control and management of the community property, subject to certain qualifications not regarded as important nor even mentioned; that in each state, upon the death of the wife the entire community property belonged, without administration, to the surviving husband; and that upon the death of the husband one-half of the property went to the surviving spouse, while the other half was subject to the testamentary disposition of the husband. The only difference between the laws of the two states which was mentioned in the opinion was

but the California courts had described the wife's interest in community property as an "expectancy" rather than as a "vested interest." Upon this basis the Attorney-General concluded that in California the husband should be taxed for all of the community income. Unfortunately for the California taxpayers, the state courts had applied the wrong label.

Thus the matter stood until 1924, when Attorney-General Stone advised the Treasury Department to resort to litigation in order to determine what rule should govern the taxation of community income in California.<sup>7</sup> The test case of *Robbins v. United States* was then prepared. The district court held that the Treasury officials had acted erroneously in taxing Mr. Robbins for all of the community income accruing to him and his wife.<sup>8</sup> It so decided, not on the theory that the wife's interest was "vested," which it regarded as an unimportant matter of form, but on the ground that the California statutes defining the husband's powers of control over community property were substantially the same as those in the other community property states. Since community income was divided in those states it should also be divided in California.

But the California taxpayers were doomed to disappointment, for the decision was reversed by the United States Supreme Court.<sup>9</sup> Mr. Justice Holmes, speaking for the Court, agreed with the judge below that the decision should rest, not upon whether the wife's interest in community property was characterized as "vested" or "expectant," but upon the husband's control over the community income. He reached the conclusion that the husband's powers of management and control should render him liable for the tax since they were so extensive as to enable him practically to dispose of it as he would his separate income. He said:

"Although restricted in the matter of gifts, etc., he alone has the disposition of the fund. He may spend it substantially as he chooses, and if he wastes it in debauchery the wife has no redress. His liability for his wife's support comes from a different source and exists whether there is community property or not. That he may be taxed for such a fund seems to us to need no

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that in Nevada the courts had called the wife's interest "vested" and had held that no inheritance tax was due upon the one-half of the community property which went to her upon her husband's death: *In re Williams*, 40 Nev. 241, 161 Pac. 741 (1916); while in California the wife's interest had been described as an "expectancy" and it had been held that an inheritance tax was due in the above situation. *In re Moffitt's Estate*, 153 Cal. 359, 95 Pac. 653 (1908), rehearing denied, 95 Pac. 1025 (1908).

<sup>7</sup> 34 Op. Att'y Gen. 395 (1924).

<sup>8</sup> 5 F. (2d) 690 (N. D. Cal. 1925).

<sup>9</sup> *United States v. Robbins*, 269 U. S. 315, 46 Sup. Ct. 148 (1926). For a good discussion of the Robbins case see Maggs, *Community Property and the Federal Income Tax* (1926) 14 CAL. L. REV. 351, 441.

argument. The same and further considerations lead to the conclusion that it was intended to tax him for the whole. For not only should he who has all the power bear the burden, and not only is the husband the most obvious target for the shaft, but the fund taxed, while liable to be taken for his debts, is not liable to be taken for the wife's, so that the remedy for her failure to pay might be hard to find."<sup>10</sup>

The expression of this view by the court left the tax situation more uncertain than ever. The Treasury had proceeded upon the theory that the division of community income depended upon whether the wife had what the courts called a "vested interest." But if it depended upon the actual control the husband exercised over the income there was little reason for not taxing the husband for all of the community income in everyone of the community property states, since as pointed out by the lower court, the husband's powers were substantially the same in all the states. In order that the whole question might be litigated the opinions of Attorney-General Palmer<sup>11</sup> were withdrawn and new test cases were begun in several of the interested states.

In the meantime, the California taxpayers, having resolved to do all in their power to make possible a division of community income, turned to the legislature for assistance and in 1927 there was added to the California Civil Code a provision reading: "The respective interests of the husband and wife in community property during continuance of the marriage relations are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172 A of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property."<sup>12</sup> This provision did not change in the slightest degree the rights or powers of either spouse, but tax liability under the theory upon which the Treasury had proceeded prior to the *Robbins* case depended, not upon the actual rights of husband and wife in community property, but upon the name which was given the wife's interest, and that interest was now re-baptized and emerged with the blessing of the legislature as "present, existing and equal" with that of the husband. No longer could it be referred to as a "mere expectancy."

This was the setting in which the test cases came on for hearing in the Supreme Court. The first to be decided was *Poe v.*

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<sup>10</sup> *Supra* note 8, at 326.

<sup>11</sup> 35 Op. Att'y Gen. 265 (1927). The opinion of March 8, 1924, reaffirmed by opinion of October 9, 1924, relating to the estate tax was also withdrawn. 35 Op. Att'y Gen. 89 (1926).

<sup>12</sup> CAL. CIV. CODE, § 161 (a), added by CAL. STATS. 1927, c. 265, in effect August 27, 1927.

*Seaborn*<sup>13</sup> which came up from the State of Washington. The income involved consisted of Mr. Seaborn's salary and profits from community property. Taking its cue from the reasoning in the *Robbins* case, the government contended that the broad powers of the husband over community property should render him liable for taxation on all of the community income. This result, it was urged, would accomplish a uniform operation of the income tax throughout all the states in the union by preventing preferred treatment of taxpayers in the community property states. Speaking through Mr. Justice Roberts, the Court replied to this argument as follows: "While the husband has the management and control of community personal property and *like power of disposition thereof as of his separate personal property*,<sup>14</sup> this power is subject to restrictions which are inconsistent with denial of the wife's interest as co-owner."<sup>15</sup> The restrictions which the court enumerated may be summarized as follows:

1. The wife may borrow for community purposes and bind the community property.
2. Since the husband may not discharge his separate obligations out of community property the wife may enjoin the collection of the husband's separate debts out of the community property.
3. The community property is not liable for the husband's torts not committed in carrying on the business of the community.

Upon examination it will be found that none of these so-called restrictions involve any limitation upon the husband's use and disposition of community income to which husbands in the non-community property states would not be subject. The fact that the wife may be able to bind the community property for debts contracted for family purposes cannot be regarded as a serious limitation on the husband's use of his income, existing only under community property systems, when it is remembered that in all states the husband is liable for the support of his family. The second proposition seems to contain the most serious limitation but it appears to be a misstatement of the law. The husband has full power to contract separate debts and contrary to the Court's statement he may pay them out of community income.<sup>16</sup> Therefore, the fact that community property is not liable to be seized

<sup>13</sup> 282 U. S. 101, 51 Sup. Ct. 58 (1930).

<sup>14</sup> Italics added.

<sup>15</sup> *Supra* note 12, at 110.

