



5-1-1951

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Recommended Citation

R. E. Fitzgerald, Joseph C. Spalding, Bernard J. McGraw & Robert A. Stewart, *Notes*, 26 Notre Dame L. Rev. 476 (1951).

Available at: <http://scholarship.law.nd.edu/ndlr/vol26/iss3/4>

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NOTES

Banks and Banking

ABILITY OF BANKS TO LIMIT LIABILITY BY CONTRACT

In an effort to limit the heavy responsibility which the common law imposes upon them, banking institutions frequently resort to exculpatory clauses in contracts with their customers. These clauses are found in stop-payment orders, and in contracts for the use of safe deposit boxes and night depositories. Banks are under a common law duty to honor stop-payment orders,¹ but safe deposit boxes and night depositories are extended services over and above the general business of banking, and do not subject banks to strict liability. It has been the contention of the banks, that in rendering these latter services, they should be allowed to protect themselves by contract because of the unique character of the relationship, and the lack of knowledge by the bank of the value of the deposit. The validity of these clauses has been attacked on the grounds of public policy, and as being contrary to accepted principles of the law of contracts and bailments. No general rule can be applied to all three situations since the validity of the clause depends on the relationship which the bank assumes—debtor, bailee or lessor.

I.

Stop-Payment Orders

The rule is settled that the drawer of an uncertified check may revoke his order to pay at any time prior to the payment of the check by the bank. The bank is bound by the revocation and after receiving notice it pays at its peril.² Banks have sought to limit this liability in one of two ways: by inserting an exculpatory clause in the pass-book, by which the clause becomes a part of the deposit contract,³ or in the stop-payment notice form.⁴ At common law a bank owed a duty to its depositors to act in good faith and with reasonable care in its regular banking relations with them. The exculpatory clauses attempt to limit the liability of the bank for negligence and inadvertence; if the clause is held valid, banks are liable only for a wilful disregard of the notice.⁵

¹ *Shude v. American State Bank*, 263 Mich. 519, 248 N. W. 886 (1933).

² 5 MICHIE, BANKS AND BANKING § 193 (Perm. ed. 1932); 34 VA. L. REV. 834 (1948).

³ 34 MINN. L. REV. 330 (1950); 33 MINN. L. REV. 179 (1949).

⁴ *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 Pac. 947 (1926); *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949); *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N. E. 488 (1932); *Gaita v. Windsor Bank*, 251 N. Y. 152, 167 N. E. 203 (1929).

⁵ *Gaita v. Windsor Bank*, *supra* note 4.

Courts of different jurisdictions,⁶ and even courts of the same jurisdiction,⁷ have viewed these clauses in different lights. A slight majority have upheld their validity on the broad tenet of freedom of contract.⁸ The courts declaring them invalid have attacked them on the ground of lack of consideration, or as contrary to public policy.⁹ The reasoning in support of both validity and invalidity appears strong and convincing.

Some courts make no mention of consideration¹⁰ while others find it where apparently there is none.¹¹ Courts which hold the exculpatory clauses invalid because of a lack of consideration have drawn a distinction between insertion of the clause in the passbook and insertion in the stop-payment order itself. If contained in the passbook it becomes a part of the original deposit contract, and it is well established that there is consideration in that situation.¹² When the clause appears on the stop-payment notice, there is debate as to whether there is adequate consideration to support it.¹³ It has been held that where the bank suffers no detriment and the depositor gains no benefit the clause is void for lack of consideration.¹⁴ In *Calamita v. Tradesmen National Bank*,¹⁵ counsel for the bank contended that the bank had a right to terminate its relationship with the depositor at any time, and that continuance of the relationship constituted consideration for

⁶ *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 Pac. 947 (1926); *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949); *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N. E. 488 (1932); *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N. E. 782 (1920); *Speroff v. First-Central Trust Co.*, 149 Ohio St. 415, 79 N. E. (2d) 119 (1948).

⁷ *Gaita v. Windsor Bank*, 251 N. Y. 152, 167 N. E. 203 (1929), *overruling* *Levine v. Bank of United States*, 132 Misc. 130, 229 N. Y. Supp. 108 (Mun. Ct. of N. Y. C. 1928); *Speroff v. First-Central Trust Co.*, *supra* note 6, *overruling* *John H. Mahon v. Huntington Nat. Bank of Columbus*, 62 Ohio App. 261, 23 N. E. (2d) 638 (1939).

⁸ *Martinez v. National City Bank of New York*, 80 F. Supp. 545 (D. Puerto Rico 1948); *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N. E. 488 (1932); *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N. E. 782 (1920); *Gaita v. Windsor Bank*, 251 N. Y. 152, 167 N. E. 203 (1929).

⁹ *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949); *Speroff v. First-Central Trust Co.*, 149 Ohio St. 415, 79 N. E. (2d) 119 (1948); Notes, *Invalidity of Clause Limiting Bank's Liability for Failure to Obey*, 44 ILL. L. REV. 530, 531 (1949); *Effect of Stipulations Relieving Banks from Liability for Failure to Comply with Stop-Payment Orders*, 28 NEB. L. REV. 437, 439 (1949).

¹⁰ *Martinez v. National City Bank of New York*, 80 F. Supp. 545 (D. Puerto Rico 1948).

¹¹ *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N. E. 488 (1932).

¹² 34 MINN. L. REV. 330 (1950).

¹³ *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949); *Speroff v. First-Central Trust Co.*, 149 Ohio St. 415, 79 N. E. (2d) 119 (1948).

¹⁴ See note 13 *supra*.

¹⁵ 135 Conn. 326, 64 A. (2d) 46 (1949).

the insertion of the clause in the stop-payment order. The court said the argument might have been valid if the bank had expressed a desire to terminate the relationship, but since it had not, there was no consideration; there must be an actual bargaining for the continuation of the relationship in return for the insertion of the exculpatory clause.

Judicial attacks upon exculpatory clauses proceeding upon the ground of public interest have been hampered by the lack of a clear line of demarcation between sound and unsound public policy. In *Hodnick v. Fidelity Trust Co.*, it was said:¹⁶

Whether or not a contract is against public policy is a question of law for the court to determine from all the circumstances in the particular case. . . . Agreements are not to be held void as against public policy, unless they are clearly contrary to what the Constitution, the Legislature or the judiciary have declared to be public policy, or unless they clearly tend to the injury of the public in some way.

Among the circumstances affecting the decision of the courts are: the wording of the clause itself, the intention of the parties, the location of the clause, the balance of bargaining power, and the social and economic benefits or detriments resulting from the use and enforcement of the clause.

Several forms of stop-payment notices reduce the "order" to a mere wish or hope: "the undersigned hereby requests,"¹⁷ "please endeavor to stop payment on my check,"¹⁸ "the undersigned makes the foregoing request as an act of courtesy only,"¹⁹ "please stop payment on Check No. 220,"²⁰ and the like. It should be borne in mind that in each of the foregoing the depositor had the intention to stop payment. It can hardly be assumed that the depositor intended to employ precatory terms to qualify the order when he had the absolute right to stop payment. Were not these notices actually meant to be unqualified to which the bank annexed the clause in an effort to escape a duty which it already owed the depositor?²¹ Are not these clauses mere snares for the unexperienced or uninformed depositor who does not know his common law rights or the legal significance of the clauses? The courts must answer these questions in deciding if the clauses are in accord with sound public policy.

