LOCAL LAW IN FEDERAL TAXATION

By EDMOND N. CAHN†

"Uniformity is an instant operation on individuals, without the intervention of assessments, or any regard to states, and is at once easy, certain, and efficacious."

Mr. Justice Paterson (1796)[1]

"We shall get nowhere rapidly with the problem of simplification until we recognize that what we bravely call uniformity on a national scale is a myth."

Randolph E. Paul (1938)[2]

I.

THE federal idea is the distinctive political device of our age, as the feudal and imperial ideas were of eras past. Since the eighteenth century, it has characterized every new development in national and international organization. Its acceptance is due to the success with which general affairs are administered without prejudice to local interests and traditions. That success has varied greatly during the federal era and today the federal idea is at its probable nadir. The more remote causes of our present crisis in federalism may be economic or military, but the signs and manifestations are fiscal. In nation after nation, financial hegemony of the central government has canceled, in whole or principal part, the concept of local autonomy. Some of these cancellations have developed within existing constitutional limits (as in the Soviet Union or the Dominion of Canada). Others have strained constitutional structure (as in the Commonwealth of Australia) or have so distorted the theoretic balance as to introduce political unitarianism (as in the Argentine Republic). In each case, however, central fiscal control has been the fulcrum by which local sovereignty was lifted from its base.

The Concept of Uniformity. The constitutional provision for apportionment of representatives and direct taxes among the states according to their respective populations was a remnant of the old "requisition" system which proved so disastrous under the Articles of Confederation.[3] Under this provision the new Federal Government could finance itself by direct taxes, but only through the devious and impractical process of apportionment. If the levy were on real property, the complications might

† Member of the New York Bar.

1. Hylton v. United States, 3 Dall. 171, 180 (U. S. 1796).

2. PAUL, STUDIES IN FEDERAL TAXATION, SECOND SERIES (1938) 5.

3. See Randolph's summary in FARRAND, RECORDS OF THE FEDERAL CONVENTION (rev. ed. 1937) 18; FISKE, THE CRITICAL PERIOD OF AMERICAN HISTORY (1888). The best analysis is that in THE FEDERALIST (1788) Nos. 15-21, 30. See also PAINE, THE CRISIS (1776) Nos. X, XI.

be endless, for there could be no dependable concomitance between respective populations (the Constitution's formula) and respective land values. Local assessment methods differed widely as to interval of valuation, technique of appraisal, enforcement of collection and the multifarious other factors involved in distributing a single state levy among its citizens.[4]

Those who had seen the Articles of Confederation dissolve in bankruptcy, futility and anarchy, succeeded in conferring a general taxing power on the new Government, a power to levy "taxes, duties, imposts and excises." And it was provided that "all duties, imposts and excises should be uniform throughout the United States." The so-called requirement of uniformity had little significance in the early years of the Republic. It was regarded not so much as a criterion for federal tax policy as an escape from the dilemma of "apportionment," an "easy, certain, and efficacious" formula to remedy the "fundamental error" [5] of apportionment.

As the Federal Government subsisted during the nineteenth century largely on "imposts, excises and duties" with but transitory resort to income or inheritance taxes,[6] the implications of "uniformity" remained dormant. Local law presented few difficulties in the administration of federal duties. If there were problems, they might well relate to direct taxes and the formula for apportionment. For example, in the series of direct taxes levied from 1798 to 1861, the Congress classified real estate and slaves together, one reason being that local law regarded slaves as real property.[7] Whatever political motives may have supported this categorization, it remains a striking instance of deference to state nomenclature. Although this deference ended early in 1861, "uniformity" retained its original constitutional background.

The twentieth century has changed all this as increasingly complex statutes of income and estate taxation have conferred a new meaning upon the word "uniform." "Uniform throughout the United States" has become a canon of judicial and administrative action, supported by the Constitution, but transcending the limited purposes which we have described. True, the objective was implicit from the beginning; for as early as the *Hylton* case, we find:

4. We have an excellent record of the problem and its solution preserved in Hylton v. United States, 3 Dall. 171 (U. S. 1796). The litigation was interesting for a variety of reasons: (1) it was the first in which the Supreme Court assumed to pass upon the constitutionality of an act of Congress; (2) the "facts" of the case were frankly manufactured, the government even agreeing to pay counsel fees on both sides; and (3) it was decided by only three of the six Justices. See 1 WARREN, THE SUPREME COURT IN UNITED STATES HISTORY (1922) 146-49. The contrast with modern practice is illustrated by United States v. Johnson, 318 U. S. 189 (1943).

5. See THE FEDERALIST (1788) No. 21.

6. See Knowlton v. Moore, 178 U. S. 41 (1900).

7. The history of these direct taxes is contained in Springer v. United States, 102 U. S. 586 (1800). In a sense, we have here a legislative instance of the interesting "qualification" problem, to be considered in part III *infra*.

> "The truth is, that the articles taxed in one state should be taxed in another; in this way the spirit of jealousy is appeased, and tranquillity preserved; in this way the pressure on industry will be equal in the several states, and the relation between the different subjects of taxation duly preserved." [8]

But the requirement was then thought an "easy, certain and efficacious" formula for the Congress, not a profoundly difficult and complex duty of the courts. The recalcitrances of local law were hardly suspected, much less the subtlety of modern tenures and business techniques. In the *Hylton* case the Court did not mention corporate consolidations, optional marital community or alimony trusts, but simply "articles."

Some Recent History. A quick reference to modern developments will suffice here, since the details of this topic are already available in Mr. Paul's study.[9] The current period begins with *Tyler v. United States,*[10] in which the United States Supreme Court upheld estate taxation of tenancies by the entirety. That litigation involved residents of Pennsylvania and Maryland, where "the amiable fiction of the common law" that husband and wife were one still survived. Hence it was urged that no interest in such tenancies passed by reason of death. The Court replied that there was at death a ripening of property rights and enjoyment in the surviving spouse and that the legislative treatment of this type of transaction was a reasonable provision against tax avoidance.

During the following year, *Poe v. Seaborn* [11] sustained division of community income in Washington and certain other community property states. The case rested, at least in part, upon a statutory construction, for the Court pointed to the legislative phrase "income *of* every individual" and held that "of" denoted ownership, not mere control. The husband's control, restricted in various respects by local law, was not regarded as tantamount to ownership of the whole. This decision has been so frequently analyzed and criticized that present purposes will be met by a single observation. Control was later held to be a sufficient gravamen for taxation even in the *Hoeper* [12] case and in a multitude of subsequent decisions.

Yet the cleavage between the majority and dissenting views in *Hoeper v. Tax Commission of Wisconsin* appeared to be just beyond the limits of the control concept. The majority, holding unconstitutional a Wisconsin statute taxing, in effect, the income of both spouses to the husband, accepted both ownership and control as permissible bases of taxation.

8. Hylton v. United States, 3 Dall. 171, 180 (U. S. 1796).

9. See PAUL, *The Effect on Federal Taxation of Local Rules of Property* in STUDIES IN FEDERAL TAXATION, SECOND SERIES (1938). See also PAUL AND MERTENS, LAW OF FEDERAL INCOME TAXATION (1934) § 33.38.

10. 281 U. S. 497 (1930).

11. 282 U. S. 101 (1930).

12. Hoeper v. Tax Commission of Wisconsin, 284 U. S. 206 (1931).

But Justices Holmes, Brandeis and Stone contended for a further gravamen—enjoyment [13]—and not long after, their concept evidently prevailed in *Douglas v. Willcuts.*[14]

One distinct effect of the impact of local law upon federal taxation may be traced here. As local institutions and modes of tenure refuse to conform to accepted tax theories, they tend to be engulfed by tax concepts expanded for that very purpose. Such an extension may be effected by Congress, as in the instance of estate taxation of life insurance,[15] but in the evolution of the principal limitations, most of the ingenuity, most of the progress, has been furnished by the Supreme Court. The merit of this expansive technique is obvious: recalcitrant local institutions are neither ignored nor obsequiously exempted; they are taxed in terms of a novel concept suitable to themselves. The novel concept will generally appear as an alternative to familiar theories, rather than in lieu of them. The progression in theory thus remains both logical and cumulative.

In *Morgan v. Commissioner* a federal estate tax on property passing under a general power of appointment was applied to what was defined by state statute as a special power. The court said:

> "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed. . . . If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law." [16]

But tax practitioners had observed with chagrin that the Treasury, in *Rudolph Wurlitzer Company v. Commissioner,*[17] also knew how to use

13. This dissent was in keeping with Holmes's theory of the predominant significance of consumption. See BIDDLE, MR. JUSTICE HOLMES (1942) 90.

14. 296 U. S. 1 (1935). See, *e.g.*, Helvering v. Clifford, 309 U. S. 331 (1940).

15. The confusion and vacillation in the estate taxation of life insurance proceeds is a familiar story, summarized in 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION (1942) c. 10. This history culminated in Lang v. Commissioner, 304 U. S. 264 (1938), which held that under the applicable regulations, the decedent's payment of premiums was the sole gravamen of taxability, and that his possessing legal incidents of ownership in the policies would not support the tax. The departure in section 404 of the 1942 Act was the adoption of alternative criteria of taxation, that is to say, either premium payment or incidents of ownership could be availed of in support of the tax.