<sup>16</sup> "The husband shall have the management and control of community personal property, with a like power of disposition as he has of his separate personal property, except he shall shall not devise by will more than one-half thereof." WASH. COMP. STAT. (Remington, 1922) § 6892. The case relied upon by the court for its statement is *Fidelity & Deposit Co. v. Clark*, 144 Wash. 520, 258 Pac. 35 (1927), in which it was held that community property was not liable for a debt arising out of a tort of the husband.

for his separate debts<sup>17</sup> is a protection to him rather than a limitation upon his control over community income. The same may be said of the proposition that community property is not liable for certain of the husband's torts. Clearly then, the husband has all the power; but he bears only half the burden, because "the wife has, in Washington, a *vested property right*"<sup>18</sup> in the community property equal with that of her husband, and in the income of the community, including salaries or wages of either husband or wife or both."<sup>19</sup> This can be regarded only as a return to the "vested interest" theory which had been accepted originally by the Treasury Department. Thus if the *Robbins* case<sup>20</sup> offered any hope that the Court would work its way out of the community property tangle by rejecting inapplicable theories of title, that hope was destroyed by the opinion in *Poe v. Seaborn*.<sup>21</sup>

Since the *Seaborn* case was decided on the basis of the label applied to the wife's interest, it was to be expected that the 1927 amendment to the California law would accomplish its purpose. The California taxpayers achieved their goal in *United States v. Malcolm*<sup>22</sup> when the Court held that a husband residing in California should be taxed for only one-half of the community income<sup>23</sup> earned in 1928. The interests of the husband and wife were such as to bring the case within the rule of *Poe v. Seaborn* because of the amendment changing the definition of the wife's interest.<sup>24</sup> The other community property cases<sup>25</sup> were decided

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<sup>17</sup> In MCKAY, COMMUNITY PROPERTY (2d ed. 1925) § 793, it is stated that this limitation is peculiar to the State of Washington and does not exist in the other community property states.

<sup>18</sup> Italics added.

<sup>19</sup> *Supra* note 13, at 111.

<sup>20</sup> *Supra* note 9.

<sup>21</sup> Referring to *United States v. Robbins*, the Court said: "In the *Robbins* case we found that the law of California, as construed by her own courts, gave the wife a mere expectancy and that the property rights of the husband during the life of the community were so complete that he was in fact the owner." *Supra* note 13, at 116. No mention is made of any "property rights" possessed by Mr. Robbins which did not also belong to Mr. Seaborn.

<sup>22</sup> 282 U. S. 792, 51 Sup. Ct. 184 (1931).

<sup>23</sup> The income consisted of the husband's salary.

<sup>24</sup> The California law was changed in 1917 and in 1923, but the amendment of 1927 was the only one mentioned in the opinion. The Board of Tax Appeals has held that the amendments of 1917 and 1923 did not give the wife a "vested interest" in community property although the later amendment gave her the power to will one-half of the property. Therefore the Board sustained the Commissioner in taxing the husband for all of the community income earned in the years 1923-1924. *Preston v. Commissioner*, 21 B. T. A. 840 (1930). The decision in *Cerruti v. Commissioner*, 4 B. T. A. 682 (1926), is in accord as to the 1917 changes which provided in substance: (1) that in a suit for separate maintenance where no divorce is granted and the marriage status continued, the court may make the same

in conformity with *Poe v. Seaborn* and now spouses in all of the community property states may divide community income between them.

The result is an inequitable distribution of the tax burden for the tax imposed upon family incomes in the community property states is much lighter than that which must be borne by families in other parts of the country. It was argued in *Poe v. Seaborn* that all of the community income should be taxed to the husband in order to accomplish a uniform operation of the tax. Mr. Justice Roberts attempted to meet this point by saying:

"This argument cuts both ways. When it is remembered that a wife's earnings are a part of the community property equally with her husband's, it may well seem to those who live in states where a wife's earnings are her own, that it would not tend to promote uniformity to tax the husband on her earnings as part of his income. The answer to such argument, however, is that the constitutional requirement of uniformity is not intrinsic, but geographic. And differences of state law, which may bring a person within or without the category designated by Congress as taxable, may not be read into the Revenue Act to spell out a lack of uniformity."<sup>26</sup>

This reasoning does not justify the result which the Court reached. In the first place, the Justice assumed that the only alternative to dividing community income equally between husband and wife was to tax the husband for all of it, including the wife's earnings; whereas the court could very well have held that salary should be taxed to the spouse who earned it and that other community income should be taxed to the husband who controlled it. This result would have accomplished substantial uniformity among all the states, and there was ample authority upon which such a decision could have been rested.<sup>27</sup>

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disposition of community property that it could if the marriage were dissolved; (2) that the husband cannot sell, encumber or lease the community realty for a period of over one year without the joinder of the wife; and (3) that upon the death of the husband no inheritance tax shall be assessed on the wife's one-half of the community property.

<sup>25</sup> Arizona: *Goodell v. Koch*, 282 U. S. 118, 51 Sup. Ct. 62 (1930); Louisiana: *Bender v. Pfaff*, 282 U. S. 127, 51 Sup. Ct. 64 (1930); Texas: *Hopkins v. Bacon*, 282 U. S. 122, 51 Sup. Ct. 62 (1930).

<sup>26</sup> *Supra* note 13, at 117.

<sup>27</sup> The salary could have been taxed to the spouse earning it on the authority of *Lucas v. Earl*, 281 U. S. 111, 50 Sup. Ct. 241 (1930), and other community income could have been taxed to the husband on the authority of *United States v. Robbins*, *supra* note 9. In *Randall v. Commissioner*, 4 B. T. A. 679 (1926) the Board held that the earnings of the wife should be taxed to her on the theory that the *Robbins* case did not pass on the question of the taxation of the wife's earnings. See *Cruikshank v. Commissioner*, 13 B. T. A. 508 (1928). The Commissioner does

Secondly, the constitutional requirement of uniformity was not involved. The question was not whether some provision of the Constitution had been violated, but which of several interpretations should be placed upon the taxing act and in deciding this issue the court certainly might have looked to the operation of the tax. Estimates based directly on community property returns indicate that the taxes levied on community incomes in 1928 were from 30% to 32% lighter than they would have been if a division of community income had not been permitted.<sup>23</sup> These figures show that there is in fact a discrimination against families residing in the non-community property states.<sup>29</sup> The only remedy for this unsatisfactory situation<sup>30</sup> appears to lie in action by Congress.

## II. *Taxation of Assigned Income*<sup>31</sup>

During the years in which community income was taxable to the husband in California, spouses living in that state resorted to various kinds of agreements for the purpose of accomplishing a division of their income which they had thus far failed to achieve under the provisions of the community property statutes.<sup>32</sup> In

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not acquiesce in the Randall decision. INT. REV. CUM. BULL. (1931) X-1, at 24.

<sup>23</sup> See Labovitz, *The Community Property System* (1931) 9 TAX MAG. 286, 291.

<sup>29</sup> In considering these figures it must be remembered that the sum which it is here estimated would be collected from the taxation of the community as a unit would result in part from the inclusion of the wife's earnings in community property. But this should not materially affect the figures since the earnings of the wife are a comparatively unimportant item in community income, particularly in the higher brackets where the division of income would have the greatest effect on the rates.