Some courts have been reluctant to uphold the exculpatory clause when it appears *in the passbook*, placing it in the category of "traps for the unwary," analogous to special conditions or limitations printed

¹⁶ 96 Ind. App. 342, 183 N. E. 488, 491 (1932).

¹⁷ *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949).

¹⁸ *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N. E. 488 (1932).

¹⁹ *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 Pac. 947 (1926).

²⁰ *Gaita v. Windsor Bank*, 251 N. Y. 152, 167 N. E. 203 (1929).

²¹ *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949).

unnoticed on the back of railroad tickets. In *Los Angeles Inv. Co. v. Home Savings Bank of Los Angeles*, the court said:²²

In order for the bank to avail itself of the statement [in the passbook] as a contract made by the plaintiff, it was necessary for the bank to prove that the statement had been called to the attention of some responsible officer of the company. Without this it cannot be fairly said that it was accepted or consented to by the company.

Inequality of bargaining power is another argument advanced for invalidity. This contention possibly is weakened if the depositor need not do business with the bank in the first place. If he could transfer his account to another bank, in the course of time, competition would resolve the difficulty. However, when one bank in a district employs the clause the rest of the banks usually follow the same practice, and the depositor must deal with one of them. Also, the bank may be the only one in a small community or rural area. Consequently, the bank usually possesses superior bargaining power. There is always the argument that if the bank refuses to stop payment unqualifiedly the depositor may cancel his account and terminate the relationship in order to protect himself.²³ But regarding the bank as an entrepreneur, should it be allowed to exonerate itself from performing the acts it is paid to perform?

The typical exculpatory clause in a stop-payment order recites: "Should this check be paid through inadvertence, accident or oversight, it is expressly agreed that the bank will in no way be held responsible."²⁴ These clauses have been held to include every act of the bank except wilful disregard of the notice. Originally, it was settled that a bank could not limit its liability by contract to avoid the consequences of negligence,²⁵ but cases holding exculpatory clauses valid are ostensibly contrary to this general rule.

The most recent cases on the subject hold the exculpatory clause invalid. In *Speroff v. First-Central Trust Co.*,²⁶ a clause was held void for lack of consideration and as being contrary to public policy. In *Calamita v. Tradesmen National Bank*,²⁷ the court held it invalid for lack of consideration without deciding the public policy question. Both cases pronounce strong arguments for the invalidity of the clauses and may prove persuasive in those jurisdictions which have not yet passed on the question.

²² 180 Cal. 601, 182 Pac. 293, 298 (1919).

²³ *Gaita v. Windsor Bank*, 251 N. Y. 152, 167 N. E. 203 (1929).

²⁴ *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949); *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N. E. 488 (1932); *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N. E. 782 (1920); *Gaita v. Windsor Bank*, 251 N. Y. 152, 167 N. E. 203 (1929).

²⁵ *Levine v. Bank of United States*, 132 Misc. 130, 229 N. Y. Supp. 108 (Mun. Ct. of N. Y. C. 1928).

²⁶ 149 Ohio St. 415, 79 N. E. (2d) 119 (1948).

²⁷ 135 Conn. 326, 64 A. (2d) 46 (1949).

At the present time, the number of jurisdictions holding the clauses valid²⁸ slightly outnumber those jurisdictions holding them void.²⁹ Jurisdictions yet to pass on the issue will find respectable authority on both sides. A definite trend is yet to be established although the more recent cases hold the clauses void as unsupported by consideration, and as contrary to public policy. The much debated Uniform Commercial Code proposes that no agreement should limit a bank's obligation on written stop-payment orders.³⁰ Whatever the solution, the depositor should be protected and the bank allowed to make a fair return on its investment. The law should not hamper expedient banking practices, but neither should banks be permitted to take advantage of uninformed depositors.

II.

Safe Deposit Boxes

Exculpatory clauses in contracts for the lease of safe deposit boxes have been litigated in relatively few instances. When courts are presented with controversies involving loss of valuables from safe deposit boxes, they generally base their decisions on the law of bailments. The pivotal point usually is either the burden of proof or the degree of care required, the express terms of the exoneration clauses seldom being in issue. But where the exculpatory clause is the basis of a defense, policy considerations occupy the attention of the courts, much as they do in the cases involving stop-payment orders.³¹

In most jurisdictions a safe deposit company is deemed a professional bailee,³² whether classified as ordinary bailee,³³ bailee for hire,³⁴ special bailee,³⁵ or bailee for mutual benefit,³⁶ and the public's

²⁸ See note 7 *supra*.

²⁹ *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 Pac. 947 (1926); *Calamita v. Tradesmen National Bank*, 135 Conn. 326, 64 A. (2d) 46 (1949); *Speroff v. First-Central Trust Co.*, 149 Ohio St. 415, 79 N. E. (2d) 119 (1948).

³⁰ UNIFORM COMMERCIAL CODE § 4-103(1)(d) (Sept. 1950 revision).

³¹ *Sporsem v. First Nat. Bank of Poulso, 133 Wash. 199, 233 Pac. 641 (1925).*

³² *Saddler v. Nat. Bank of Bloomington*, 403 Ill. 218, 85 N. E. (2d) 733 (1949).

³³ *Bedford, State Treasurer v. Colorado National Bank of Denver*, 104 Colo. 311, 91 P. (2d) 469 (1939); *Takoma Park Bank v. Abbott*, 179 Md. 249, 19 A. (2d) 169 (1941); *Cohen v. Manufacturers Safe Deposit Co.*, 297 N. Y. 266, 78 N. E. (2d) 604 (1948); *In re Thompson*, 183 Misc. 168, 50 N. Y. S. (2d) 614 (Surrogate Ct. 1944); *Bank of California et al. v. City of Portland*, 157 Ore. 203, 69 P. (2d) 273 (1937); *Mitchell v. First National Bank of Confluence*, 136 Pa. Super. 467, 7 A. (2d) 513 (1939).

³⁴ *Hauck v. First Nat. Bank of Highland Park*, 323 Ill. App. 300, 55 N. E. (2d) 565 (1944); *Schmidt v. Twin City State Bank*, 151 Kan. 667, 100 P. (2d) 652 (1940); *Underhill v. United States Trust Co.*, 195 Ky. 149, 241 S. W. 812 (1922).

³⁵ *Blair v. Riley*, 37 Ohio App. 513, 175 N. E. 210 (1930).

interest in competent operation of safe deposit companies is recognized.³⁷ A few jurisdictions designate them landlords³⁸ or warehousemen.³⁹ By denominating a safe deposit company a professional bailee, the courts recognize that any clause which attempts to excuse negligence is detrimental to the public interest. Professional bailees who insert the exculpatory clauses in contracts are met by the underlying rule that a bailee may not contract away the consequences of his own negligence.⁴⁰ However, there is unanimity in holding that he is not an insurer.⁴¹

Where a safe deposit company is labeled a bailee, the burden of proving negligence becomes an important element. Generally, a bailor need merely prove delivery to the bailee, and the bailee's failure to redeliver, to make out a prima facie case.⁴² However, there is a distinction between the safe deposit bailment and the ordinary bailment. In the usual bailment, where the bailee knows the nature and approximate value of the property and exercises *exclusive* control over it, no hardship is imposed by requiring him to disprove his negligence by a preponderance of the evidence. But in safe deposit cases, where the bailee does not know the precise nature of the property, it has been suggested that the courts specify the relationship a quasi-bailment⁴³ and adopt a less stringent rule of evidence.