16. 309 U. S. 78, 80 (1940). Reference to local law may be "inferred from the nature of the problem with which Congress was dealing." Jerome v. United States, 318 U. S. 101, 104 (1943). The federal law follows the local property rule and will not necessarily accord with the local tax rule. For example, a federal estate tax deduction will be granted for commissions allowable under local law computed upon gains or increases realized during administration, although no corresponding state deduction is permitted. See Lewis v. Bowers, 19 F. Supp. 745 (S. D. N. Y. 1937); Matter of Hard, 24 N. Y. S. (2d) 867 (App. Div. 1941).

17. 81 F. (2d) 971 (C. C. A. 6th, 1936). The question here was whether certain preferred stock was non-voting, so as to permit compliance with the statutory conditions

local law. That significant case held that the role of local law in federal taxation is not confined to rules of property but embraces every category of relevant statute or decision. Thus it was established that taxpayers could not avail themselves of "uniformity" as a technique of tax avoidance, and the Treasury could hardly be expected to honor the principal by loss of revenue. Some thought, in their bitterness, that uniformity had become only a new implement of the Commissioner,[18] that he could respect or ignore local law, as the interests of the fisc required.

The *Stuart*[19] case, however, has allayed these fears. After suitable obeisance in the direction of the *Morgan* and similar decisions, the Court relegates an entire segment of tax criteria to the rules of local law:

> "When Congress fixes a tax on the possibility of the revesting of property or the distribution of income, the 'necessary implication,' we think, is that the possibility is to be determined by the state law. Grantees under deeds, wills and trusts, alike, take according to the rule of the state law. The power to transfer or distribute assets of a trust is essentially a matter of local law."[20]

Perhaps the broad implications of these phrases will not be sustained by subsequent rulings; but in any event, they offer the necessary antithesis to the *Morgan* doctrine. Since law is a conceptual science, the boundaries of nomenclature remain indistinct.[21] Names flow freely into the realm of substance, so that mere rejection of local titles and labels would only begin to solve the problem. Names in law are heavily encrusted with real distinctions and implications. Where nomenclature ends and substantial difference begins—that is the question.

In addition to this judicial activity, Congress has been exceedingly busy.[22] The Committee reports relating to the Revenue Act of 1942 disclose persistent and strenuous efforts to achieve uniformity.[23] In the Act itself local rules, local distinctions and presumptions are explicitly declared void, irrelevant, unavailable. Pervading the statute is the ideal of a uniform national tax system, which will operate equally and with

for filing a consolidated return. The articles of incorporation of the taxpayer deprived the stock of voting power, and it did not appear that any preferred stockholder had sought to exercise the right to vote. The Commissioner was nevertheless sustained in his contention that, since the charter provision was in direct violation of local (Illinois) law, the shares must be regarded as voting stock.

18. Compare Higgins v. Smith, 308 U. S. 473 (1940).

19. Helvering v. Stuart, 317 U. S. 154 (1942).

20. *Id.* at 161.

21. See Madison's brilliant exposition in THE FEDERALIST (1788) No. 37.

22. There was, at the same time, a reexamination of a substantial part of the tax structure, culminating after approximately six months debate in Pub. L. No. 753, 77th Cong., 2d Sess. (Oct. 21, 1942).

23. See illustrations in *Report of the Finance Committee on H. R. 7378*, SEN. REP. No. 1631, 77th Cong., 2d Sess. (1942) §§ 120, 402, 403.

identical incidence "on individuals, without . . . any regard to states." But is such uniformity attainable?

II.

Clearly, the question just posed cannot be answered a priori. Nor in all probability can a single, categorical answer be induced. Yet a series of specific instances, all involving the quest for uniformity, can be surveyed; and such relative inferences as they may inspire can be drawn.

One or two preliminary generalizations appear. In the first place, when the principal problem is one of collection procedure, uniformity will be almost perfect. Diversities of local law are entitled to respect where they bear upon the ownership, use or transfer of property; but they can hardly be permitted to interfere with the process of enforcing federal tax assessments. As a matter of elementary self-preservation, the national government must pass over state variations, whether founded in reason, history or mere idiosyncracy, to the end of collecting its bills. Thus local exemption statutes cannot influence the superior claims of the Federal Treasury; nor can the latter be compelled to honor state procedure as to recording of liens.[24] In the practice of collection, national supremacy implies maximum uniformity.

In the second place, there are important forces transcending state lines which make for substantive uniformity. There is more affinity, for example, between the interests, the techniques, the customs, the modes of bookkeeping of bankers in different, even distant, states than between those of bankers and farmers within the same state. Social and economic horizontal stratifications are frequently more potent than the vertical stratifications of state boundaries. The latter are conceptual and economically artificial; the former, pragmatic, visible and politically active. Madison saw these "factions" as a possible menace to republican society, and he rightly called for an everlastingly recurrent balancing of their many interests.[25] But the "factions" have proven something more than mere brawlers in the arena of government: they have joined hands across legal borders and have converted the federal idea into a national union.

Nationwide similarity in economic activities has, of course, long been reflected in our tax laws, and, in fact, antedates the Constitution. What is new is the growing sensitiveness of classification as between business and business. The stress of war has exposed distinctions which long remained implicit. What neater summation could be found than the present language of section 722 of the Internal Revenue Code? Industry is here segregated from industry in terms fearfully abstract, but translatable

24. See Detroit Bank v. United States, 317 U. S. 329 (1943); Michigan v. United States, 317 U. S. 338 (1943). See also PAUL, *op. cit. supra* note 9, at 47.

25. THE FEDERALIST (1788) No. 10.

into just those objectives and experiences which businessmen intimately know,[26] such as abnormality of output, interruptions of production, industry-wide depression or eccentricity of profits cycle.

The stratifications of business transcending state lines have had their effects on the movement toward uniform state laws, restatement of the law, and expansion of the interstate commerce clause. What might be assumed, by way of hypothesis, is that uniformity in the operation of federal taxes is more feasible as to the various categories of commercial law than as to the traditional institutions of personal law. This hypothesis might be explained, in part, by the more general statutory codification of commercial law. The principal cause, however, is that personal law, being more firmly tied to the traditions, history and mores of the state, yields slowly and stubbornly to centripetal impulses.[27] It enjoys the same "cultural" distinctiveness which the Russian, Canadian and Swiss Constitutions have sought to preserve. If our assumption is correct, we have here a significant moral for federalism.

Alimony and Separate-Maintenance Payments. The purposes of section 120 of the 1942 Revenue Act are familiar. This section was enacted not only to shift the tax burden to the spouse actually receiving alimony payments, but also to produce national uniformity in the tax treatment of these payments.[28] The Supreme Court, beginning with a clear concept in *Douglas v. Willcuts* [29] that income used to discharge the duty of support was taxable to the husband, had taken an inviting turn in the *Fitch*[30] and *Leonard* [31] cases, relying on local law to determine the nature of the husband's duty, had begun to feel uneasy in the *Fuller* [32] decision in which the taxpayer successfully took advantage of local law, and had come close, in *Pearce v. Commissioner*,[33] to leaving the road entirely. It seemed time for a change of route.

The pangs of draftsmanship are all too manifest in the new section 120. In the practice of law, instruments tend to grow and foliate far beyond original expectations; and here what began as a simple determination to shift the tax burden to the recipient ended as a substantial code of rules and particularized presumptions. As new possibilities and sets of fact were envisaged, section 120 was expanded to embrace them. It seemed that there would never be an end to the needed qualifications

26. This section has already ended a copious literature. See Miller, *Relief Provisions of the New Excess Profits Tax Act* (1943) 21 TAXES 195.

27. Perhaps for the same reason that the most primitive (and by like token, the most important) verbs are irregular in various languages.

28. See *Report of the Finance Committee on H. R. 7378, loc. cit. supra* note 23.

29. 296 U. S. 1 (1935).

30. Helvering v. Fitch, 309 U. S. 149 (1940).

31. Helvering v. Leonard, 310 U. S. 80 (1940).

32. Helvering v. Fuller, 310 U. S. 69 (1940).

33. 315 U. S. 543 (1942). See Comment (1942) 56 HARV. L. REV. 428, 437.

despite the initial confinement of the section to cases of divorce or legal separation.

Nevertheless many questions implicit in the section were unanswered by those qualifications. Since a divorce or legal separation was the point of departure, could not the Commissioner question its validity?[34] Since a separation agreement might be the occasion for payments, could not the Commissioner challenge the agreement under requirements or inhibitions of local law? Is a long anterior separation agreement a "written instrument incident to such divorce or separation"? Does an antenuptial agreement[35] or an agreement subsequent to the decree or an order amending the decree[36] constitute such an instrument? As the statute speaks of "minor children of such husband," what does it intend as to adult incompetents, and what law fixes the age of majority?

But there are graver difficulties than those presented by these questions. In order to embrace the many ramifications and vagaries of particular cases, the section sets up a variety of ironclad presumptions. These presumptions are simply instances of "drawing the line somewhere" and are clearly defensible once one admits the necessity of a line.[37] But the somewhere can apparently mean anywhere. The presumed application of insufficient payments is a case in point. Local law is honored, in part, by excepting from the new general rule, payments for support of minor children—provided that the share so applicable is fixed by "the terms of the decree or written instrument." Statute or decision is irrelevant; the share must be designated in the bond. This rule is perhaps defensible. But if the aggregate payments prove insufficient, section 120 simply attributes them first to the children's share, in quite possible defiance not only of statute and decision but of the decree or agreement itself. Thus the husband who pays less than he ought, perhaps for reasons of genuine inability, is, in addition, penalized taxwise.