<sup>30</sup> Another objection to the result reached in the test cases is the burden it places upon the federal courts. Attempts are constantly made to return separate income as community income in order that it may be divided, and frequently it is difficult to ascertain whether particular items of income should be classified as separate or community. In order to determine the question, the courts must have evidence which is sometimes difficult to secure, and they are required to pass upon close questions of state law which may or may not have been decided by the state courts. See *Lucas v. Baucum*, 50 F. (2d) 806 (C. C. A. 5th, 1931); *Merren v. Commissioner*, 51 F. (2d) 44 (C. C. A. 5th, 1931).

<sup>31</sup> Consideration of assignments of income from a corporation to its stockholders is outside the scope of this article. On this question see *Rensselaer & S. R. Co. v. Irwin*, 249 Fed. 726 (C. C. A. 2d, 1918); *Eddy's Steam Bakery v. Rasmusson*, 47 F. (2d) 247 (D. C. Mont. 1931); *Central Life Assur. Soc. v. Commissioner*, 51 F. (2d) 939 (C. C. A. 8th, 1931); Note (1931) 41 YALE L. J. 130.

<sup>32</sup> The Supreme Court of California has held that whatever effect the 1927 amendment may have on property acquired after its effective date, it cannot in any manner relate to or govern the "ownership" of property acquired prior thereto. *Stewart v. Stewart*, 204 Cal. 546, 269 Pac. 439 (1928). In view of this decision it seems likely that income from commu-

the first cases which arose the courts defeated these attempts at tax reduction by holding that the particular agreements in question did not, by their terms, prevent the assigned income from becoming community property, and therefore did not prevent it from being taxable to the husband under the *Robbins* case. The leading case on this question is *Blair v. Roth*,<sup>33</sup> involving an agreement between husband and wife which provided in substance that the parties should contribute their earnings to a common fund which they should own equally. The Circuit Court of Appeals, reversing the Board of Tax Appeals,<sup>34</sup> held that in spite of the agreement the earnings of the wife remained community property for tax purposes and should be taxed to the husband. The court said that "at most, the agreement here was for an assignment by each of the parties of one-half of his or her earnings to the other; that at the instant they were received, the salaries were, by the law, impressed with the status of community property, and were taxable with reference to that status; and that the obligation to pay the tax so computed could not be escaped by contributing such incomes to the so-called partnerships between the two members of the community, any more effectively than by contributing it to a like enterprise as between one member of the community and a third person."<sup>35</sup> Under the law of California, spouses have always had full power to change the status of their property by agreement.<sup>36</sup> Thus, in later cases the *Roth* decision was interpreted to hold merely that under the terms of agreement there in question, the wife's earnings remained community property and therefore taxable to the husband, and consequently the issue became largely a question of whether or not the spouses specifically agreed that their income should be called "separate" or "community." Their actual relation to, or rights in, the income was of minor importance. Thus, when husband and wife agreed that the income from their joint account should be divided between them equally as their "separate property" and that the earnings of each should be his or her "separate property" it was

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nity property acquired in California prior to 1927 must be taxed to the husband under the *Robbins* case, unless the spouses can accomplish a division of the income by means of an assignment.

<sup>33</sup> 22 F. (2d) 932 (C. C. A. 9th, 1927), *cert. den.*, 277 U. S. 588, 48 Sup. Ct. 436 (1928).

<sup>34</sup> The Board rested its decision in *Roth v. Commissioner*, 4 B. T. A. 834 (1926), on the authority of *Randall v. Commissioner*, *supra* note 27, in which it had held that the *Robbins* case had not passed on the question of the taxation of the wife's earnings which should be taxed to the wife in absence of any agreement. As to the *Randall* case the Circuit Court said, *supra* note 32, at 933, "But inasmuch as appellee does not urge upon us the reasoning of that decision, we need not discuss it; it is sufficient to say that we deem it to be unsound."

<sup>35</sup> *Supra* note 33, at 934.

<sup>36</sup> See COMMUNITY PROPERTY § 95, CAL. JURIS. SUPP. (1930) at 135.

held that no part of the wife's income under the agreement should be taxed to the husband;<sup>37</sup> but when the parties agreed that their property should be owned by them equally,<sup>35</sup> or as joint tenants,<sup>39</sup> it was held that the husband should be taxed for the wife's income including her salary.

The courts continued to adhere to this theory until the United States Supreme Court decided the case of *Lucas v. Earl*.<sup>40</sup> The spouses had agreed in 1901 that all property which they owned or thereafter acquired, including salaries, should be held by them as joint tenants. The husband claimed that under this agreement his salary for the years 1920-1921 should be taxed one-half to him and one-half to his wife. Following the previous cases, the Board of Tax Appeals and the Circuit Court decided the case on the basis of whether or not the agreement converted the earnings into "separate property," the Board holding that it did not<sup>41</sup> and the Court that it did.<sup>42</sup> The Supreme Court, in one of Mr.

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<sup>37</sup> *Krull v. Commissioner*, 10 B. T. A. 1096 (1928), acquiesced in by the Commissioner, INT. REV. CUM. BULL. (1931) X-1, at 36. In the following cases the Board held that the wife's earnings should not be taxed to the husband because the parties had agreed that such earnings should be the "separate property" of the wife: *Gassner v. Commissioner*, 4 B. T. A. 1071 (1926), acquiesced in by the Commissioner, INT. REV. CUM. BULL. (1931) X-1, at 24; *Busche v. Commissioner*, 10 B. T. A. 1345 (1928), acquiesced in, INT. REV. CUM. BULL. (1931) X-1, at 10; *Harris v. Commissioner*, 10 B. T. A. 1374 (1928), acquiesced in, INT. REV. CUM. BULL. (1931) X-1, at 27. See *Salomon v. Commissioner*, 4 B. T. A. 1109 (1926), acquiesced in, INT. REV. CUM. BULL. (1931) X-1, at 57.

<sup>38</sup> *Belcher v. Lucas*, 39 F. (2d) 74 (C. C. A. 9th, 1930). *Phillips, Sternhagen and Murdock*, dissented from the decision of the Board of Tax Appeals, 11 B. T. A. 1294 (1928), which was affirmed by the Circuit Court. The ground of their dissent was that the agreement prevented the wife's earnings from ever becoming community property.

<sup>39</sup> *Richter v. Commissioner*, 10 B. T. A. 1377 (1928). In *Wehe v. McLaughlin*, 30 F. (2d) 217 (C. C. A. 9th, 1929), a husband tried to do by agreement what the California Legislature accomplished by the 1927 amendment. He executed an instrument called a "waiver" in which he stated that since there was doubt as to whether the wife had a "vested right" in her half of the community property, he "waived" all rights in the one-half of the property and declared "that said wife's share is vested in her and hereby conveyed to her, and that I merely retain the right of management and control thereof as provided in section 172, as her trustee." The court held that all of his earnings should be taxed to him, saying, at 218: "Granting the competency of the parties, and assuming the delivery of the instrument relied upon, we are of the opinion that it does not purport to convert any part of appellant's future earnings into the separate property of the wife." See also *Brunton v. Commissioner*, 15 B. T. A. 348 (1929).