In jurisdictions characterizing the safe deposit company as a bailee, the tendency of the courts is to fasten liability on the defendant bailee on the theory that the contract should be construed most strongly against it.⁴⁴ In *Sporsem v. First National Bank of Poulsbo*,⁴⁵ the suit was by a depositor to recover for valuables stolen from a safe deposit box by burglars. The exculpatory clause recited that the bank:

³⁶ *Kramer v. Grand National Bank of St. Louis*, 336 Mo. App. 1022, 81 S. W. (2d) 961 (1935); *Moon v. First Nat. Bank of Benson*, 287 Pa. 398, 135 Atl. 114 (1926).

³⁷ See Note, *The Significance of Comparative Bargaining Power in the Law of Exculpation*, 37 COL. L. REV. 248 (1937).

³⁸ *Tow v. Evans*, 194 Ga. 160, 20 S. E. (2d) 922 (1942); *Kohlsaat v. First Nat. Bank of St. Paul*, 226 Minn. 471, 33 N. W. (2d) 712 (1948).

³⁹ *New Jersey Title Guarantee and Trust Co. v. Rector et al.*, 76 N. J. Eq. 587, 75 Atl. 931 (1910).

⁴⁰ *Pilson v. Tip-Top Auto Co.*, 67 Ore. 528, 136 Pac. 642 (1913).

⁴¹ *Hauck v. First Nat. Bank of Highland Park*, 323 Ill. App. 300, 55 N. E. (2d) 565 (1944); *Morgan v. Citizen's Bank of Spring Hope*, 190 N. C. 209, 129 S. E. 585 (1925); *Wilson v. Citizens Central Bank of Nelsonville*, 56 Ohio App. 478, 11 N. E. (2d) 118 (1936).

⁴² *Rosendahl v. Lemhi Valley Bank*, 43 Idaho 273, 251 Pac. 293 (1926); *Schaefer v. Washington Safety Deposit Co.*, 281 Ill. 43, 117 N. E. 781 (1917).

⁴³ VAN ZILE, *ELEMENTS OF THE LAW OF BAILMENTS AND CARRIERS* § 196 (2d Ed. 1908).

⁴⁴ *Saddler v. National Bank of Bloomington*, 403 Ill. 218, 85 N. E. (2d) 733 (1949).

⁴⁵ 133 Wash. 199, 233 Pac. 641 (1925).

. . . agrees to exercise the same diligence in the protection of said box and its contents against loss by fire or burglary that it uses in the protection of its own property, but assumes no liability whatever for any loss or damage that may occur.

The bank, relying on the contract, contended that evidence tending to show negligence in not preventing the burglary was inadmissible. The court ruled out this contention categorically stating that it was against public policy to permit a bailee for hire to exempt himself from liability for his own negligence.

In *Schaefer v. Washington Safety Deposit Co.*,⁴⁶ the clause provided that the liability of the bank was limited to the exercise of ordinary care in preventing unauthorized persons from opening the box. The court stated that if the clause purported to excuse negligence in any other respect, it would be ineffective as against public policy. In *McDonald v. Wm. D. Perkins & Co.*,⁴⁷ the construction of an exculpatory clause was not necessary to the decision, but the court noted in dictum the inability of a safe deposit company to exempt itself from the consequences of its negligence.

When a layman rents a safe deposit box, it is hardly conceivable that he fully understands the legal consequences of the various clauses contained in the contract. The necessity of mutual assent has been the subject of legislation,⁴⁸ although the cases are silent on the point. The courts apparently are content to use the all-inclusive term "public policy" as the basis of their decisions. Likewise, the safe deposit cases mention nothing of the question of comparative bargaining power, seemingly an important element in the determination of the validity of these clauses.⁴⁹

The New York courts, expressing the minority view, have said that the effect of the clause is to be determined by an interpretation of the wording of the contract, and in the absence of an express contract, the law of bailments should control.⁵⁰

As a general rule it might be said that the validity of exculpatory clauses depends on the relationship created by safe deposit contract.

⁴⁶ 281 Ill. 43, 117 N. E. 781 (1917).

⁴⁷ 133 Wash. 622, 234 Pac. 456 (1925).

⁴⁸ MO. REV. STAT. § 8117 (1939). PA. STAT. ANN. tit. 7, § 819-1020 (1939) recites: "The bank . . . shall receive such papers or other personal property, and rent out such receptacles or safe deposit boxes, upon the terms or conditions prescribed by it, but such terms and conditions shall not be binding upon the corporations or persons availing themselves of such service unless they receive notice thereof."

⁴⁹ See Note, *The Significance of Comparative Bargaining Power in the Law of Exculpation*, 37 COL. L. REV. 248 (1937).

⁵⁰ *Coons v. First Nat. Bank of Philmont*, 218 App. Div. 283, 218 N. Y. Supp. 189 (3d Dep't 1926); *Sagendorph v. First Nat. Bank of Philmont*, 218 App. Div. 285, 218 N. Y. Supp. 191 (3d Dep't 1926).

Confronted by the general rule that a bailee for hire cannot limit his liability for negligence, many safe deposit companies stipulate in the contract that the relationship is to be that of landlord and tenant. This might be interpreted as a subtle exculpatory clause in itself, since fewer restrictions are placed upon the relationship of landlord and tenant who contractually seek to define their liabilities than upon that of bailor and professional bailee.⁵¹ If the safe deposit company is successful in labeling the relationship as one of landlord and tenant, then the major policy considerations which would normally invalidate the clause are not applicable. There is no public interest to be served in contracts between landlords and tenants while such an interest is manifestly present in contracts with professional bailees. Contracts of tenancy are considered to be of a private nature and the parties are regarded as being in a position of comparative equality of bargaining power.⁵² Nor is the safe deposit company, under the rules of landlord and tenant law, saddled with the burden of disproving negligence.

The relationship of landlord and tenant in safe deposit leases, has been recognized by judicial decision⁵³ and by statute.⁵⁴ Few statutes go as far as the Texas enactment⁵⁵ which simply provides that the relationship is to be governed by the law of landlord and tenant. This statute also recites that the safe deposit lessee shall be deemed in *exclusive* possession of the box and contents, effectively excluding any application of the law of bailments. If safe deposit companies are successful in getting such a statute passed, a correct interpretation of the law of lessor and lessee would hold that exculpatory clauses should not be voided as contrary to public policy.

The policy considerations which bar the right of warehousemen to limit liability for their negligence are applicable, in large measure, to safe deposit companies. A few states have expressly classified safe

⁵¹ See *Kolt v. Cleveland Trust Co.*, Ohio App., 93 N. E. (2d) 788, 791 (1950): "Contracts relieving the promisor from liability even for his negligence have been upheld on the broad grounds of freedom of contract guaranteed by the federal and state constitutions. For example, as between landlord and tenant, it has been held that the relationship is not a matter of public interest but relates exclusively to the private affairs of the parties concerned and that the two parties stand upon equal terms."

⁵² *Kirshenbaum v. General Outdoor Advertising Co.*, 258 N. Y. 489, 180 N. E. 245 (1932).

⁵³ *Tow v. Evans*, 194 Ga. 160, 20 S. E. (2d) 922 (1942); *Kohlsaat v. First Nat. Bank of St. Paul*, 226 Minn. 471, 33 N. W. (2d) 712 (1948).