But the wife too has her complaints. She may not avoid tax liability for the children's shares unless the terms of the decree or agreement ex-

34. It goes without saying that such a result would be socially undesirable, but extreme cases (such as "mail order" divorces) might necessitate it. The proportions of the problem are reduced by Williams v. North Carolina, 317 U. S. 287 (1942). See also Part III *infra*.

35. The regulations answer this question in the negative, unless the ante-nuptial agreement is somehow incorporated in a separate agreement or decree. U. S. Treas. Reg. 103, § 19.22(k)-1. Thus a line once drawn calls for another line.

36. Both an agreement subsequent to the decree and an order amending the decree, if obtainable under local law, apparently satisfy the statute. *Ibid.*

37. "In law as in life, lines have to be drawn. But the fact that a line has to be drawn somewhere does not justify its being drawn anywhere. The line must follow some direction of policy, whether rooted in logic or experience. Lines should not be drawn simply for the sake of drawing lines." Dissenting opinion of Mr. Justice Frankfurter, in Pearce v. Commissioner, 315 U. S. 543, 558 (1942).

pressly fix the respective proportions. Thus the wife's tax on moneys allocable, under mandate of both conscience and local law, to the benefit of the children may actually exceed her own nominal share. In any case, spouses operating under one set of rules as to their taxes and another as to familial duties, are bound to be perplexed. Nor are these difficulties none the less real because they operate only within a single family unit, for the unit has, by hypothesis, been split.

The difficulties created by section 120 illustrate the compulsion engendered by the insistance upon statutory uniformity within the area of personal law to enact, not a tax statute, but a whole code of substantive rules and irrebuttable presumptions, and the consequent creation of two parallel and frequently conflicting canons of regulation. The potential harm is exceedingly great, for the main purpose of the Federal Revenue Code is to facilitate and make uniform tax administration, regardless of the ethics and ethos of state codes. Here, for instance, even if we assume that the Federal Government should regulate the incidents of marital dissolution,[38] we are justified in insisting upon a regulation in terms of all the social objectives involved. And these are too large even for a Ways and Means Committee.

The point is that all taxes have some regulatory effect, and the more itemized and particularized the tax statute, the more incisive and detailed its regulation. No one can doubt that future decrees and separation agreements will be drafted with one eye to section 120, and the other to the normal inclinations, needs and interests of the spouses and their children. If Congress "draws the line somewhere" in such great detail, it plots out a shape to which transactions are induced to conform. Thus the eventual incidence of the section is warped by its own normative influence. What was conceived as a tax rule, convenient, though roughly pragmatic, ends as a pattern for action, a guide to the draftsman for which he discards the precedents in office files and formbooks. One is reminded of the statutory "standard clauses" for insurance policies.

Perhaps Congress had no other choice. Perhaps it was impossible or at least impracticable to shift the tax incidence of alimony payments without undertaking this mosaic of draftsmanship. This proposition, however, is at least debatable, for much in section 120 could have been left to the accustomed distinctions of local law. And even the new section is not wholly emancipated from state rules, for who will make bold to interpret a decree or separation agreement without some deference to them? In support of specificity it will be argued that disregard for local law and the resulting inflexibility are not too high a price to pay for exactness and certainty. Better a precise line, even in the wrong place, than a

38. See Mr. Justice Frankfurter's resumé of federal control over marriage and divorce in other countries, in Williams v. North Carolina, 317 U. S. 287, 304 (1942).

series of scattered dots; and if spouses choose to follow this line in agreements and decrees, the incidental harm in a few cases cannot outweigh the advantages, both to the Treasury and to the taxpayer, of fixing and anchoring tax liability.

This view has prevailed in the disparate area of gift and estate taxes. Federal regulation of inheritance,[39] though an encroachment on the traditional preserves of the states, seems warranted by more than convenience of tax collection. The changes in the nature and shape of our economy have converted large aggregations of capital wealth into a federal problem, appropriate for control by federal regulatory taxation. Although the same may be true of the area of marital dissolutions, there is nothing peculiar to its dissolution which makes the marital state a federal concern if it is not such from its inception.

But even with respect to inheritance, where the federal interest clearly appears, regulation should be intelligent, purposeful, teleological—not an uncalculated incident of fiscal convenience. Certainly these criteria apply a fortiori to the institutions of marriage and family, which have traditionally been placed on a plane considerably above that of income, property and taxes. If it be inevitable that Congress legislate upon such subjects, let it do so advisedly and solemnly, after weighing the laws and customs of the various states and the probable impact of its contemplated fiscal design. In such instances, a commission of authorities, interested in social consequences rather than revenue yield, might be called to council. The values involved are prime; they should not remain mere fiscal by-products.

Powers of Appointment. Here again Congress advisedly sought a uniform national rule, and with a substantial measure of success. The Committee reports include such brave phrases as "regardless of the nomenclature used in creating the power and local property law connotations," and "to be construed so as to give uniform Federal application."[40] For present purposes, only two aspects of the new section 811 (f) are important: has it achieved complete uniformity and is it objectionable in the same sense as the alimony section, that is, does it crudely regulate a field reserved for state control?

The *Stuart*[41] opinion seems to refer most questions concerning wills, trusts and deeds to local law, a proposition which would have been self-evident to the framers of our Constitution.[42] But, in federal taxation, it is generally understood that local law enters the scene only by Congressional leave, only when, expressly or by "necessary implication," Congress adopts it as determinative of the particular gravamen. Perhaps the

39. See Cahn, *Federal Regulation of Inheritance* (1940) 88 U. OF PA. L. REV. 297.
40. *Report of the Finance Committee on H. R. 7378, supra* note 23, § 403.
41. Helvering v. Stuart, 317 U. S. 154 (1942).
42. See THE FEDERALIST (1788) No. 31.

phrase "necessary implication" has more than a single meaning. The "implication" may be "necessary" where the statutory language indicates legislative intent to point to local law. It may be equally "necessary" under Constitutional mandate, for as classifications for federal taxation drift farther and farther away from local property rules, they may eventually run afoul of the Fifth Amendment. The power of Congress to categorize for purposes of effectual tax administration is deservedly broad, but it is probably not without limits. The gap between property, as defined by local law, and taxable class, must be traversable by a bridge of reason.

Fortunately, the daily operations of the Commissioner and the courts prove more realistic than the fond hopes of Congressional committees. When local law seems clearly determinative, its appropriateness is taken for granted—all proclamations and admonitions to the contrary notwithstanding. When, for example, section 811 (f) (2) (B) says "if the power is not exercisable to any extent for the benefit of the decedent," it invites resort to local law—coincidentally, in precisely the respect involved in the *Stuart* case. When provision is made exempting powers "released" before a certain date, what other than local law can determine whether there has been a release?[43] And surely the most critical question involved in this section, namely, what classes of beneficiaries may be appointed under a particular will or deed, will be resolved in the light of state statutes and decisions. Here, at least, there is no "uniform federal application."

Of course, section 811 (f) has long influenced the forms of inter vivos and testamentary disposition. As amended, it will continue such regulatory effect with increasing force and intensity, for rates are higher and the section is much more explicit. But here, as has already been indicated, the subject is one of direct federal concern, involving as it does a device for the transmission of capital wealth. Thus, although there is regulation in the most obvious sense, it is warranted—if intelligent.

Section 811 (f) meets the objections which we raised to the alimony section. It follows the bend and flow of traditional distinctions, preserving them when they are substantial, passing over them when they are merely nominal.[44] It groups the taxable and segregates the exempt not

43. See U. S. Treas. Reg. 105, § 81.24. Various states have subsequently enacted statutes extending or clarifying the right to release and the appropriate procedure. See, *e.g.*, NEW YORK REAL PROPERTY LAW § 183. For a proposal to emancipate the problem from local law, see Alexander, *Taxation of Powers of Appointment under the Revenue Act of 1942* (1943) 56 HARV. L. REV. 742; Griswold, *Powers of Appointment and the New Revenue Act—A Foreword* (1943) 56 HARV. L. REV. 739. The rebuttable presumption of releasability conferred by the regulations goes about as far as federal rules permit. Many incongruities would arise if powers were conclusively releasable for purposes of the estate tax, though demonstrably not susceptible of release under local law.

44. See Griswold, *Powers of Appointment and the Federal Estate Tax* (1939) 52 HARV. L. REV. 929, for the motifs of the new statute. Much material of value in interpre-

according to arbitrary lines or mere administrative convenience, but with sensitive fidelity to the economics and the ethics of its topic. If transactions are taxed which previously escaped, the reason for the new categorization is evident. For example, the conveyancer's metaphysics of *Helvering v. Grinnell* [45] has been discarded by the amendment. Finally, when rights and duties under local law determine tax incidence, this section does not forbid resort to statute and decision, or, like section 120, confine the Court's view to the words and terms of the particular instrument.