<sup>40</sup> 281 U. S. 111, 50 Sup. Ct. 241 (1930).

<sup>41</sup> *Earl v. Commissioner*, 10 B. T. A. 723 (1928). The Board rested its decision on *Blair v. Roth*, *supra* note 33.

<sup>42</sup> *Earl v. Commissioner*, 30 F. (2d) 898 (C. C. A. 9th, 1929). The Court distinguished *Blair v. Roth*, *supra* note 33, on the ground that in that case there had been no agreement that the earnings should be joint property.

Justice Holmes' characteristically concise opinions, swept the husband's contention aside and rested its conclusion that he should be taxed for the full amount of his salary upon a broad interpretation of the Revenue Act. Referring to the argument that Mr. Earl's salary became joint property upon the instant that it was received, Justice Holmes said:

"We well might hesitate upon the latter proposition, because however the matter might stand between husband and wife he was the only party to the contracts by which the salary and fees were earned, and it is somewhat hard to say that the last step in the performance of those contracts could be taken by anyone but himself alone. But this case is not to be decided by attenuated subtleties. It turns on the import and reasonable construction of the taxing act. There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew."<sup>43</sup>

The Justice made it perfectly plain that he was resting his opinion on the broad proposition that the import of the Revenue Act is to tax salary as a unit to the person who earns it<sup>44</sup> and that he was not relying upon the technical theory that the instant the salary was earned, title to it vested in the husband subject to the assignment to the wife.<sup>45</sup>

This reasoning injected a new element into the taxation of family income. Taken at its face value it indicated that salary should be taxed to the spouse earning it, irrespective of any assignment and regardless of whether it was considered separate or community income. The Board of Tax Appeals took this view and held that it was not necessary to decide whether an agreement between spouses living in California made the wife's salary her separate property, or whether the salary was taxable to the husband under the *Robbins* case,<sup>46</sup> for in any event, it was tax-

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<sup>43</sup> *Supra* note 40, at 114.

<sup>44</sup> Just how this "import" is found in the terms of the act is not so clear. No tax is levied upon earnings and salary as such, and no distinction is made between income derived from salaries and that from other sources. See § 22 (a) of the Revenue Act of 1928.

<sup>45</sup> No attention was given to the possibility that the agreement might have been invalid as an assignment of future earnings. See 1 WILLISTON ON CONTRACTS (1920) § 414.

<sup>46</sup> *Dohrmann v. Commissioner*, 19 B. T. A. 466 (1930), followed in *Dohrmann v. Commissioner*, 19 B. T. A. 507 (1930), and *Davis v. Commissioner*, 20 B. T. A. 931 (1930). See also *Davis v. Commissioner*, 10 B. T. A. 1233 (1928).

able to the wife who earned it.

But this doctrine had to be dealt with by Mr. Justice Roberts in deciding *Poe v. Seaborn*.<sup>47</sup> It will be remembered that part of the community income involved in that case consisted of Mr. Seaborn's salary. If the import of the taxing act is to tax salary to the person who earns it, how could the Court hold that one-half of Mr. Seaborn's salary should be taxed to his wife? Mr. Justice Roberts attempted to clear up this difficulty by saying: "The very assignment in that case [*Lucas v. Earl*] was bottomed on the fact that the earnings would be the husband's property else there would have been nothing on which it could operate. That case presents quite a different question from this, because here, by law, the earnings are never the property of the husband, but that of the community."<sup>48</sup> Thus, the argument based on a technical theory of title, which was brushed aside by Mr. Justice Holmes as an "attenuated subtlety," was made the basis of the decision by Mr. Justice Roberts.

This interpretation of the *Earl* case has led to further confusion. Assume, for example, that in a community property state, one spouse assigns or releases to the other his or her community interest in the other's earnings. To whom should this interest be taxed? Under the doctrine of the *Earl* case, as stated by Mr. Justice Holmes, the earnings would all be taxed to the spouse earning them, who in this case would be the *assignee*. But under the theory of the *Earl* case, as interpreted by Mr. Justice Roberts, the question arises as to whether the interest assigned would not first vest in the *assignor*,<sup>49</sup> which would make this interest first the "property" of the spouse assigning it and therefore taxable to such spouse rather than to the assignee. In this situation the Board of Tax Appeals has adopted the first theory and held that the earnings assigned should be taxed to the assignee who earned them,<sup>50</sup> while the General Counsel of the

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<sup>47</sup> *Supra* note 13.

<sup>48</sup> *Id.*, at 117.

<sup>49</sup> Under *Poe v. Seaborn*, *supra* note 13, this community interest would, in absence of agreement, be taxed to the spouse "owning" it.

<sup>50</sup> This question was presented to the Board in *Roth v. Commissioner*, 22 B. T. A. 587 (1931), which involved the same parties as *Blair v. Roth*, *supra* note 33. After the decision in *Blair v. Roth*, Mr. and Mrs. Roth entered into a written agreement specifically stating that any property they owned or acquired should be "separate property" owned by them equally. Armed with this agreement they appealed to the Board on the question as to whether all of the wife's salary earned in 1923-1925 should be taxed to the husband under the *Robbins* case, *supra* note 9. The Board held that one-half of the wife's earnings had been released to her and therefore never became income to the husband. *Murdock and Arundell* dissented on the ground that the wife's earnings must first have become community property and therefore taxable to the husband. The Commissioner acquiesces

Bureau of Internal Revenue has rendered an opinion to the effect that the assigned earnings should be taxed to the assignor in whom they first vested.<sup>51</sup> Both the Board and the General Counsel rested their opinions in part on the authority of *Lucas v. Earl*. The question must await clarification by the Supreme Court unless the problem is eliminated by a change in the Revenue Act.

The agreements considered thus far have involved community income, but spouses residing in non-community property states have resorted to similar devices in order to accomplish assignments of their income. In considering the effect of these arrangements the Federal Courts and the Board of Tax Appeals have usually relied upon property concepts for the basis of their decisions, just as they have done in the community property cases, with the result that the law is becoming embroiled in a mass of technicality which bids fair to confuse completely the tax issues involved. The doctrine has been propounded, and the courts quite generally profess to follow it, that an assignment of future income will not relieve the assignor from his tax liability unless there is transferred an "existing property interest" in the source from which the income is derived. In deciding what constitutes an "existing property interest," and what amounts to a transfer of such an interest, the courts have reached results which are bewildering to those not conversant with legal niceties.