⁵⁴ OKLA. STAT. tit. 6, § 441 (Cum. Supp. 1949), provides: "Any landlord in the business of renting safe deposit boxes may by contract limit its liability and may make reasonable regulations for the conduct of the business. Such regulations shall be reduced to writing and delivered to the tenant. Any limitations as to liability shall be in printing or writing of the same size and type as the other provisions of the contract."

⁵⁵ TEX. STAT., REV. CIV. art. 342-906 (1948).

deposit companies as warehousemen, either by judicial decision⁵⁶ or statute,⁵⁷ making all statutes and rules pertaining to warehousemen equally applicable to safe deposit companies. A short survey of the law concerning exculpatory clauses in relation to warehousemen serves to point up most of the policy considerations which are involved in safe deposit contracts.

To make an exculpatory clause a valid subsisting part of the warehouseman contract, there must be mutual assent.⁵⁸ It has been held that the clause should be carefully scrutinized in the light of public policy.⁵⁹ Add the proposition that a contract of lease should be construed most strongly against the safe deposit company,⁶⁰ and it is reasonable to conclude that many of the exoneration clauses inserted in safe deposit box leases will not be upheld unless they are brought specifically to the attention of the depositor. It is against the social interest to permit professional bailees to limit their liability for negligence,⁶¹ and since warehousemen are charged with a statutory duty of due care, any contractual attempt to lessen that duty is also contrary to legislative policy.⁶² In jurisdictions imposing the duties of warehousemen on safe deposit companies, the courts would be consistent only by declaring the exculpatory clauses invalid.

Legislatures have not been silent concerning the right of safe deposit companies to limit their liability by contract. Several states have expressly recognized the right in two principal classes of statutes. The first type recognizes the right to limit liability by contract but sets an amount below which the company may not excuse itself. The figure is computed by multiplying the annual box rental by an arbitrary number, usually either three hundred⁶³ or five hundred.⁶⁴ The second type is a more general recognition of the right, usually reciting that the relationship is to be based "upon such terms as may be agreed by

⁵⁶ *New Jersey Title Guarantee and Trust Co. v. Rector et al.*, 76 N. J. Eq. 587, 75 Atl. 931 (1910).

⁵⁷ S. C. CODE § 7902 (1942), recites: "Every trust company doing a safe deposit business . . . shall be deemed a warehouseman as to such property, and all existing statutes and laws affecting warehousemen shall apply to such deposits. . . ." See also WASH. REV. STAT. ANN. § 469-3 (1944).

⁵⁸ *Smith's Transfer & Storage Co. v. Batigne*, 34 A. (2d) 705 (Mun. Ct. D. C. 1943); *Colgin v. Security Storage & Van Co.*, 208 La. 173, 23 So. (2d) 36 (1945).

⁵⁹ *Voyt v. Bekins Moving & Storage Co.*, 169 Ore. 30, 119 P. (2d) 586 (1941).

⁶⁰ *Saddler v. National Bank of Bloomington*, 403 Ill. 218, 85 N. E. (2d) 733 (1949).

⁶¹ *Arkansas Power & Light Co. v. Kerr*, 204 Ark. 238, 161 S. W. (2d) 403 (1942).

⁶² *French v. Bekins Moving & Storage Co.*, 118 Colo. 424, 195 P. (2d) 968 (1948).

⁶³ IOWA CODE § 528.65 (1946); NEB. REV. STAT. § 8-501 (1943).

⁶⁴ MD. ANN. CODE GEN. LAWS, art. 23, § 293 (1939).

the parties.”⁶⁵ Types of statutes to which reference has already been made determines the right to limit liability by the law of landlord and tenant⁶⁶ or by the statutory regulation of warehousemen.⁶⁷ The clear and unmistakable language of all the statutes probably accounts for the paucity of cases on the subject.

III.

Night Depositories

The Ohio Court of Appeals is found to be the only court which expressly has passed on the validity of exculpatory clauses in contracts for the use of night depositories.⁶⁸ It held the contract valid and not contrary to public policy.

As in safe deposit contracts, the power to contract away liability in night depository agreements depends upon the nature of the relationship created and the liabilities that arise by legal implication from that relationship. It has been held that the use of a night depository gives rise to a bailment for mutual benefit,⁶⁹ regardless of whether or not anything more is required of the customer to bring about the debtor-creditor relationship. Night depository contracts are of two classes: those which require the depositor to merely drop the sack in the chute,⁷⁰ and those which require the depositor to redeem the sack on the next banking day.⁷¹ In the first type, the relationship of debtor-creditor automatically arises when the teller examines, counts and accepts the money, and enters it as a general deposit.⁷² In the second, the debtor-creditor relationship arises only when the customer personally gives the money to the teller for entry as a general deposit. In both situations, while the money sack remains in the night receptacle, the relationship is one of bailment for mutual benefit since there has been no unequivocal acceptance of the deposit by the bank.

⁶⁵ MONT. REV. CODES ANN. § 5-514 (1947); N. Y. BANKING LAWS § 96; OHIO GEN. CODE ANN. § 710-110 (Supp. 1946); TENN. CODE ANN. § 3890 (Williams 1934). WASH. REV. STAT. ANN. § 469-5 (1944) is typical: “Whenever any safe deposit company shall let or lease any vault . . . such safe deposit company shall be bound to exercise due care to prevent the opening of such vault, safe, box or receptacle by any person other than the lessee thereof . . . and said parties may provide in writing the terms, conditions and liabilities in said lease.”

⁶⁶ See note 54 *supra*.

⁶⁷ See note 57 *supra*.

⁶⁸ *Kolt v. Cleveland Trust Co.*, Ohio App., 93 N. E. (2d) 788 (1950).

⁶⁹ *Kolt v. Cleveland Trust Co.*, *supra* note 68; *Bernstein et al. v. Northwestern Nat. Bank in Philadelphia*, 157 Pa. Super. 73, 41 A. (2d) 440 (1945).

⁷⁰ *Bernstein et al. v. Northwestern Nat. Bank in Philadelphia*, *supra* note 69.

⁷¹ *Kolt v. Cleveland Trust Co.*, Ohio App., 93 N. E. (2d) 788 (1950).

⁷² *United States v. Holt*, 234 Mo. App. 25, 131 S. W. (2d) 59 (1939).

Since the relationship is one of bailment, it is supposed that the rule prohibiting a bailee to limit his liability for negligence should apply. But in *Kolt v. Cleveland Trust Co.*,⁷³ it was held that the clause was not contrary to the public interest. However, there is case law in Ohio⁷⁴ indicating that there are policy considerations contrary to this decision, and it has been intimated that the case may be overruled.⁷⁵ The particularism evident in the contract of exculpation, plus the very elaborate safety methods employed by the bank, probably influenced the court in upholding this particular clause.

The policy considerations in the night deposit cases present problems similar to those of safe deposit bailments. However, the manner in which night deposits must of necessity be made may influence the courts to permit exculpation even in those jurisdictions which hold them invalid when applied to safe deposit companies. The bank has no opportunity to have an agent present at the time the bailment is initiated, and if no form of exculpation be permitted, the public might find itself without this convenient special service.

Conclusion

Courts, in determining policy, must decide whether there is a greater public interest to be served in obtaining more low-cost banking facilities than in extending the common law protection to newer types of services. Courts have failed to follow a consistent pattern in determining the validity of exculpatory clauses, which suggests that the problem is probably one for the legislatures.

Exculpatory clauses in stop-payment orders should not be allowed unless the customer *knowingly* and *voluntarily* agrees to the arrangement. This is patently the better view since the bank is under a duty to accept an unqualified order as a necessary incident to the business of banking.