Community Interests. The 1942 Revenue Act whittles off the first segment of special privileges enjoyed by residents of community property states. A new section 811 (e) (2) provides that all of the community interests, instead of the former one-half thereof, shall be included in computing a decedent's gross estate for death tax purposes. Here again the Committee reports dismiss local law from the scene.[46]

But the statute itself attempts no such dismissal. It speaks of property "held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country" and thus directly compels resort to local law for the categorization of any particular item. The delineation of the marital community varies considerably from state to state,[47] and so will the application of the section. Moreover, the second sentence of section 811 (e) (2) provides that the taxable community interest shall in no case be less than the share which "was subject to decedent's power of testamentary disposition." [48] This particular minimum is clearly a function of local law.

Section 811 (e) (2) excepts from the community interest "compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property." These exceptions might seem to invite difficulties, for their classification varies from state to state. But the section is skillfully drafted. It excepts such part of the interest held as community property. Hence the operation here is very clear: determine whether an item is or is not community property under substantive rules of local law; in this process, the cus-

tation of the new statute is to be found in Eisenstein, *Powers of Appointment and Estate Taxes* (1943) 52 YALE L. J. 296, 494.

45. 294 U. S. 153 (1935).

46. *Report of the Finance Committee on H. R. 7378, supra* note 23, § 402.

47. Compare, for example, CAL. CIVIL CODE § 162-72a, with LA. CIVIL CODE arts. 2386-2404.

48. Query whether the LA. CIVIL CODE arts. 1493 *et seq.*, creating "forced portions" for children and others, puts such property beyond the testator's power of testamentary disposition under the second sentence of section 811(e)(2)? As the decedent has certain testamentary control over the manner of payment of such portions and may, under specified circumstances, LA. CIVIL CODE arts. 1617 *et seq.*, disinherit entirely, the answer should be negative.

tomary presumptions attach to the Commissioner's findings and may not be offset by contrary state presumptions;[49] if an item is thus found to be community property, it may still be excluded by actual proof (without aid of local presumptions) of identity or origin within the excepted class; then the effect of the minimum provision under the second sentence is determined, substantive doctrines of local law again being applied, after the presumptions involved in the Commissioner's findings have been given effect. In these proceedings, the Commissioner may be found on either side of the fence. Especially where the wife dies first, he will contend for classification as community property. Taxpayers, who have always cut their cases to their pocketbooks, are slowly beginning to recover from the shock induced by the Commissioner's doing likewise.

What has been achieved here is not literal uniformity, but rather a fine measure of equality and fairness. Local law still pervades estate taxation of community property, but the variations will henceforth conform to the economic facts of the situation. Taxes will fall, as they ought, upon those who own, control or enjoy. The superficial uniformity that ignores local diversity is not to be found here. Uniformity of burden and incidence has been attained. And in a federal system this would appear the only legitimate objective.

Estate Tax Deductions and Miscellaneous Other Topics. It will be observed that the problems involved in the "uniformity" concept have little to do with local nomenclature and, in fact, begin to disclose their true nature only when that nomenclature is thrust aside. The *Pelzer*[50] decision introduced just such a chain of development[51] when it established a national definition of "present" interests for purposes of the gift tax exclusion. Local labels were discarded, but the substance and essential character of particular interests continued to be drawn from state law.

49. Resort to "explanatory legislative history" is warranted despite the apparent clarity of the statute. See Harrison v. Northern Trust Co., 317 U. S. 476 (1943). *Cf.* Radin, *A Short Way with Statutes* (1942) 56 HARV. L. REV. 388. We may accordingly rely upon the Committee reports to the effect that "state presumptions are therefore not operative against the Commissioner." See *Report of the Finance Committee on H. R. 7378, supra* note 23, § 402. The effect is cancellation of the authority of Howard v. United States, 125 F. (2d) 986 (C. C. A. 5th, 1942), in which the taxpayer was permitted to eke out inadequate proof by use of the local presumption. The pertinent rebuttable presumption of LA. CIVIL CODE arts. 2404, 2405, is clearly not a local property rule, and was mistakenly accorded weight in a case arising under federal law. Moreover, as such disputable presumptions are mere local rules of evidence, they should not be available to the Commissioner despite his greater difficulty in ascertaining and proving the true facts. The ordinary presumptions in favor of the Collector (regularity of exaction) and of the Commissioner (correctness of findings) are sufficient.

50. United States v. Pelzer, 312 U. S. 399 (1941).

51. See Smith v. Commissioner, 131 F. (2d) 254 (C. C. A. 8th, 1942); Commissioner v. Lowden, 131 F. (2d) 127 (C. C. A. 7th, 1942).

Moreover, many of the complaints raised by enthusiasts for uniformity may be traced not to local law but to unwise construction of federal law. It is rather late now to criticize the line of cases reversed by section 405 of the 1942 Revenue Act, limiting estate tax deductions to the amount of estate property available to pay them, but it may fairly be said that their rule was both unfortunate and unnecessary.[52] Section 405 rescues the subject from its former fantastic condition, imposed by the circuit courts.

But where is the uniformity? Surely the allowable deductions will vary more than ever from state to state, along with local rules of exemption and payment of debts. In fact, the new section uses the phrase "under the applicable law," to wit, the law of the jurisdictional situs. In the superficial sense, the new version of section 405 has contributed nothing to "a nationwide system of taxation."

Viewed from the standpoint of equitable taxation, however, the amendment is excellent. It establishes a principle which, while variable in its local application, inevitably results in justice and fair treatment. This is the highest type of fiscal uniformity, one which consists not in calling disparate things by the same name but in classifying and grouping them under an unchangeable rule of reason. Only in mathematics is equality a synonym for identity. If, then, taxpayers under different local systems are treated equally, if the tax burden is fairly shared without regard to mere geography, uniformity in its substantial sense has been achieved.

Such accomplishments are the result of patient study for which good intentions are no substitute. They must be sifted and thought through, delayed, if necessary, in enactment until their consequences are safely predictable. An instance in point is the confusion exemplified by the *Del Drago* case, in which the New York Court of Appeals held that Congress had preëmpted the ultimate apportionment and incidence of the federal estate tax and that a state statute of apportionment was therefore unconstitutional.[53] The Supreme Court reversed this decision,[54] for although the Internal Revenue Code contains incidence provisions[55] covering small portions of the federal estate tax, the balance thereof is left to local disposition. The Code incidence provisions are completely without system. Hence, doubts as to constitutionality of local incidence statutes; hence, separate federal causes of action governing only part of the federal estate tax;[56] hence, probable conflicts between state and federal rules of apportionment as to exemptions, widows' shares, life estates and the like. And even while the *Del Drago* case was pending in the courts and focusing

52. See Helvering v. O'Donnell, 94 F. (2d) 852 (C. C. A. 2d, 1938).
53. *In re* Del Drago's Estate, 287 N. Y. 61, 38 N. E. (2d) 131 (1941).
54. Riggs v. Del Drago, 317 U. S. 95 (1942).
55. See INT. REV. CODE § 826(b)(c) (1939).
56. See United States Trust Co. v. Sears, 29 F. Supp. 643 (D. Conn. 1939).

attention on these confusions, Congress added to them by adopting the new section 826 (d).

Obviously, these incidence provisions cannot stand as they are. They may be expanded to cover the entire federal estate tax, or they may be repealed. Since the present tax is imposed on the transmission rather than the receipt of inheritance, the latter course would seem preferable. In any case, this area should belong wholly to one or the other jurisdiction, not piecemeal to both. If the federal courts eventually do assume exclusive jurisdiction, they will find state law indispensable as to the meaning and effect of individual wills, even as to the purport of a clause directing apportionment of the tax.[57]

Finally, we are entitled to ask whether disregard of local law serves the interests of the Treasury. In such cases as the *Wurlitzer*[58] and *Keiffer*,[59] it was local law that brought in the tax upon transactions which would have otherwise been exempted. These transactions were formed and shaped by peculiarities of local policy until they fitted into taxable categories. The Commissioner raised the issue of state law and prevailed. If he had not, avenues of tax avoidance would have been opened. It seems more valuable to close those avenues than, by shutting our eyes to the realities of the case, to attain a standard of impeccable uniformity. Taxes concern practical matters, such as the incidents of right and duty created by local law.

Summary. These illustrations make clear that absolute uniformity is not attainable. A federal poll tax might come close, for individual human beings are irreducible integers. Under the Constitution, however, such a tax must be apportioned according to census of the entire population, so that uniform imposition would involve collection from infants, aliens, paupers, and so forth. Even these extreme measures, obviously unjust and inadequate as revenue sources, could not effect perfect uniformity, in view of the variation of the value of the dollar from time to time and from state to state. Uniformity is at best a limit to be approached, not an objective to be achieved.

---

57. See Farmers' Loan & Trust Co. v. Winthrop, 238 N. Y. 488, 144 N. E. 769 (1924), *cert. denied*, 266 U. S. 633 (1925).

58. Rudolph Wurlitzer Co. v. Commissioner, 81 F. (2d) 971 (C. C. A. 6th, 1936).

59. Felicie G. Keiffer Estate, 44 B. T. A. 1265 (1941). *Accord*, Howard v. United States, 125 F. (2d) 986 (C. C. A. 5th, 1942). It is interesting to note that the statute involved in these cases, LA. CIVIL CODE art. 1749, was subsequently repealed. See LA. CIVIL CODE (Supp. 1942) arts. 1749.1-.3. Perhaps the repeal was only *post hoc*, but one may be permitted the surmise that it was also *propter hoc*. Thus federal taxation influences the shape of state civil laws and may serve to destroy old established institutions. This particular statute had been part of the Louisiana Code since 1808, having been derived from the Code Napoleon. See 3 LOUISIANA LEGAL ARCHIVES (1940) pt. I, 963-64. If there were non-tax reasons for its repeal, the local legislature does not appear to have perceived them prior to these decisions.