This can be illustrated by a few recent cases. In *Hall v. Burnett*, the petitioner was in the employ of an insurance company and in 1905 entered into a contract with the company which provided that he should be paid, in addition to his salary, a commission on all renewal premiums received by the company for insurance written during the life of the contract. Petitioner remained in the employ of the company and in 1920 entered into an agreement with his wife whereby he assigned to her an interest in the commissions to the extent of a specified amount per annum. The wife, in turn, agreed to surrender her inchoate rights in her husband's property. The question was presented as to whether the petitioner should be taxed for the portion of the commissions paid the wife during the years 1921-1924. Since the contract with the company expired in 1920, all the services required of petitioner were performed prior to 1921. The Board of Tax Appeals held that all of the commissions should be taxed

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in the decision. INT. REV. CUM. BULL. (1931) X-1, at 56. See also Roth v. Commissioner, 17 B. T. A. 1330 (1929).

<sup>51</sup> G. C. M. 9938, INT. REV. CUM. BULL. (Dec. 7, 1931), X-49, at 2. The case presented to the General Counsel was that of a husband and wife residing in California who on August 1, 1927, entered into an agreement that the salary of the husband should be his "separate property." The General Counsel stated that this agreement would not prevent one-half of the husband's salary from being taxed to the wife under the Malcolm case, *supra* note 22.

to the petitioner on the ground that he attempted to assign "future income" rather than an "existing property right."<sup>52</sup> Upon appeal this decision was reversed by the Court of Appeals of the District of Columbia.<sup>53</sup> In attempting to distinguish the case from *Lucas v. Earl*<sup>54</sup> the court said, "In the view we take of this case, [*Hall* case] what was assigned was neither income nor earnings, but property. It was not an assignment of future earnings but the transfer of a property right, and though this property right gave rise to future income, uncertain and contingent though it might be as to amount, that fact does not destroy the distinction."<sup>55</sup>

In the later case of *Bishop v. Commissioner*<sup>56</sup> which also involved assignment of insurance commissions, the Circuit Court of Appeals for the Seventh Circuit professed to follow the distinction made in the *Hall* case but reached just the opposite result on the ground that there had been no assignment of a "present property right." The feature of the case chiefly relied upon by the court to distinguish it from *Hall v. Burnet* was the language of the instrument by which the commissions were assigned. The assignment provided that the commissions should not be payable to the assignee "unless and until they become due and payable to" the assignor under the terms of his contract with the insurance company. The court said: "It is perfectly obvious from this language that petitioner had no intention of conveying a property right *in praesenti*, but only in future income as it might

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<sup>52</sup> *Hall v. Commissioner*, 17 B. T. A. 752 (1929). Green, Love and Smith dissented on the ground that there had been an assignment of an interest under an existing contract. In the dissent, at 756, it is said: "I cannot doubt that if the respondent had contended that the amounts received under the contract by petitioner's wife were taxable income to her, such contention would have to be sustained upon the authority of *Irwin v. Gavitt*."

<sup>53</sup> *Hall v. Burnet*, 54 F. (2d) 443 (App. D. C. 1931), *cert. den.* 52 Sup. Ct. 408 (1932).

<sup>54</sup> *Supra* note 40.

<sup>55</sup> *Supra* note 53, at 444. In *Nelson v. Ferguson*, 56 F. (2d) 121 (C. C. A. 3d, 1932), the court followed this reasoning. An employee had assigned a patent to his employer in return for one-third of the profits which he later assigned to his wife. Referring to the distinction between the assignment of a "property right" and the assignment of "future earnings" the court said: "This seems to be the central point of the *Earl* case not only as expressed in the opinion in that case but as restated in *Poe v. Seaborn*. There the assigned income sprang from services which were not property and which, of course, could not be assigned. Here the income sprang from assigned property and if validly assigned, the income was that of the assignee, the owner of the property, and was taxable as hers." *Id.*, at 125. For cases in which insurance commissions were taxed to the assignor, see *Stokes v. Commissioner*, 22 B. T. A. 1386 (1931); *Browne v. Commissioner*, 3 B. T. A. 826 (1926).

<sup>56</sup> 54 F. (2d) 298 (C. C. A. 7th, 1931). The court affirmed the decision of the Board of Tax Appeals which is reported in 19 B. T. A. 1108 (1930).

become due to him."<sup>57</sup> It should be noted that the court does not question the validity or enforceability of the assignment, but refuses to recognize it for tax purposes solely because it does not evidence an "intention" on the part of the assignor to transfer a "present property right." As an assignment of renewal commissions the instrument was probably just as effective as the one considered in the earlier case, but in neither the *Hall* case nor the *Bishop* case was the court concerned with the actual operation of the assignment.

This requirement that there must be a transfer of a "property right" has led to unsubstantial distinctions and confusing results in other assignment cases.<sup>58</sup> Thus, where a *cestui* assigned to his wife a two-thirds interest in all income from a certain trust "intending hereby to convey to and vest in" her an undivided two-thirds interest in such income, the court held that the income should not be taxed to the assignor since the assignment transferred a "present property interest" in the trust;<sup>59</sup> but where the assignment provided that the trustees should pay over

<sup>57</sup> *Supra* note 56, at 301.

<sup>58</sup> Where a lawyer assigned to his wife the right to forty per cent of his compensation under a contingent fee contract, the Board held that the fees should be taxed to him on the authority of *Lucas v. Earl*, *supra* note 40, although there was a dissent on the ground that a "property right" had been assigned, *Daugherty v. Commissioner*, 24 B. T. A. 531 (1931). See also, *Stack v. Commissioner*, 22 B. T. A. 707 (1931); *Blumenthal v. Commissioner*, 15 B. T. A. 1394 (1929). In *Siegel v. Commissioner*, 20 B. T. A. 563 (1930), income under an annuity contract was held taxable to the assignee. The Commissioner does not acquiesce in the decision. INT. REV. CUM. BULL. (1931) X-1, at 93. There are a number of cases involving the assignment of income from corporate stock. Cf. *Bettendorf v. Commissioner*, 49 F. (2d) 173 (C. C. A. 8th, 1931); *Le Blanc v. Commissioner*, 7 B. T. A. 256 (1927). See also *Smith v. Commissioner*, 25 B. T. A. 291, 299 (1932); *Warner v. Commissioner*, 5 B. T. A. 963 (1926); *Hoffmann v. Commissioner*, 3 B. T. A. 964 (1926). The last two cases are not acquiesced in by the Commissioner. INT. REV. CUM. BULL. (1931) X-1, at 82, 95.