The validity of the clauses in safe deposit and night deposit contracts depends upon the relationship which the courts or the legislatures, which actually are interpreting their public policy, imply from the contract. If the safe deposit company is classified a landlord, the clause probably will be upheld, but in those states where the safe deposit company has the duties of a professional bailee, the clause will be regarded as a nullity. Bearing in mind that in neither instance are all the elements of a true bailment present, some protection should be accorded the banks.

R. Emmett Fitzgerald
Joseph C. Spalding

⁷³ Ohio App., 93 N. E. (2d) 788 (1950).

⁷⁴ *Agricultural Ins. Co. v. Constantine*, 144 Ohio St. 275, 58 N. E. (2d) 658 (1944).

⁷⁵ 4 VAND. L. REV. 346 (1951).

Courts

LIMITATIONS ON HABEAS CORPUS IN THE FEDERAL DISTRICT COURTS

The procedural status of habeas corpus in the federal courts is still shrouded in uncertainty, notwithstanding recent attempts to clarify it.¹ There is still a lack of unanimity concerning the requirement of an application for certiorari to the Supreme Court as part of the exhaustion doctrine. The effect of a denial of habeas corpus or of certiorari by the Supreme Court upon a subsequent petition for habeas corpus, has not been precisely determined. Consequently, an analysis of the present position of habeas corpus will not be without profit. To present first a brief history of the writ, including a discussion of its expanded use—primarily in the last twenty years—and to investigate the ambit of the habeas corpus power which the federal district courts today possess is the purpose of this article.

I.

History

Illuminating historical studies of the origin and development of habeas corpus are available elsewhere.² Therefore, a cursory survey will suffice to bring the current problems into focus.

The writ, after a long struggle, was first firmly secured in statutory form by the famous Habeas Corpus Act of 1679,³ and came to America as part of the common law. Deeming the security afforded by this writ of vital importance, the founding fathers provided in the Constitution that "The Privilege of the Writ of Habeas Corpus shall not be suspended, unless when in Cases of Rebellion or Invasion the public Safety may require it."⁴ In the first half of the nineteenth century, the traditional ground for the application of the writ—namely, lack of jurisdiction⁵—was disturbed by legislation.⁶ Thus began a century of extending the scope of this ancient writ.

¹ See, e.g., 63 STAT. 105 *et seq.* (1949), 28 U. S. C. § 2241 *et seq.* (Supp. 1950); *Darr v. Burford*, 339 U. S. 200, 70 S. Ct. 587, 94 L. Ed. 761 (1950).

² HURD, *HABEAS CORPUS* 129 (2d ed. 1876); Note, *The Freedom Writ—The Expanding Use of Federal Habeas Corpus*, 61 HARV. L. REV. 657 (1948).

³ 31 CAR. 2, c. 2 (1679).

⁴ U. S. CONST. Art. I § 9.

⁵ This ground is occasionally relied upon at the present time. *Holland v. Eidson*, 90 F. Supp. 314 (W. D. Mo. 1950).

⁶ 4 STAT. 634 (1833), extended the utilization of the writ to prisoners held under either state or federal authority for any act committed in violation of a law or judicial mandate of the United States. 5 STAT. 539 (1842), brought prisoners, who were foreign subjects held by state or federal authority for acts committed under recognized foreign law, within the protective coverage of the writ.

Monumental, perhaps, in this growth was the act passed in 1867⁷ which gave federal courts the power to grant the writ in any case where a person's confinement violates the Constitution, or any treaty or law of the United States. This statute became the legal skeleton upon which the federal courts, gradually becoming more due process-minded,⁸ draped the federal procedural doctrines applied today—doctrines designed to enable the federal courts to test the constitutionality of state judicial administration without impinging on the remaining vestiges of state sovereignty.

Illustrative of these procedural principles are the following: Habeas corpus is a writ of right and not of course.⁹ Not only must a sound case be presented,¹⁰ but it must also appeal to the discretion of the court as necessitating expediency.¹¹ It should not be employed as a device which interrupts the orderly proceedings in a capable court acting with jurisdiction.¹² It should not be allowed to become a substitute for an appeal.¹³

But rising above the foregoing rules are two more troublesome doctrines: (1) the necessity of exhausting state remedies, and (2) the "consideration" of previous action by other courts. These two doctrines play a vital role in the uncertainty surrounding habeas corpus at the present time. They provide the point of departure for the investigation of the basic problem to be analyzed here: admitting that it exists in name, does any *real* habeas corpus power actually reside today in the federal district courts.

To maintain that the solution of this problem lies simply in an examination of these two rules and nothing more would indeed be fallacious. There are other lesser factors involved. But since they are usually allied to one or the other of the two main principles, they will be acknowledged in the treatment of the principle to which they are more intimately related. It is well to note that lying behind and forming the basis for all these rules is the discretion of the court. It still remains, ostensibly at least, within the exercise of discretion of the federal district court, as influenced by the above principles, either to grant or deny habeas corpus.

Generally, before a court will weigh the effect of previous court action on a case, it will require the petitioner to show that he has

⁷ 14 STAT. 385 (1867).

⁸ See *Darr v. Burford*, 339 U. S. 200, 221, 70 S. Ct. 587, 94 L. Ed. 761 (1950) (dissenting opinion of Justice Frankfurter).

⁹ *Ex parte Frederick*, 149 U. S. 70, 13 S. Ct. 793, 37 L. Ed. 761 (1893).

¹⁰ *Rogers v. Peck*, 199 U. S. 425, 26 S. Ct. 87, 50 L. Ed. 256 (1905).

¹¹ *Goto v. Lane*, 265 U. S. 393, 44 S. Ct. 525, 68 L. Ed. 1070 (1924).

¹² *Urquhart v. Brown*, 205 U. S. 179, 27 S. Ct. 459, 51 L. Ed. 760 (1907).

¹³ *Ex parte Belt*, 159 U. S. 95, 15 S. Ct. 987, 40 L. Ed. 88 (1895).

exhausted all of his state remedies. Therefore, the presentation of the "previous court action" phase will follow that of the exhaustion doctrine.

II.

Exhaustion Doctrine

The classic pronouncement of the exhaustion principle is that found in the per curiam decision of *Ex parte Hawk*¹⁴ where the Supreme Court said:

Ordinarily an application for habeas corpus by one detained under a state court judgment of conviction for crime will be entertained by a federal court only after all state remedies . . . in the state courts and in this Court by appeal or writ of certiorari, have been exhausted.

This rule, save for the significant omission of the clause referring to an appeal or writ of certiorari to the Supreme Court, has been recently codified.¹⁵ It should be emphasized that the Court in *Ex parte Hawk* stated that there must be an exhaustion of remedies in the Supreme Court by either appeal or certiorari.

In order to show how the power of the lower federal courts has gradually deteriorated, the history behind this alternative requirement of exhaustion by appeal or certiorari must be studied. As early as 1886,¹⁶ it was suggested that before a lower federal court should grant habeas corpus, a writ of error (which has since been replaced by an appeal to the Supreme Court¹⁷) must have been brought. Though the Court then felt otherwise, it was only five years later that it included the writ of error from the Supreme Court as one of the remedies to be exhausted.¹⁸ The rationale behind this requirement was that a writ of error, being allowed as of course at that

¹⁴ 321 U. S. 114, 116, 64 S. Ct. 448, 88 L. Ed. 572 (1944).