We have noted the senses in which uniformity is desirable. In the first place, it helps to brush aside mere local labels and by the same token aids in the quest of economic substance. So viewed, uniformity is simply an instrument in the armory of concepts by which courts seek to break through appearance to reality.[60] In the second place, the desire for uniformity makes Congress and the courts more sensitive to the existence of special privileges and keener in the formulation of techniques for their removal. This is again a utilitarian value. In short, uniformity is not a final good, to be sought at all costs, but an intermediate good, useful to the extent that it serves larger ends. A federal philosophy requires room for diversity,[61] and local variations are not incompatible with a just tax system.

III.

We now consider the problems incident to determination of applicable local law, including the procedures involved in ascertaining the law of a particular state, conflict of laws issues, and the function of the Supreme Court in such processes. It is assumed for present purposes that local law governs as to some critical link in the chain of tax reasoning, that, expressly or by necessary implication, reference has been made to state rules, and that the court and parties are sufficiently aware of the issue [62] so that local law is not simply taken for granted.

A preliminary distinction should be made here. So intensely have students and courts been preoccupied with the ramifications of *Erie Railroad v. Tompkins* [63] that little organized thought has been accorded to the wide area of federal jurisprudence which it does not touch. Even where the problem arises under a federal statute, local law may be determinative of the result. On a single day in January, 1943, the Supreme Court held local law to control in three unrelated cases involving bankruptcy,[64] taxation,[65] and public utility rates.[66] But even these instances,

60. See Cahn, *Taxation: Some Reflections on the Quest of Substance* (1942) 30 GEO. L. J. 587.

61. The resolutions adopted on Dec. 21, 1942, in memory of Justice Brandeis and presented to the Supreme Court by Judge Magruder, describe "one of his firmest convictions: that the strength of America lies in diversity, not uniformity; that local cultures and traditions should be preserved and fostered, a sense of local responsibility quickened, local leadership evoked and encouraged."

62. See Public Utilities Commission v. United Fuel Gas Co., 317 U. S. 456, 462 (1943).

63. See the articles and decisions collected in Zlinkoff, *Erie v. Tompkins: In Relation to the Law of Trademarks and Unfair Competition* (1942) 42 COL. L. REV. 955-66.

64. Harris v. Zion's Savings Bank & Trust Co., 317 U. S. 447 (1943).

65. Harrison v. Northern Trust Co., 317 U. S. 476 (1943).

66. Public Utilities Commission v. United Fuel Gas Co., 317 U. S. 456 (1943), in which jurisdiction rested primarily upon a federal right of action although diversity of citizenship also appeared.

which might readily be multiplied, do not begin to show the limitations of the *Erie Railroad* doctrine. What is more significant than the variety of examples governed by local law, despite lack of diversity of citizenship, is the broad territory in which a general federal law continues to reign. This federal common law simply cannot be exorcised.

In the field of taxation, general law concepts are frequently used to bulwark theories peculiar to that field. For example, if brothers create simultaneous reciprocal trusts, each containing provisions which were inspired by the presence of comparable provisions in the other, resort will be had to chancery jurisprudence to achieve the desired tax result.[67] The doctrines of the equity courts will be employed, not merely as instances of analogous treatment of such arrangements, but as demonstrative of the true and substantial relationships involved. In the same manner, the federal courts will apply the common law canons of construction to wills, deeds or statutes, all quite without evidence that these canons exist in any specific local law.[68] In fact, most federal statutes would be incomprehensible if the framework of modern common law, and of twentieth century capitalism, were not assumed. It will be seen that these powerful assumptions play a cogent role in the ascertainment of applicable local law.

Local Law as a Question of Fact. Lawyers have become so accustomed to calling foreign law a question of fact [69] that they would be disturbed by any other characterization. It is, indeed, a strange species of fact, the determination of which involves expert testimony or affidavits to educate the judge, briefing and argument almost identical in technique with the presentation of issues of law, and decision in the form of a common law "finding" of the rule, which is announced in an opinion containing precedents, citations, textbook and statutory references, and the balance of judicial paraphernalia for a holding of law. In the United States, the distinction between law and fact is further obscured because federal courts take judicial notice of state laws [70] and, in diversity of citizenship cases, they become courts of the respective states.

At the risk of missing some excellent entertainment in metaphysics, we shall by-pass this question. Whether local law is an issue of law or of fact, or a "mixed issue of law and fact," is important only in terms of

67. See Lehman v. Commissioner, 109 F. (2d) 99 (C. C. A. 2d, 1940).

68. See, for example, the dissenting opinion in Helvering v. Stuart, 317 U. S. 154, 171 (1942).

69. See Morris, *Law and Fact* (1942) 55 HARV. L. REV. 1303. The distinction between law and fact is currently most conspicuous in determining the scope of judicial review of administrative findings. See Brown, *Fact and Law in Judicial Review* (1943) 56 HARV. L. REV. 899.

70. See Morris, *loc. cit. supra* note 69.

concrete corollary propositions of procedure. These corollary propositions, the rules of law in operation, cannot be subsumed under either premise without losing much of their pragmatic value. A working system is usually indefensible in pure reason. We shall endeavor to state some of the rules and leave the superthéory to the ether.

This much at least is clear: where local law prevails, it is not to be deemed incorporated by reference into the federal tax statute so as to become a matter of federal law. Rather local law determines some ultimate fact which, in turn, determines liability under the federal statute. For instance, in the *Stuart* case,[71] the critical question was not the state of Illinois law or the ambiguity in Illinois decisions. For federal tax purposes, the critical question was whether the corpus of the *Stuart* trust might be revested in the grantor. Of course, it was necessary to consider Illinois law in order to decide this latter question, but that circumstance did not convert the Illinois law into anything more than an efficient cause of the true gravamen of taxation. The operation of local law is strictly that of a premise in a syllogism, of which the conclusion will be the ultimate taxable, or non-taxable, fact. For example, if a mother creates a trust, the income of which is payable to her children, she may be taxable as to the income if she is responsible for her children's support. Her responsibility for her children's support is the critical fact. That fact is and should be ascertained in terms of local law. Local law thus does not create federal tax liability: its function is to determine independent juridical relations upon which Congress may or may not choose to fasten a tax. In terms of this analysis, the majority of the Supreme Court correctly regarded the *Stuart* proceedings in the circuit court of appeals as determining an issue of "fact" as to Illinois law, but characterized the conclusion below inaccurately as "a finding of the ultimate fact." The "ultimate fact" was the impossibility of the fund's return to the grantor. The ellipsis in reasoning, which is perfectly apparent, tends to disguise the true function of local law.

It is hardly necessary to repeat here all that has been written on the application of the *Erie Railroad* case to pleading, evidence and burden of proof. Although the case does not purport to control our topic, its implications as to sources of local law are customarily observed.[72] The federal courts in tax cases, as in other fields of law, exercise a wide measure of judgment and discretion in their ascertainment of state law and are by no means bound to a mechanical or imitative technique.[73] Actually, the net result is very frequently in terms of general common law con-

71. See Helvering v. Stuart, 317 U. S. 154, 162 (1942).

72. Sometimes, as in the *Howard* case, the *Erie* doctrine has had a confusing effect. See note 49 *supra*.

73. See Zlinkoff, *loc. cit. supra* note 63.

cepts with local cases thrown in for appearance and good measure.[74] There are, of course, specific problems peculiar to tax litigation which require particular mention.

In the first place, the presumption attaching to the Commissioner's findings embraces every link in the chain leading to the assessment. Thus local law may be presumed either to conform to or differ from general law,[75] as may serve the interests of the Treasury in the special case. Since the taxpayer relies more often upon exceptions or peculiarities of his own local law, the Commissioner is usually seen to resist these exceptions and to contend for propositions of general application.

The cases show that there is virtually no limit to the types of evidence by which local law may be proved. Statutes, ordinances, legislative history, decisions, textbooks and law review articles are frequently referred to.[76] It is interesting to note that judges' common law background is reflected in their emphasis upon decisions rather than upon statutes. Perhaps they have learned how easily one can squeeze through, burrow under or clamber over legislative language. In any event the broad statement seems justified that decisions will be expansively, statutes restrictively, construed.

These considerations are intimately tied up with the burden of proof as it may fall in the particular case. Prior to *Pearce v. Commissioner*[77] the Supreme Court had established the rule as to burden of proof in alimony trust cases. Whether the Commissioner proceeded against the husband or the wife, the taxpayer had the burden of proof; but the husband was required to show by "clear and convincing proof" that his obligation of support had terminated while the wife had only to establish doubts and uncertainties as to discharge of the duty of support under local law.[78] The *Pearce* case demonstrated how little this distinction could contribute to the development of a workable rule. The majority of the Court proceeded to enlarge the area of the wife's burden, rather than to permit her to profit by its previous holdings. It preferred to re-examine the Texas law and, finding that law uncertain as to the power of the local court to add to the husband's obligations, nevertheless assessed the tax against the wife for lack of proof that the local court also had power to remake the particular consummated property settlement. Thus, as frequently occurs in the various fields of private law, a shift in the scope and burden of proof effected a shift in the applicable rule of substantive law.