<sup>59</sup> *Commissioner v. Field*, 42 F. (2d) 820 (C. C. A. 2d, 1930), affirming the decision of the Board in *Field v. Commissioner*, 15 B. T. A. 718 (1929), which is not acquiesced in by the Commissioner. INT. REV. CUM. BULL. (1931) X-1 at 79. From the decision of the Board there was an interesting dissent in which it was said (p. 727) "under varying states of fact the principle has been consistently recognized that by an assignment of future income the assignor does not escape the tax. To say that such an assignment is a transfer of an interest in the fund is to override the principle by casuistry." In the following cases trust income was not taxed to the assignor on the theory that there had been an assignment of an interest in the trust fund: *O'Malley-Keyes v. Eaton*, 24 F. (2d) 436 (D. C. Conn. 1928); *Young v. Gnichtel*, 28 F. (2d) 789 (D. N. J. 1928); *Blaney v. Commissioner*, 13 B. T. A. 1315 (1928); *Hubbell v. Commissioner*, 14 B. T. A. 1040 (1929); *Clark v. Commissioner*, 16 B. T. A. 453 (1929); *Blair v. Commissioner*, 18 B. T. A. 69 (1929). The Commissioner acquiesces in the *Clark* case but not in the *Blaney* or *Blair* cases. INT. REV. CUM. BULL. (1931) X-1, at 13, 75.

the income to the assignee as it became payable to the *cestui*, it was held that there was no transfer of the "property right which produced the income" and therefore the assignor remained liable for the tax.<sup>60</sup> The same theories are applied in the cases involving the assignment of rents,<sup>61</sup> royalties,<sup>62</sup> and the proceeds from the sale of real estate.<sup>63</sup> For example, in *Leydig v. Commissioner*,<sup>64</sup> the husband executed an assignment to his wife of a one-half interest in all oil and gas royalty interests which had been or should be received by him. The court held that the husband should be taxed for one-half of the royalties received from oil and gas leases executed before the assignment but should be taxed for all the royalties from leases made after the assignment. The reasoning of the court is that the assignment operated to transfer the right to receive royalties under existing leases, which was an "assignable property right," but did not have the effect of transferring an interest in the oil and gas in place and therefore only gave the wife the right to royalties from future leases when the husband should receive them. If the court had regarded unaccrued royalties as a species of incorporeal hereditament and therefore a "present property right" which was transferred by the assignment, the husband would have escaped

<sup>60</sup> *Porter v. United States*, 52 F. (2d) 1056 (Ct. Cl. 1931). *Cf. Shellabarger v. Commissioner*, 38 F. (2d) 566 (C. C. A. 7th, 1930), where the court, reversing the Board, 14 B. T. A. 695, held that the income should not be taxed to the assignor. The court said (p. 567): "The mere fact of Maud's [assignor] receiving it does not indicate that it was her taxable income. The statute does not impose an income tax upon everything which is received by the taxpayer" and ". . . it is quite immaterial whether there was employed language purporting to convey a half interest in the net income, or agreeing to pay over the half as it was received—the result is the same." Where the petitioner assigned a portion of her income under a trust to her husband with the provision that if he should assign it, it should revert to her, the Board held that she should be taxed for it. *Power v. Commissioner*, 23 B. T. A. 428 (1931). See also, *Welch v. Commissioner*, 12 B. T. A. 800 (1928).

<sup>61</sup> *Bing v. Bowers*, 22 F. (2d) 450 (S. D. N. Y. 1927), *aff'd* 26 F. (2d) 1017 (1928); *Woods v. Commissioner*, 5 B. T. A. 413 (1926); *Ward v. Commissioner*, 22 B. T. A. 352 (1931).

<sup>62</sup> *Infra* note 64. See also *Ferguson v. Commissioner* 45 F. (2d) 573, 577 (C. C. A. 5th, 1930); *McKee v. Alexander*, 48 F. (2d) 838 (W. D. Okla. 1931); *Walker v. Commissioner*, 6 B. T. A. 1142 (1927); *Browning v. Commissioner*, 16 B. T. A. 485 (1929).

<sup>63</sup> *Huntington v. Commissioner*, 15 B. T. A. 851 (1929), not acquiesced in by the Commissioner, INT. REV. CUM. BULL. (1931) X-1, at 82; *Bryan v. Commissioner*, 19 B. T. A. 111, 123 (1930). See also *Liggett v. Commissioner*, 5 B. T. A. 169 (1926); *Eyestone v. Commissioner*, 12 B. T. A. 1232 (1928); *Rogers v. Commissioner*, 15 B. T. A. 638 (1929).

<sup>64</sup> 43 F. (2d) 494 (C. C. A. 10th, 1930), affirming the decision of the Board, 15 B. T. A. 124 (1929). In the Board there was a dissent on the ground that the assignment was merely an assignment of "future income" as to both past and future leases.

taxation for all of the wife's royalties.<sup>65</sup>

Numerous cases have come to the courts involving the assignment of income from partnership enterprises and recently one of these cases was decided by the Supreme Court. The important facts were as follows: Leininger, who was the petitioner, and M. G. Monaghan organized a partnership to engage in the laundry business, each partner owning a one-half interest in the business. In 1920 Leininger entered into a written agreement with his wife to the effect that she was a full partner with him and entitled to share equally the profits and losses. M. A. Monaghan, who at that time represented the Monaghan interests, was notified of this agreement and apparently acquiesced. Mrs. Leininger contributed no capital and took no part in the management of the business. The question was presented as to whether Mr. Leininger should be taxed for his wife's share of the profits.

The Board of Tax Appeals held that he should be, stressing the facts that the wife contributed no capital; that the interest stood in petitioner's name on the books; that the profits were paid to the petitioner and were deposited by him in a joint account, although his wife had a separate account; and that no accounting was ever had between petitioner and his wife.<sup>66</sup> This decision was reversed by the Circuit Court of Appeals for the Sixth Circuit.<sup>67</sup> The court had two arguments to meet. First, the usual one was advanced that this was an assignment of "future income" which should not relieve the assignor from his tax liability. In answering this argument the court used the familiar doctrine of the assignment cases and said: "We cannot regard this contract as a mere assignment of an interest in future profits 'if, as and when' received. It creates mutual rights and liabilities; it is irrevocable; it creates, at least as between the parties, a vested interest in a property right; and the specified profits and losses were hers, not his."<sup>68</sup> The second argument was based on the section of the Revenue Act which provides: "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year."<sup>69</sup> Following the reasoning of an earlier case<sup>70</sup> the government contended that this section prescribes a general policy for the taxation of partnerships and that it provides that each partner shall be taxed for his full dis-

<sup>65</sup> Phillips J., dissented from the decision of the court on this ground.

<sup>66</sup> Leininger v. Commissioner, 19 B. T. A. 621 (1930).

<sup>67</sup> Leininger v. Commissioner, 51 F. (2d) 7 (C. C. A. 6th, 1931).

<sup>68</sup> *Id.*, at 8.