¹⁵ 28 U. S. C. § 2254 (Supp. 1950), provides that: "An application for a writ of habeas corpus in behalf of a person in custody pursuant to the judgment of a State court shall not be granted unless it appears that the applicant has exhausted the remedies available in the courts of the State, or that there is either an absence of available State corrective process or the existence of circumstances rendering such process ineffective to protect the rights of the prisoner.

"An applicant shall not be deemed to have exhausted the remedies available in the courts of the State, within the meaning of this section, if he has the right under the law of the State to raise, by any available procedure, the question presented."

¹⁶ *Ex parte Royall*, 117 U. S. 241, 6 S. Ct. 734, 29 L. Ed. 868 (1886).

¹⁷ A statute in 1928 provided: "That the writ of error in cases, civil and criminal, is abolished. All relief which heretofore could be obtained by writ of error shall hereafter be obtainable by appeal." 45 STAT. 54 (1928).

¹⁸ *Wood v. Brush*, 140 U. S. 278, 290, 11 S. Ct. 738, 35 L. Ed. 505 (1891). There the court said ". . . that after the final disposition of the case by the highest court of the State, the circuit court, in its discretion, may put the party who has been denied a right, privilege or immunity claimed under the Constitution or laws of the United States to his writ of error from this court, rather than interfere by writ of habeas corpus."

time,¹⁹ was deemed merely the next step in orderly appellate procedure. This reasoning cannot be applied to the rule requiring certiorari, because certiorari is a discretionary writ which may be denied for various collateral reasons without judgment ever being passed upon the merits.²⁰ Just what rationale the Court relied upon in *Ex parte Hawk* for its insertion of the certiorari requirement into the orthodox writ of error rule is difficult to determine. In not one of the cases relied upon in the *Hawk* decision was the exhaustion of the writ of certiorari required or even mentioned.²¹ Thus it appears on the surface at least that an unwarranted extension of the exhaustion doctrine was promulgated by the *Hawk* case.²²

The circuit courts have added several less important limitations on the habeas corpus power of federal district courts. For instance, the Court of Appeals for the Ninth Circuit added the requirement of good faith to the exhaustion rule when it said:²³

To make a showing of having exhausted state remedies, it is not sufficient for the seeker of Federal relief to present a plausible argument that the state courts would probably not decide in his favor, anyway. He must make an actual attempt to obtain redress in the state courts, and must prosecute that attempt in *good faith*. [Emphasis supplied.]

In another case, a petitioner had not learned of the denial of his writ of error coram nobis until eight days after the time limit for appealing from it had expired. He was nevertheless told to *attempt* to appeal from the denial. The court said:²⁴

The fact that it was "impossible for him to have served and [to] file a notice of appeal within five days as required by the rules governing appeals to the Supreme Court of Washington," does not excuse his

¹⁹ Justice Frankfurter in his dissenting opinion in *Darr v. Burford*, 339 U. S. 200, 235, 70 S. Ct. 587, 94 L. Ed. 761 (1950), pointed out that "a writ of error was a writ of right" until legislation in 1916, 39 STAT. 726 (1916), and in 1925, 43 STAT. 936 (1925), changed its status. After these statutes were passed, "The right was gone. Only an opportunity—and a slim one—remained."

²⁰ "The denial of a writ of certiorari imports no expression of opinion upon the merits of the case, as the bar has been told many times." *United States v. Carver*, 260 U. S. 482, 490, 43 S. Ct. 181, 67 L. Ed. 361 (1923). For an indication of the character of reasons relied upon in granting certiorari, see Rule 38 (5), Rules of the Supreme Court of the United States, following 28 U. S. C. § 354 (1946), and at 306 U. S. 718 (1938).

²¹ The following cases were relied upon: *Ex parte Abernathy*, 320 U. S. 219, 64 S. Ct. 13, 88 L. Ed. 3 (1943); *Mooney v. Holohan*, 294 U. S. 103, 55 S. Ct. 340, 79 L. Ed. 791 (1935); *Kennedy v. Tyler*, 269 U. S. 13, 46 S. Ct. 1, 70 L. Ed. 138 (1925); *Urquhart v. Brown*, 205 U. S. 179, 27 S. Ct. 459, 51 L. Ed. 760 (1907); *Tinsley v. Anderson*, 171 U. S. 101, 18 S. Ct. 805, 43 L. Ed. 91 (1898).

²² A closer examination of this apparent extension will be found in the portion of the text to which note 42 *infra* refers.

²³ *Hampson v. Smith*, 162 F. (2d) 334, 335 (9th Cir. 1947).

²⁴ *Mason v. Smith*, 162 F. (2d) 336, 337 (9th Cir. 1947).

non-action in the matter. He should have made the effort, and he must still make the effort, before he can successfully contend that he has exhausted all state remedies.

Very similar in this respect is *Woods v. Nierstheimer*,²⁵ where the petitioner was told that he must first exhaust his statutory coram nobis remedy notwithstanding the fact that the statute of limitations governing it had already run.

Further indication of the waning habeas corpus power in the federal district courts was apparent in *Huffman v. Smith*.²⁶ There the court of appeals manifestly ignored the discretion vested in the district courts when it said that “. . . it is a *condition precedent* to a *consideration* of his petition for a writ of habeas corpus that the petitioner has sought the similar relief in Washington state courts.” The implication created by the use of the phrase “condition precedent” is that in no case, not even one involving unusual circumstances, may a district court consider the issuance of habeas corpus before all the remedies have been exhausted. The usual rule, where state remedies have not been exhausted, is that a district court may entertain a petition for habeas corpus where there are exceptional circumstances.²⁷ Finally, the Supreme Court in *Mooney v. Holohan*²⁸ added the requirement that not only the direct but also the collateral state remedies must be exhausted.

Both the rule that certiorari from the Supreme Court and the requirement that collateral state remedies be exhausted were given general recognition until the Supreme Court decided *Wade v. Mayo*.²⁹ There the Court, speaking through Justice Murphy, removed much of the rigidity of both rules. Referring to the requirements of certiorari from the Supreme Court as part of the exhaustion process, the Court said:³⁰

But the reasons for this exhaustion principle cease after the highest state court has rendered a decision on the merits of the federal constitutional claim. The state procedure has then ended and there is no longer any danger of a collision between federal and state authority.

²⁵ 328 U. S. 211, 66 S. Ct. 996, 90 L. Ed. 1177 (1946).

²⁶ 172 F. (2d) 129, 130 (9th Cir. 1949). [Emphasis supplied.]

²⁷ *Plaine v. Burford*, 180 F. (2d) 724 (10th Cir. 1950); *Cain v. Benson*, 163 F. (2d) 822 (6th Cir. 1947); *Ex parte Brown*, 90 F. Supp. 50 (E. D. Mich. 1950). See also 28 U. S. C. § 2254 (Supp. 1950). The Court in *Ex parte Hawk*, 321 U. S. 114, 118, 64 S. Ct. 448, 88 L. Ed. 572 (1944) enumerated unusual circumstances when it said that a federal court should entertain a petition for habeas corpus in cases “. . . where resort to state court remedies has failed to afford a full and fair adjudication of the federal contentions raised, either because the state affords no remedy . . . or because in the particular case the remedy afforded by state law proves in practice unavailable or seriously inadequate. . . .”

²⁸ 294 U. S. 103, 55 S. Ct. 340, 79 L. Ed. 791 (1935).