74. See, for example, Colston v. Burnet, 59 F. (2d) 867 (App. D. C. 1932). As to the vitality left in *Swift v. Tyson*, see Clearfield Trust Co. v. United States, 318 U. S. 363 (1943).

75. See Helvering v. Fitch, 309 U. S. 149 (1940).

76. The Chief Justice's phrase is "all available data." See Helvering v. Stuart, 317 U. S. 154, 171 (1942).

77. 315 U. S. 543 (1942).

78. See Comment (1943) 56 HARV. L. REV. 428, 438.

It is no longer important whether the majority was correct in the *Pearce* case. The Revenue Act of 1942 [79] has rendered the principle problem academic, but it is still of significance that the requirement of "clear and convincing proof" on the one hand as against mere doubts and uncertainties on the other creates an unworkable technique of procedure. Federal courts generally assume that there is discoverable local law on every conceivable proposition. It is their duty to find it. Insofar as local law contributes to the determination of a critical fact involving federal tax liability, the burden of proving it as against the Commissioner's presumption should not vary from taxpayer to taxpayer. The Commissioner's determination being prima facie correct, all taxpayers should have the same burden of rebutting it. Departure from this policy will lead to further confusion comparable to that of the *Pearce* case. A presumption in favor of anyone other than the Commissioner must eventually be honored in the breach.[80]

Availability of State Law. To what extent is the burden of proof met by production of a local judgment or decree determinative of the same set of facts? This question, simple on its face, presents no little embarrassment to the federal judiciary. On the one hand, there is the deference naturally owed to a state court and the respect due to the parties' reliance upon by its decree. On the other hand, experience shows how frequently "constructions" are obtained upon the suggestion of the parties in proceedings which, if not collusive, are at least "friendly." Then again, the federal courts, in cases not involving diversity of citizenship, are generally reluctant to vie with state tribunals in the ascertainment of state law because the state judge is presumably better equipped for the task and because confusion must result from a conflict of views as to the local rule.

Faced with this dilemma, the federal courts have usually accepted the state decree unless its collusive nature appeared on its face.[81] Of course,

79. See section 120 of the 1942 Revenue Act.

80. Even such a presumption as that the common, but not statute, law of other common law jurisdictions is the same as that of the forum can lead to confusion; the Commissioner does not need it, and the taxpayer should be required to make out his case without a priori aids. But in cases where this presumption might be availed of, the desired result is often reached quite implicitly. See MERTENS, LAW OF FEDERAL INCOME TAXATION (1943) §§ 50.61-50.71, where instances of conflicting presumptions are discussed. The author concludes that the presumptions in favor of the Commissioner (like other recognized presumptions such as that of regularity of corporate action) has no evidentiary weight, that it does not create a "burden of proof," but simply a "burden of going forward." Although there is much judicial language to that effect, the conclusion seems to overstate actual practice, as illustrated by the *Pearce* case and summarized in Rule 32 of the Tax Court.

81. See PAUL, *op. cit. supra* note 9, at 46; PAUL AND MERTENS, *op. cit. supra* note 9, at 15; Freuler v. Helvering, 291 U. S. 35 (1934); Otto C. Botz, 45 B. T. A. 970 (1941), *appeal pending;* C. C. Harmon, 1 T. C. 40 (1942); cases collected in Helvering v. Rhodes' Estate, 117 F. (2d) 509 (C. C. A. 8th, 1941).

a decree obtained *ex parte* or by consent of adversary parties should prove nothing; but one resulting from a seriously contested proceeding in which opposing interpretations were argued or briefed is entitled to acceptance, even though secured during the pendency of the federal tax litigation and for use therein.[82] Requirements in the tax court should include: evidence of substantial opposition, at least to the extent of independent appearances by attorneys for parties having adverse interests or guardians *ad litem* for infants or incompetents; oral argument or submission of briefs; serious attention devoted therein to the presently pertinent issue, so that it shall not have been disposed of merely *en passant;* necessity of determining the particular issue, so that its disposition will not be obiter. If the taxpayer can establish these four propositions, the decree should be accepted as fixing local law. If he cannot, the presumption attached to the Commissioner's findings should not be rebutted by the decree alone. In the latter case, the decree remains evidentiary of the state rule, its weight to be measured in terms of all the circumstances, including the prestige of the particular state court.[83] The question here is not whether the issue was adjudicated in the sense of being res adjudicata, but how it was adjudicated.

To what extent may the Commissioner plead and prove local law for the purpose of invalidating an executed transaction? It is assumed here that the parties have completed the transaction and that they maintain its validity—for example, a sale which, if executory, would be unenforceable under the local Statute of Frauds. The problem is largely substantive, but its procedural implications make it appropriate for discussion at this point. Obviously, some transactions, objectionable in their nature, should not bind the Commissioner, while others, quite innocuous, should be free from attack.

The general rule is that the tax courts will give effect to executed transactions despite the Commissioner's contention of their invalidity under state law. Nor may the taxpayer plead the illegality of his own executed transaction, of another's transfer to him or of his transfer to another for an illegal executory consideration. The virtue of antecedents is not examined in the process of ascertaining economic consequences.[84]

Although the Commissioner cannot usually raise the local Statute of Frauds as to executed sales, he is permitted to do so as part of a broader

82. See Blair v. Commissioner, 300 U. S. 5 (1937).

83. See Brainard v. Commissioner, 91 F. (2d) 880 (C. C. A. 7th, 1937), *appeal dismissed,* 303 U. S. 665 (1938).

84. See Marbelite Corp. of America v. Commissioner, 30 B. T. A. 311 (1934), *aff'd,* 77 F. (2d) 713 (C. C. A. 9th, 1935); Joseph S. Finch, 23 B. T. A. 1153 (1931); Francis M. Camp, 21 B. T. A. 962 (1930). However, in a recent decision, the local Rule against Perpetuities was held available to the Commissioner to invalidate an inter vivos trust created by the decedent and thus to add the corpus thereof, less the value of an initial life estate, to the decedent's gross taxable estate. See Abby R. Smith, 1 T. C. 963 (1943).

attack on the characterization of the transaction. In *Colston v. Burnet*,[85] for example, the absence of a written memorandum in an alleged agreement between husband and wife was used as a makeweight by a skeptical court. But if the relations involved are of unimpeachable good faith, the tax courts will not disturb what the parties have done. Thus, although local law prohibits contracts between husband and wife, bona fide salaries paid by one to the other have been held deductible.[86]

There are, however, some instances in which the Treasury may rely on local law to invalidate completely executed transactions. These appear to fall into three principal classes: those in which the transaction violates such a strong rule of local public policy as to offend the judicial conscience;[87] those in which local law prevents the transaction from being "closed," as by giving an infant the right to revoke or rescind;[88] and those in which local law prevents the transaction from coming into legal existence, as by prohibiting the issuance of non-voting stock.[89] Of course, the most familiar instances fall under the first heading, involving such matters as gambling losses, payments for bribes, and the like. These, however, have little need of local statutes, for they are condemned by general common law doctrines.

Conflict of Laws. Assuming that the result of a federal tax litigation is determined by local law, what local law governs? This question has heretofore received little attention, perhaps because those interested in conflicts principles have been preoccupied with the problems of *Klaxon Company v. Stentor Electric Manufacturing Company*[90] and *Griffin v. McCoach*,[91] or because choice of law arises only interstitially in the tax courts. Whatever the reason, conflicts questions have lacked that detailed and meticulous study so characteristic of federal tax scholarship.

It will be remembered that the *Klaxon* and *Griffin* cases imposed upon federal courts the duty of applying local rules of conflicts as part of the local law which they were bound to administer. But these cases involved diversity of citizenship and, despite the generality of their language, do

85. 59 F. (2d) 867 (App. D. C. 1932).

86. See Samuel Shapiro, 29 B. T. A. 1012 (1934); Anna E. Riley, 29 B. T. A. 160 (1933).

87. This was one of the grounds of decision in Colston v. Burnet, 59 F. (2d) 867 (App. D. C. 1932). But the expenses of an illegal business, *i.e.*, one held illegal by a Post Office Department fraud order, have been deductible. Heininger v. Commissioner, 133 F. (2d) 567 (C. C. A. 7th, 1943). The existence of a federal "public policy" (under whatever name or label) can hardly be ignored. It may invalidate transactions in which local public policy finds no taint.

88. See note 59 *supra.*

89. See Rudolph Wurlitzer Co. v. Commissioner, 81 F. (2d) 971, 974 (C. C. A. 6th, 1936), for a noteworthy dissent.

90. 313 U. S. 487 (1941).

91. 313 U. S. 498 (1941).

not impinge upon the area of federal taxation. When Congress points to state law in the application of a tax statute, it impliedly leaves to the administrative and judicial machinery the task of ascertaining that law, that is to say, the problems of conflicts as well as of municipal law. Of course, it sometimes prescribes what are in effect statutory rules of conflicts, such as in the treatment of stock in domestic corporations owned by a non-resident alien.[92] Clearly, the power to levy taxes embraces the incidental means.[93] In general, however, conflicts problems are left to the courts.