<sup>69</sup> This is section 181 of the Revenue Act of 1928. The provision has been the same since the 1918 act.

tributive share of the partnership profits irrespective of his interest in such profits. Taking this interpretation of the Act, the government argued that Mrs. Leininger was not a partner and therefore all of the profits distributed to petitioner should be taxed to him. But the court rejected the government's construction of the Act saying: "We do not see that section 218 (a) <sup>71</sup> undertakes to fix any policy as to who is to be deemed to receive the income; it merely extends the definition of individual income so as to include undivided partnership profits." <sup>72</sup>

The Supreme Court in *Burnet v. Leininger* <sup>73</sup> reversed the Circuit Court and affirmed the decision of the Board. The rationale of Mr. Chief Justice Hughes was that the wife was not made a partner and "upon the facts as found, the agreement with Mrs. Leininger cannot be taken to have amounted to more than an equitable assignment of one-half of what her husband should receive from the partnership." <sup>74</sup> Apparently the Court accepted the government's construction of the Act and made the question turn upon whether Mrs. Leininger was made a partner or not. The implication of the decision is that had she been made a partner, her share of the profits could not have been taxed to her husband. The effect of the decision, therefore, depends upon what persons the Court will consider partners for tax purposes. The Court said that Mrs. Leininger could not be regarded as a partner since there was no finding that the other partners had consented to her being made a member of the partnership. The fact that the agreement between Leininger and his wife was communicated to the other partners was not proof of their consent.<sup>75</sup>

The objection to this emphasis on membership in the firm lies in the fact that Mrs. Leininger might have been included in the partnership without any material change in her position. She might have been made a member of the firm without being given any share in the management of the business and without having contributed either capital or services.<sup>76</sup> In that event Mr. Lein-

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<sup>70</sup> Harris v. Commissioner, 39 F. (2d) 546 (C. C. A. 2d, 1930).

<sup>71</sup> Revenue Act of 1918.

<sup>72</sup> *Supra* note 67, at 8. Commissioner v. Barnes, 30 F. (2d) 289 (C. C. A. 3d, 1929), is in accord with the court's decision.

<sup>73</sup> 52 Sup. Ct. 345 (1932).

<sup>74</sup> *Id.*, at 346.

<sup>75</sup> The fact that the other partners apparently acquiesced in the agreement might have been made the basis of a finding that they consented to Mrs. Leininger being made a partner.

<sup>76</sup> In *Hinshaw v. Commissioner*, 16 B. T. A. 1236, 1239 (1929), where petitioner's son was held to be a partner with petitioner although he contributed no capital, the Board said: "As a matter of law it may be said that regardless of the question as to whether or not the wife and son had contributed any, or an equal part of the capital, the father then and there had a legal and moral right to give to each such interest in the business as he felt inclined to give them."

inger would not have been taxed for his wife's share of the profits if the reasoning of the court were followed, and that is the result which the Board of Tax Appeals has reached. Although in the *Leininger* case the Board reached the same conclusion that the Supreme Court did,<sup>77</sup> the Board has held in other cases that when a man makes a member of his family a partner with him in his business he should not be taxed for that person's share of the profits, even when he retains the management of the business and the other person has contributed neither capital nor labor.<sup>78</sup> The reason given for this result is the interpretation of the partnership provision of the Act which the Supreme Court followed in the *Leininger* case.<sup>79</sup> Thus the organization of the family part-

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<sup>77</sup> *Supra* note 66. In *Battleson v. Commissioner*, 22 B. T. A. 455 (1931), a husband assigned his interest in a partnership to his wife but did not make her a partner. The Board held that although the wife owned part of the partnership property and although she would have a right to an accounting from her husband, the income from the partnership was part of his distributive share and should be taxed to him. Love, Trussell and Matthews dissented, arguing that the wife "owned" the income and that the Sixteenth Amendment does not authorize "the taxing of one person on another's income"; neither does the statute require that such be done. It was stated that the word "partner" in the partnership provision is used as synonymous with "owner."

<sup>78</sup> In the following cases the Board has held that a partnership was created and that each partner should be taxed for his distributive share of the partnership profits: *Reeb v. Commissioner*, 8 B. T. A. 759 (1927), where petitioner retained in himself the power of management and control over the business and assigned a part interest to his wife as trustee for their minor child. The Commissioner does not acquiesce in this decision. INT. REV. CUM. BULL. (1931) X-1, at 90. *Wilson v. Commissioner*, 11 B. T. A. 963 (1928), not acquiesced in by the Commissioner, INT. REV. CUM. BULL. (1931) X-1 at 96, where petitioners made their wives partners, although the latter contributed neither capital nor services, were unfamiliar with the business, and took no active part in its management. *Phelps v. Commissioner*, 13 B. T. A. 1248 (1928), acquiesced in by the Commissioner, INT. REV. CUM. BULL. (1931) X-1, at 51, where the agreement between petitioner and his wife was oral and the wife contributed neither capital nor services, and where it appeared that the arrangement was entered into for the purpose of reducing taxes. *Olds v. Commissioner*, 15 B. T. A. 560 (1929), not acquiesced in by the Commissioner, INT. REV. CUM. BULL. (1931) X-1, at 88, where petitioner made his daughters partners with him but retained control of the business, and where it was provided that the daughters might draw out profits only in such amounts as the petitioner saw fit to pay them. Accord generally: *Loper v. Commissioner*, 12 B. T. A. 164 (1928); *Harrington v. Commissioner*, 21 B. T. A. 260 (1930); *Oakley v. Commissioner*, 24 B. T. A. 1082 (1931). In *Tally v. Commissioner*, 22 B. T. A. 712 (1931), it was held that no partnership existed where petitioner, his wife, and son provided in the purported partnership agreement that the petitioner should be "absolute dictator as to the methods and policies to be pursued in the management thereof, particularly including the manner, method, and amount of all expenditures, and division of all profits." See also *Felton v. Commissioner*, 18 B. T. A. 64 (1929); *Kasch v. Commissioner*, 25 B. T. A. 284 (1932).

<sup>79</sup> If the interpretation which the Supreme Court places upon the part-

nership remains as a method of accomplishing an assignment of income which will be effective for the purpose of reducing the tax burden.

This review of the cases involving the taxation of assigned income indicates that the courts have not generally followed a consistent tax policy, but have reached their decisions by applying theories of property or partnership which have led to confusing results. The tax falls sometimes upon the assignor and at other times upon the assignee, depending upon whether the assignment transfers a "present property right" in the source of the income or whether the assignee is made a partner in the business from which the income is derived. It is extremely unlikely that the courts can extricate themselves from the difficulties of this situation without some change in the Revenue Act.