²⁹ 334 U. S. 672, 68 S. Ct. 1270, 92 L. Ed. 1647 (1948).

³⁰ *Id.*, 334 U. S. at 680.

The problem shifts from the consummation of state remedies to the nature and extent of the federal review of the constitutional issue. The exertion of such review at this point, however, is not in any real sense a part of the state procedure. . . .

Matters relevant to the exercise of our certiorari discretion frequently result in denials of the writ without any consideration of the merits. . . . Where it is apparent or even possible that such would be the disposition of a petition for certiorari from the state court's judgment, failure to file a petition should not prejudice the right to file a *habeas corpus* application in a district court.

Realizing this change in policy, several circuit courts upheld the district courts in reviewing the merits of the case on a habeas corpus petition though certiorari had not been sought.³¹

The *Wade* case also relaxed the rule, established by the *Mooney* case,³² that all state remedies, direct and collateral, must be exhausted, when the Court said:³³

The crucial point is that Wade [the petitioner] has exhausted one of the two alternative routes open in the Florida courts for securing an answer to his constitutional objection. . . . The exhaustion of but one of several available alternatives is all that is necessary.

Shortly after the *Wade* decision, Congress enacted the legislation referred to above³⁴ which codified the exhaustion doctrine set forth in the *Hawk* case. The statute in part provides that "An applicant [for habeas corpus] shall not be deemed to have exhausted the remedies . . . of the state . . . if he has the right . . . to raise, by any available procedure, the question presented." Because of their proximity in time, there is a strange admixture in subsequent cases, of the *Mooney* rule requiring the exhaustion of collateral state remedies, the *Wade* doctrine that pursuance of an alternative remedy is sufficient, and the codification of the *Hawk* decision. A case appearing soon after the statute was enacted, decided that the *Wade* rule requiring the exhaustion of but one of several state remedies could not, in the face of the statute, be controlling.³⁵ Here, the petitioner already had been refused a writ of habeas corpus by the Supreme Court of Missouri. This refusal was apparently based upon a consideration of the federal claim of the petitioner. He was instructed to make another attempt in the state courts since "The doctrine of exhaustion of state court remedies to so test the legality of his detention requires that he do so."³⁶

³¹ *Miller v. Hudspeth*, 176 F. (2d) 111 (10th Cir. 1949); *Collingsworth v. Mayo*, 173 F. (2d) 695 (5th Cir. 1949).

³² *Mooney v. Holohan*, 294 U. S. 103, 55 S. Ct. 340, 79 L. Ed. 791 (1935).

³³ 334 U. S. 672, 677-8, 68 S. Ct. 1270, 92 L. Ed. 1647 (1948).

³⁴ See note 15 *supra*.

³⁵ *Lyle v. Stewart*, 80 F. Supp. 167 (W. D. Mo. 1948).

³⁶ *Id.* at 170.

On the other hand, in a later case, the Court of Appeals for the Second Circuit reached a contrary result.³⁷ There the petitioner failed to pursue his direct remedies and turned instead to the collateral relief of habeas corpus. The court stated, "This we understand to suffice. 'The exhaustion of but one of several available alternatives is all that is necessary,' *Wade v. Mayo* . . ." ³⁸

The confusion was shortlived. In 1950, the Supreme Court in *Darr v. Burford* stated that "Whatever deviation *Wade* may imply from the established rule will be corrected by this decision."³⁹ The Court firmly restated the rule pronounced in the *Hawk* case,⁴⁰ that ordinarily the prisoner must petition the Supreme Court for certiorari before seeking habeas corpus in the district courts. This case is of great importance because it brings to a climax the conflict on the exhaustion rule.

The importance of this decision, and its shortcomings in attempting to correct the implications of the *Wade* case, were sharply outlined and criticized by Justice Frankfurter in his dissent.⁴¹ Perhaps the basic objection of the dissenting opinion is that the Court required a petition for certiorari (which, traditionally, can be denied without casting any adverse shadows upon the merits) without revealing what effect a denial is to have. This, Justice Frankfurter warned, will create grave confusion in the district courts.⁴² To this, Justice Reed, speaking for the Court, appeared to be replying when he said: "The issue of the effect of such denial [of certiorari] . . .

³⁷ United States *ex rel.* Morrison v. Foster, 175 F. (2d) 495 (2d Cir. 1949).

³⁸ *Id.* at 497.

³⁹ *Darr v. Burford*, 339 U. S. 200, 210, 70 S. Ct. 587, 94 L. Ed. 761 (1950). Criticizing this statement as a polite method of overruling *Wade v. Mayo*, Justice Frankfurter, in his dissent cautions, 339 U. S. at 221: "Decisions on matters of procedure within the Court's control ought not to be like shifting sand. Quick fluctuations in them should be avoided unless a rule of practice has proven itself mischievous in practice. The real question before us in this case is whether *Wade v. Mayo* . . . should be overruled. . . . Respect for an explicit adjudication on a matter of procedure very recently rendered after the fullest consideration, as well as the soundness of the decision, should lead us to adhere to *Wade v. Mayo*."

⁴⁰ 321 U. S. 114, 64 S. Ct. 448, 88 L. Ed. 572 (1944).

⁴¹ *Darr v. Burford*, 339 U. S. 200, 219, 70 S. Ct. 587, 94 L. Ed. 761 (1950).

⁴² *Id.*, 339 U. S. at 224-5: "Some judges will infer that denial of certiorari bears on the exercise of *habeas corpus* jurisdiction. Others will feel they should adhere to this Court's old avowals concerning denial until they are told explicitly to the contrary. Most confusing of all, many judges . . . are unlikely to resolve the ambiguity decisively. Instead, they will take an equivocal position in denying a writ of *habeas corpus*, relying in part on the discretionary aspect of *habeas corpus* and in part on the fact that this Court denied certiorari." Some of these fears have been realized indeed. One writer has already pointed out that the court in *Goodwin v. Smyth*, 181 F. (2d) 499 (4th Cir 1950), has taken Justice Frankfurter's "equivocal" position. 2 STAN. L. REV. 788, 793 (1950). The same might also be said of the decision in *Commonwealth ex rel. Gibbs v. Ashe*, 93 F. Supp. 542 (W. D. Pa. 1950).

is not here in this case. We doubt the effectiveness of a voluntary statement on a point not in issue."⁴³

The dissent also points out that cases involving federal claims by state prisoners often involve complex local laws which must be construed and properly applied before the federal questions can be answered. The cases cited in the dissent⁴⁴ exemplify the confusion resulting where the Supreme Court, unfamiliar with the peculiar state law, takes the case directly from the state court on certiorari rather than allowing the district court, familiar with the local laws, to clarify the issues in a habeas corpus proceeding. In the majority opinion, Justice Reed, apparently fully aware of this difficulty, points out:⁴⁵

There may be issues of state procedure . . . problems made difficult by the frequent practice of state courts to dismiss the applications without opinion. If this Court has doubts concerning the basis of state court judgments, the matter may be handled . . . with an express direction that the petitioner may proceed in the federal district court without prejudice from the denial of his petition for certiorari.

Justice Frankfurter rallied with the reply that:⁴⁶

Instead of allowing these local issues to be canvassed initially in the District Courts, it is now proposed . . . that they be brought here enveloped in the fog of State procedural law and then . . . [be left] to the District Courts to lift the fog after we have concluded that it is too thick for us to pierce. Such procedure, I submit, would neither further the administration of justice nor be conducive to the proper use of this Court's time. . . .