The ordinary rules of conflicts, as developed in the nations of the western world, are highly abstruse and conceptual in nature and frequently inappropriate to such a pragmatic operation as the collection of taxes. What theories have evolved in the area of private international law are a compound of history, metaphysics, commercial convenience, accident and public policy. Perhaps the strongest single influence has been the intellectual desire for symmetry. In any case, the rules and canons of conflicts were not consciously designed to resolve tax cases, and their effectiveness for that purpose is purely coincidental.

The juridic developments of the last fifteen years illustrate these remarks. Tax courts have, in constitutional cases affecting state jurisdiction,[94] sharply modified the shape of traditional conflicts concepts, such as *mobilia sequuntur personam,* uniqueness of domicile and the categorization of rents. As time goes on, we may expect the extension of this process to choice of local law in federal tax litigation.

The implicit modification of rules of conflicts, which has already begun, is based on the assumption that taxable transactions have an independent economic situs. For tax purposes, the pertinent local law is that of the economic situs, whatever other law might govern the property or transaction in ordinary civil litigation. Conflicts questions are viewed as supererogatory and are simply avoided. For example, in *Lang v. Commissioner,*[95] the courts all assumed that domiciliary law determined the nature of premium payments upon life insurance policies, without regard to the place of contract, the place of performance, the clauses of the policies showing the parties' intent or any other circumstance which might control in a litigation between Lang or his beneficiaries and the insurance companies.[96] Lang's domicile fixed the economic situs of the payments. No alternative local law was considered.

92. See INT. REV. CODE §§ 862, 863 (1939).

93. See THE FEDERALIST (1788) No. 44.

94. See Guterman, *Revitalization of Multiple State Death Taxation* (1942) 42 COL. L. REV. 1249.

95. 304 U. S. 264 (1938).

96. In the certificate of the circuit court of appeals, no conflicts question was noted. See Lang v. Commissioner, 23 Am. F. Tax R. 1145 (C. C. A. 9th, 1938). Nor did the Board of Tax Appeals consider choice of local law, although at least four Lang policies

Such silent assumptions render difficult the task of a commentator. Propositions of law thus grow out of what the court does, without light from what it says. There are, however, a number of decisions in which conflicts questions have been explicitly determined, and these enable us to draw defensible conclusions. That the *Klaxon* rule has no application is quite clear, for the federal courts in tax cases continue to apply the rules of conflicts which in their opinion are best supported by reason and precedent. But reason, precedent and even economic situs may bow to the practical needs of an effectual tax system. For instance, when the consequences of corporate action are involved, the law of corporate domicile has been held to control, whatever the domicile of the individual stockholder.[97] And when the transaction is one of frequently recurrent nature, the courts will endeavor to apply a general presumption of local law in the interests of ease and uniformity.[98] These legitimate objectives are bound to qualify the traditional rules of conflicts. The presumption of a specific state rule, viewed either as the weight of authority or as the most easily administered, is a particularly provocative development.

The pull of economic situs has had an interesting effect upon "qualification" issues.[99] In those cases in which qualification is most significant, the tax courts have tended to look to the law of economic situs as determinative. This is, of course, what occurred in the *Fair* case,[100] in which the question was whether Cuban hypotecas constituted real estate located outside of the United States, and hence exempt from the federal estate tax. The circuit court "qualified" the hypotecas, in conformity with Cuban law, as real estate. That decision involved, not conflicts of local law, but the interpretation of a federal tax statute. Hence, although economic situs may afford a proper theoretical criterion of qualification when conflicts of local law are involved, it does not support the conclusion reached in the *Fair* case.

Two recent decisions illustrate the qualification problem in choice of local law. *Commissioner v. Skaggs*[101] involved the community or sepa-

were with the Mutual Life Insurance Co. of New York. See Julius C. Lang, 34 B. T. A. 337, 339 (1936). For the same general approach on this score, see Newman v. Commissioner, 29 B. T. A. 53 (1933), *aff'd*, 76 F. (2d) 449 (C. C. A. 5th, 1935), *cert. denied*, 296 U. S. 600 (1935); Cannon v. Nicholas, 80 F. (2d) 934 (C. C. A. 10th, 1935).

97. See Helvering v. McGlue's Estate, 119 F. (2d) 167 (C. C. A. 4th, 1941); Rudolph Wurlitzer Co. v. Commissioner, 81 F. (2d) 971 (C. C. A. 6th, 1936); Estate of Henry W. Putnam, 45 B. T. A. 517 (1941).

98. See Estate of Henry W. Putnam, 45 B. T. A. 517 (1941).

99. See Nussbaum, *Characterization in the Conflict of Laws* (1940) 40 COL. L. REV. 1461.

100. Fair v. Commissioner, 91 F. (2d) 218 (C. C. A. 3d, 1937), criticized 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION (1942) 125-27. See (1937) 37 COL. L. REV. 500; Note (1937) 46 YALE L. J. 687.

101. 122 F. (2d) 721 (C. C. A. 5th, 1941).

rate property status of rents of California lands owned by a resident of Texas. The court held that "the question whether property is real or personal is to be solved by the law of the place where it is *actually* located." Hence the rents were "qualified" in terms of California law. From the standpoint of the conflict of laws this decision was the sheerest *petitio principii*. Where the property was "located" was the very question posed by the circumstances. But the court was on the right path; it dismissed the usual notions of imputed situs as "too artificial and tenuous" and looked to economic realities.

Fooshe v. Commissioner[102] reached a comparable result, though on less substantial grounds. There the petitioner, a married man, entered into an agreement in Missouri calling for continued payment of certain renewal commissions on life insurance sold there, all as part of his future compensation for moving to California where he was to act as branch manager. The court held these renewal commissions to be community income because California law did not exclude from the marital community property to which the husband had an "inchoate right" before he entered the state. Whether the "doctrine of inchoate right" existed in Missouri or in general law was not considered. Thus, again, the conclusion appears to violate fundamental principles of qualification and to beg the critical question in the case.[103] But whatever the reasoning, the result is sound. Petitioner's services were rendered in California; his agreed compensation was the exchange for those services—hence the right to renewal commissions had, as to him, its economic origin in that state.

We may conclude, therefore, that federal courts in tax cases employ the customary rules of conflicts, unhampered by the *Stentor* doctrine, but modified by the concept of economic situs and by devices designed for ease of administration, such as the presumption of conformity of local law to the general rule. These factors can hardly be compartmentalized; they will inevitably leak over into other divisions of the law, and their realistic influence should be all to the good.

Function of the Supreme Court. Three recent decisions, two in the field of taxation and the third in constitutional law, illustrate the subtleties in federal relations, created by local law. In the *Pearce* case, the majority of the Supreme Court investigated and found its own version of Texas law. In *Helvering v. Stuart*,[104] the majority declined to reexamine the finding of the circuit court of appeals as to local law. In *Public Utilities Commission v. United Fuel Gas Company*,[105] the majority

102. 132 F. (2d) 686 (C. C. A. 9th, 1942). *Cf.* Cerf v. Lynch, 237 App. Div. 283, 261 N. Y. S. 231 (1932), *aff'd*, 262 N. Y. 549, 188 N. E. 59 (1933).

103. See RESTATEMENT, CONFLICTS OF LAWS (1934) § 7. See for analysis and criticism, Robertson, *A Survey of the Characterization Problem in the Conflict of Laws* (1939) 52 HARV. L. REV. 747.

104. See 317 U. S. 154, 165 (1942).

105. 317 U. S. 456 (1943).

made its independent determination of Ohio law—but with explicit reluctance and only because of the felt pressure of "public interest." It is difficult to reconcile the positions of the individual Justices in these respective decisions. That of Mr. Justice Frankfurter shows the most consistency —dissenting in the *Pearce* case, joining with the majority in the *Stuart* case, and expressly yielding to the exceptional compulsion of the facts in the *United Fuel* case.

Every consideration in the normal case deters the Supreme Court from "becoming a Court of first instance for the determination of the varied rules of local law prevailing in the forty-eight states." [106] In the first place, the circuit court is presumed to be well informed on the subject since the pertinent local law is usually that of a state within its particular circuit. One or more judges of the circuit court may be members of the bar of the state in question, and, in any event, education in state laws is an inevitable consequence of sitting on the circuit bench. Secondly, the Supreme Court cannot "make" state law by its independent inquiry, but may embarrass, offend or confuse.[107] Thirdly, the task of finding local law is incompatible with the business of the Court and with the calibre of the issues which it considers. State law, as observed above, serves only to determine circumstances and relations upon which Congress may choose to fasten a federal tax. Its influence in the litigation is, therefore, less than immediate. Finally, there are forty-eight states, and their laws change and evolve from year to year. Thus practical considerations as well as deference to federalism should induce the Court to refrain from determining local law, however tempting this task sometimes may be.

But even this good rule has its exceptions. When, for instance, large matters of public interest are involved, the Court's duty extends to indirect and remote contributing causes. The dimensions of public interest may be determined by considerations of political morality or by federal apportionment of power or by actual revenue results. When in a particular case these factors assume impressive proportions, the Supreme Court will not be deterred from its own inquiry into local law. *Poe v. Seaborn* [108] offers a good illustration. There, circumstances invited the Court to examine an institution, community property, common to several states, peculiar in its historic derivation, and of far-reaching fiscal significance. Whether or not the result was correct, the issues were large enough to merit disposition by the Supreme Court, disposition which has guided the several circuits in which community property cases frequently arise.