### *III. Taxation of the Family as a Unit*

A change in the Revenue Act which would provide for the taxation of the family as a unit would eliminate the discrimination resulting from the community property decisions and would at the same time destroy most of the difficulties arising from the assignment cases. A simple method of accomplishing this result would be the adoption of a provision to the effect that in comput-

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nership provision of the Revenue Act is followed, and it is held that each partner shall be taxed on his distributive share of the partnership profits, difficult questions arise as to what constitutes a partnership and what the term "distributive share" means. See *Copland v. Commissioner*, 41 F. (2d) 501 (C. C. A. 7th, 1930), where it was held that the business constituted a "joint adventure" and not a partnership, and therefore assigned income should not be taxed to the assignor. Cf. *Osborn v. Commissioner*, 22 B. T. A. 935 (1931), where the Board held that the assignees, who had contributed neither capital nor services, were not members of the "joint adventure," and that the income paid to them should be taxed to the assignor. See also *Bowers v. New York Trust Co.*, 9 F. (2d) 548 (C. C. A. 2d, 1925); *Ruprecht v. Commissioner*, 39 F. (2d) 458 (C. C. A. 5th, 1930); *Hellman v. United States*, 44 F. (2d) 83, 90 (Ct. Cls. 1930). Cases have arisen where the courts and Board have held that a partner should not be taxed for his full distributive share of the partnership profits. See *Rucker v. Blair*, 32 F. (2d) 222 (C. C. A. 9th, 1929), where it was held that the partnership profits were community income and should be taxed one-half to the husband who was a member of the partnership, and one-half to the wife who was not a partner. Cf. *Larson v. Burnet*, 50 F. (2d) 308 (App. D. C. 1931). See also *Pugh v. United States*, 48 F. (2d) 600 (S. D. W. Va., 1931), and *Biggs v. Commissioner*, 15 B. T. A. 1092 (1929), where the state law governing the partnership provided that the wife could not be a partner with her husband. In cases where a partnership interest is held in trust it has been held that the trustee-partner should not be taxed for his distributive share of the partnership profits. *Cohen v. Commissioner*, 31 F. (2d) 874 (C. C. A. 4th, 1929); *Hallahan v. Commissioner*, 14 B. T. A. 584 (1928); *Hamerslag v. Commissioner*, 15 B. T. A. 96 (1929). Cf. *Luce v. Burnet*, 55 F. (2d) 751 (App. D. C. 1932).

ing the taxes payable by husband and wife living together the tax should be based on their combined income and should be borne by each spouse in the proportion which his or her income bears to the combined income; or the provision might read that the rate to be used in computing the tax of each spouse should be that applicable to their combined income. Thus, if *A* and *B* were living together as husband and wife and each received a taxable net income of \$4000, each would be compelled to pay one-half of the tax due on a net income of \$8000; each spouse would be taxed in proportion to his or her income, but at the rate applicable to their combined income. The combined tax due from husband and wife would not be altered by any change in the distribution of the income between them, nor would it be affected by the fact that part or all of the income was community property. If it were thought desirable to make the provision more inclusive, it might be provided that the income of unemancipated minor children should be added to the income of their parents, and the rate applicable to this total combined income should be used in computing the tax payable by the parents and by the children. If the burden thus placed upon family incomes proved to be too heavy, a larger exemption might be permitted married persons.

One of the first problems to be faced in considering such a change in the law would be its constitutionality. Under the proposed statute a husband or wife whose spouse had a separate income would be taxed individually at a higher rate than a husband or wife whose spouse had no separate income. Thus *A* with an income of \$4000, whose wife also had an income of \$4000, would be compelled to pay a larger tax than if his wife had no income. The constitutional objection urged against such a system of taxation would be that it results in an unreasonable discrimination against spouses with separate incomes. However, such a contention is, not sound. The family is an economic unit, at least in the vast majority of cases, and the husband whose wife has a separate income is subjected to a lighter financial burden than one whose wife is entirely dependent upon his income. The income of either spouse is usually available to meet family expenses, and as far as the actual enjoyment of it is concerned it makes little difference which spouse owns it. Ordinarily the only exception to this would arise in the case of husband and wife who were separated, but such persons need not come within the terms of the act, since it might apply only to spouses living together as members of a family.

The only case which has immediate bearing on the constitutional question presented is *Hoeper v. Tax Commission*<sup>80</sup> recently decided by the Supreme Court. The case involved the validity of

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<sup>80</sup> 52 Sup. Ct. 120 (1931).

certain sections of the Wisconsin income tax law which provided that the husband should be taxed for the total combined income received by him and his wife and each child under eighteen years of age. There had been assessed against the husband a tax computed on the basis of his income combined with that of his wife which was derived from separate property which she had owned prior to her marriage. The Court held, Justices Holmes, Brandeis and Stone dissenting, that the tax was unconstitutional on the ground that it was a violation of the due process clause to tax the husband for income which was his wife's separate property and over which she had complete control. The Court said: "We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the Fourteenth Amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income."<sup>81</sup> This statement taken alone would seem to raise serious doubt as to the validity of the proposed tax but it must be considered in connection with the case decided. As applied in the *Hoeper* case the Wisconsin law imposed upon the husband the whole tax for the combined income; it did not apportion the tax between the spouses. The appellant made this clear in the opening statement of his brief, which reads: "Whether the two statutes might have been construed as together authorizing only a collection from each spouse of that one's proportionate share of the tax is not involved."<sup>82</sup> Therefore, the Court did not pass on the question presented by the proposed provision. It treated the problem before it as being merely that of taxing one person for another's income and although this approach avoided the real issues involved,<sup>83</sup> it was a view which the Court could logically take since the whole tax was imposed on the husband.<sup>84</sup> In considering the tax imposed under the suggested statute, a different issue would be presented since each spouse would pay only his or her proportion of the total tax. The problem raised would have to be considered as one of classification and as pointed out above there is good reason for taxing spouses with

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<sup>81</sup> *Id.*, at 122.

<sup>82</sup> Brief for Appellant, p. 5.

<sup>83</sup> As pointed out above, the family is an economic unit and the husband does derive substantial benefit from the separate income of his wife. Therefore to tax him for his wife's income is not the same as to tax him for the income of a stranger.

<sup>84</sup> In *Burk-Waggoner Ass'n v. Hopkins*, 269 U. S. 110, 46 Sup. Ct. 48 (1925), it was held that an association might be taxed as a corporation although it was a partnership by the state law under which it was organized. In that case the court found sufficient reason for taxing the income to an entity which did not technically "own" it under the state law.

separate incomes at higher rates. Consequently the *Hoeper* decision would not be authority for holding the proposed tax unconstitutional.

Even though there be doubts as to the validity of the proposed statute, it is submitted that the present situation regarding the taxation of family income makes the experiment desirable. Some means should be found for eliminating the discrimination resulting from *Poe v. Seaborn* against families residing in non-community property states. When the Revenue Acts of 1921 and 1924 were being drafted, it was proposed that there should be included in them a provision for the taxation of community income to the spouse who had the right of management and control.<sup>85</sup> These proposals were defeated, possibly because there was some fear that they would throw the balance in favor of the non-community property states. This objection could not possibly be made to the tax suggested. It would establish a uniform national system for the taxation of family income and would destroy many of the difficulties now arising from the assignment of income from one member of the family to another.

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<sup>85</sup> See REPORT OF THE COMMITTEE ON WAYS AND MEANS OF THE HOUSE OF REPRESENTATIVES, REPORT No. 350, 67th Congress, First Session, p. 11, and CONFERENCE REPORT No. 486 of the same Congress, p. 21; HEARINGS BEFORE THE COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, 68th Congress, First Session, Revenue Revision, pp. 194, 348, 349, 375, 478, 482.