106. Helvering v. Stuart, 317 U. S. 154, 164 (1942).

107. See Railroad Commission v. Pullman Co., 312 U. S. 496, 499 (1941). Where local (procedural) law determining the appropriateness of remedy or the finality of state action is in doubt, remanding the case to the state court is appropriate. See Whitman v. Wilson, 318 U. S. 688 (1943).

108. 282 U. S. 101 (1930).

It should be noted, however, that such instances are so rare that they support, rather than impair, the general rule.

The Supreme Court might consider the practicability of sanctioning a rebuttable presumption of the uniformity of local rules. As we have indicated, the Tax Court seems to gravitate toward such a presumption. Perhaps that policy will aid the Commissioner in the performance of his duties and facilitate the determination of doubtful cases. A general federal rule, subject to rebuttal only upon clear demonstration of local law to the contrary, might reduce the problem of state diversity to its proper and justifiable proportions. Perhaps this was the motive underlying the Chief Justice's dissent in *Helvering v. Stuart*. But the suggestion should be viewed with great care, for it involves all the complexities which culminated in the *Pearce* case. Presumptions which may clash with that in favor of the Commissioner's findings are undesirable.

There is one distinctly valuable service which the Supreme Court could render to the sound administration of local law in federal tax cases. As indicated, the circuit courts are groping toward tenable rules of conflicts in those litigations in which choice of state law is involved. The criteria have not become fixed, for the influence of economic situs upon traditional conflicts concepts is as yet only implicit. Guidance by the Supreme Court in the form of general propositions seems particularly appropriate.[109] Until such propositions are established, the selection of applicable local law will remain uncertain and speculative.

Fundamentally, the Supreme Court as head of the administrative hierarchy cannot afford to expend its energies on mere reproduction or repetition of the functions of subordinate bodies. With respect to our topic, its business consists first of the disposition of those matters of local law which materially affect the federal tax system, and second, of furnishing standards of guidance to the remainder of the assessment machinery. We may hope that it will perform these functions in the instant field, as it has done elsewhere.

IV.

Uniformity is more easily described than promoted. Once its virtues have been summarized and its inescapable limitations perceived, we naturally look for concrete measures of improvement. The objective surely deserves most serious reflection, influencing as it does both fiscal returns and equality of burden. Moreover, in a world of rapid and sudden change, tax systems must be susceptible of quick conformance to new and unexpected conditions. Only if the tax structure displays a high degree of

109. We have the scintilla of a beginning in the *Stuart* majority opinion, where the Court points out that Illinois "is the residence of the parties, the place of execution of the instrument, as well as the jurisdiction chosen by the parties to govern the instrument." Helvering v. Stuart, 317 U. S. 154, 162 (1942).

uniformity in operation, can it be readily adapted to shifts in the economic scene and in the needs of government. What are the sources from which greater uniformity may be expected to flow?

The Congress. Mr. Paul has called attention to the varieties of situations which "afford an obvious opportunity for Congress to indicate more specifically, by the very language of the federal statute, whether state law is to be respected or ignored." [110] While in the same study, he warns against excessive "specificity in the terminology of federal statutes," his general recommendation retains its force and value. The insertion of a simple phrase, such as "under applicable law," [111] at the right place in a revenue act will sufficiently indicate intent to point to local law. On the other hand, if Congress desires to ignore local differences and distinctions, a statement to that effect in the committee reports will usually suffice.[112] Definitions by statute are exceedingly dangerous and should be approached with great trepidation.

In a recent article [113] the suggestion was made that Congress adopt federal rules of conflict of laws. We are here concerned only with the validity of that suggestion as it relates to taxation. Clearly, however, conflicts rules suitable to ordinary litigation will prove inappropriate if imported into tax proceedings. It has been shown that conflicts questions in tax cases have their own peculiar aspect, colored as they are by considerations of a unique character, deeply pragmatic and anti-conceptual. They evolve and change from time to time, along with modifications in the general tax structure. They should not be bound down by legislative formalization. Here, at least, flexibility is more valuable than certainty.

When we come to the adjective side of the question, we find more concrete hope of promoting uniformity. The creation of a single appellate tax court, as recommended during the past several years,[114] would undoubtedly forward this purpose. This proposal has elsewhere been treated in detail and does not require extended discussion here. Its merits are by no means confined to the present topic. That a single appellate court would serve to reduce variations and differences in the incidence of taxation is hardly disputed, even by those who question the reform on other grounds.

The Courts. Accurate demarcation of the area allotted to local law is largely a judicial function. The Supreme Court in the *Stuart* case outlined a segment of that area, that is to say, rights arising out of wills,

110. See PAUL, *op. cit. supra* note 9, at 31.

111. Compare INT. REV. CODE § 812(b) (1939).

112. See Harrison v. Northern Trust Co., 317 U. S. 476 (1943).

113. See Schoch, *Conflict of Laws in a Federal State: The Experience of Switzerland* (1942) 55 HARV. L. REV. 738.

114. See Traynor, *Administrative and Judicial Procedure For Federal Income, Estate, and Gift Taxes—A Criticism and a Proposal* (1938) 38 COL. L. REV. 1393. See also PAUL, *op. cit. supra* note 9, at 51.

trusts and decedents' estates. These elements of personal law are highly indigenous in their nature and most intimately reflect the interest of the respective states in the welfare and property of their citizens. Such local law is entitled to particular regard. But this policy is susceptible of abuse. It may be used to create local institutions involving tax privilege, where nothing in the mores of the state justifies such action. If the courts then extend federal tax benefits to such institutions, they make themselves instruments of inequality and by the same token impair the legitimate operation and prestige of local law.

For example, the Tax Court has recently accorded the customary income tax privileges to the Oklahoma "optional community property" system.[115] In so doing, the Court rejected several contentions of the Commissioner, including one to the effect that the peculiar provisions of the Oklahoma statute created a marital community in form only. Each spouse retains, under Oklahoma law, such extensive control over community property standing in his name, that the marital partnership can be regarded as a mere legal figment without substance.[116] Moreover, the Oklahoma community is "optional"; hence, only those spouses who agree in writing to hold their property by community tenure are drawn without the common law status.

This element requires more than passing thought. The Tax Court disposed of it quite summarily. No distinction was seen between a community property system operative only if invoked, as in Oklahoma, and one operative unless expressly revoked, as in the traditional community property states. But here, in terms of our analysis, we have a distinction with a substantial difference. Assuming by way of hypothesis that *Poe v. Seaborn*[117] remains good law, the community property systems to which it was intended to apply embodied tradition, history, local mores, and statewide application. That these institutions permitted spouses to avoid community tenure by express agreement, only served to prove the general state rule. Local law was declared by the Supreme Court, in deference to the scope and depth of that general rule, to control the situation. The rationale of *Lucas v. Earl*[118] was deemed avoided, not by the skillful election of individual arrangements, but by the structure and essential nature of state institutions. Whatever its label, a community property

115. See C. C. Harmon, 1 T. C. 40 (1942), followed in several Tax Court memorandum decisions.

116. The Oklahoma community would appear to be one for federal tax purposes only. The wife's complete power of control and disposition over community property standing in her name and the freedom thereof from liability for the husband's debts are hard to reconcile with the statutory label, or with the purely theoretical protestation that each "shall be vested with an undivided one-half interest" in the community property. 32 Okla. Stat. §§ 8, 56, 57, 58 (1941).

117. 282 U. S. 101 (1930).

118. 281 U. S. 111 (1930).

system operative only if invoked by private contract is an anticipatory arrangement for the shifting of income, unsupported by the philosophy of *Poe v. Seaborn.*

It is because local law plays such a significant and irreducible role in federal taxation that courts must be loathe to extend exceptions or to credit peculiarities of state tenure. The criterion by which cases are to be classified is subtle at best; it should never become merely mechanical. Whenever the local statute appears to be inspired by the objective of special tax privileges, unrelated to historic institutions of the state, it must be examined with a high measure of skepticism. Otherwise, the decisions of recent years prohibiting anticipatory arrangements [119] for the transfer of income will be progressively undermined.

We have urged above that the Supreme Court should give special guidance as to choice of local law in federal tax cases. This, it seems, should be done as explicitly as possible. The Commissioner and the inferior courts would profit much from express holdings on conflict of laws issues. Incidental advantage by way of increased certainty would accrue to taxpayers and their counsel. These rules should be general in form and may be entirely free of local theories and eccentricities.

Historic Causes. What will best promote uniformity is the everlasting centripetal push within the United States. That push is now worldwide and may soon be expressed through international implements. From state to state, however, the process of coalescence becomes daily more apparent, as does the increasing artificiality of local boundary lines. This remedy is slow, but equally inevitable. Unitarianism of government will probably not result, but in human affairs it is the emphasis that instructs, and the emphasis is unmistakable.

Historic processes should be cultivated, not rushed. The time has hardly come to ignore in taxation the very real interests and relations which prevail in all other domestic activities. Local law is frequently the expression of profound psychological habits, from which men may be induced, but not compelled, to depart. In due course the consolidation of classes and the perception of national unity will erase these differences. The American will some day be emancipated from geographical accident. "But all this requires a conceived identification of one's interests with those of an unlimited community." [120]

119. See Helvering v. Horst, 311 U. S. 112 (1940); Helvering v. Eubank, 311 U. S. 122 (1940).

120. See PEIRCE, COLLECTED PAPERS (1931) 654.