The differences of opinion as to the importance of allowing only the highest federal tribunal to reverse the highest state tribunal seems to underlie all of the preceding points of controversy. The inconvenience occasioned by requiring all cases to come up to the Supreme Court on certiorari in the first instance is more than offset, according to the Court, by the benefits derived from the preservation of the dual system of government. The dissent, on the other hand, also recognizing that the proper federal-state relationship should be maintained, does not place this desirable relationship above the practical and more expedient procedure of allowing district courts to rule on state convictions in the first instance.

III.

Prior Court Action Doctrine

The consideration in a habeas corpus proceeding in a federal district court of previous determinations by another court involves two situations. The first arises out of a previous application for a writ

⁴³ Darr v. Burford, 339 U. S. 200, 214, 70 S. Ct. 587, 94 L. Ed. 761 (1950).

⁴⁴ *Id.*, 339 U. S. at 230.

⁴⁵ *Id.*, 339 U. S. at 215.

⁴⁶ *Id.*, 339 U. S. at 232.

of habeas corpus, in either a state or federal court. The second concerns the effect to be given a denial by the Supreme Court of certiorari to the state court upholding the conviction.

It was established at an early date that denial of a writ of habeas corpus would not be considered *res judicata*.⁴⁷ However, because of the great number of applications flooding the federal courts,⁴⁸ the trend in recent years has been to allow the court examining the application to "consider" previous denials.⁴⁹ An expression of this doctrine was aptly propounded in a recent federal decision where the court said:⁵⁰

While action of the Virginia courts [in denying habeas corpus] and the denial of certiorari by the Supreme Court [on the habeas corpus petition] were not binding on the principle of *res judicata*, they were matters entitled to *respectful consideration* by the court below; and in the absence of some most unusual situation, they were sufficient reason for that court to deny a further writ of habeas corpus. [Emphasis supplied.]

While most courts have followed the rule that former denials are not to be considered *res judicata*, the "respectful consideration" which they are to give to former denials has caused an effect not far removed from *res judicata*.⁵¹ This is especially true in a situation where the allegations in the second petition for habeas corpus bring to the court's attention the identical grounds urged by the petitioner in the earlier application for the writ. If the first petition has been denied, after a full hearing, then the court may deny the second on this basis alone.⁵²

⁴⁷ In *Carruth v. Taylor*, 8 N. D. 166, 172, 77 N. W. 617 (1898), the court observed that, "At common law . . . an order in habeas corpus proceedings remanding the petitioner to custody is not *res judicata*. The first adjudication at common law was not a bar to another inquiry upon the same state of facts."

⁴⁸ See chart of statistics in *Darr v. Burford*, 339 U. S. 200, 233, 70 S. Ct. 587, 94 L. Ed. 761 (1950) (dissenting opinion).

⁴⁹ *Holiday v. Maryland*, 177 F. (2d) 844 (4th Cir. 1949); *United States ex rel. Innes v. Hiatt*, 141 F. (2d) 644 (3d Cir. 1944); *Slaughter v. Wright*, 135 F. (2d) 613 (4th Cir. 1943); *Beard v. Bennett*, 114 F. (2d) 578 (D. C. Cir. 1940); *United States ex rel. Bergdoll v. Drum*, 107 F. (2d) 897 (2d Cir. 1939).

⁵⁰ *Stonebreaker v. Smyth*, 163 F. (2d) 498, 499 (4th Cir. 1947). In this case the petitioner had filed a petition for habeas corpus in the Corporation Court of the City of Newport News. When this court dismissed the petition, he appealed to the Supreme Court of Appeals of Virginia for a writ of error. Upon the denial of the writ he turned to the Supreme Court for a writ of certiorari. The Supreme Court denied the writ, *Stonebreaker v. Smyth*, 323 U. S. 754, 65 S. Ct. 81, 89 L. Ed. 603 (1944). Then he filed a petition for habeas corpus in the Federal District Court of the United States for the Eastern District of Virginia. When this petition was refused, the appeal in the instant case followed.

⁵¹ *Garrison v. Johnston*, 151 F. (2d) 1011 (9th Cir. 1945); *Slaughter v. Wright*, 135 F. (2d) 613 (4th Cir. 1943); *United States ex rel. Bruno v. Reimer*, 103 F. (2d) 341 (2d Cir. 1939).

Perhaps the more difficult segment of this "effect of prior court action" phase is the proper consideration to be given prior action of the Supreme Court on a petition for certiorari. A distinction might be drawn between the result where certiorari was granted and the merits of the case reviewed, and where certiorari was denied, which does not indicate that the merits were considered. However, since the Supreme Court in *White v. Ragen*⁵³ restated a single rule applying to both alternatives, the inference is that the distinction is immaterial. The Court in that case, citing *Ex parte Hawk*,⁵⁴ stated that:

If the Court denies certiorari after a state court decision on the merits, or if it reviews the case on the merits, a federal district court will not usually re-examine on habeas corpus the question thus adjudicated.

The fact that this rule treats both a denial of certiorari and a review upon certiorari as being of equal significance in the subsequent petition for habeas corpus has caused a definite divergence of judicial opinion. At least one circuit court has stated that a denial of certiorari is not *res judicata* and has no prejudicial effect whatever upon the merits of the petitioner's claim.⁵⁵ On the other hand, the Court of Appeals for the Second Circuit has regarded a denial of certiorari as tantamount to a final adjudication. In the case of *Schechtman v. Foster*,⁵⁶ Judge Learned Hand stated that "unless we are altogether to disregard the action of the court of last resort [the Supreme Court] in the very case itself, the denial ought to be conclusive."

This controversy still persists. Certiorari may be denied on any one of several collateral grounds;⁵⁷ consequently, it may or may not involve a determination upon the merits. It, therefore, is argued that the rule requiring a district court to "consider" the denial is an additional restriction upon the habeas corpus power of the district courts.

Conclusion

The foregoing analysis of the various rules has attempted to illustrate what appears to be a trend toward the withdrawal of habeas corpus power from the federal district courts in cases dealing with state incarceration. This withdrawal has been effected by broadening the concept of the exhaustion doctrine which operates to preclude the

⁵² *Swihart v. Johnston*, 150 F. (2d) 721 (9th Cir. 1945); *Guterman v. Hiatt*, 65 F. Supp. 285 (M. D. Pa. 1946).

⁵³ 324 U. S. 760, 65 S. Ct. 798, 89 L. Ed. 1348 (1945).

⁵⁴ 321 U. S. 114, 118, 64 S. Ct. 448, 88 L. Ed. 572 (1944).

⁵⁵ *McCrea v. Jackson*, 148 F. (2d) 193 (6th Cir. 1945).

⁵⁶ 172 F. (2d) 339 (2d Cir. 1949).

⁵⁷ See note 20 *supra*.

district court from entertaining the petition in the *first instance*; and by means of the expanded "prior court action" formula which warns the district court, *after* the remedies have been exhausted, not to re-examine the merits because another court—either the Supreme Court by a denial of certiorari or a state supreme court by a denial of habeas corpus—has already done so. An illustration of this dilemma with which the district courts today are confronted is the view announced in *Bernard v. Brady*.⁵⁸ Two petitions had been filed with and denied by the Supreme Court. The court, reviewing a subsequent denial of habeas corpus by a district court, stated:⁵⁹

If the petitions to the Supreme Court be treated as the equivalent of an application for certiorari, the petition below was properly denied, since a federal district court should not ordinarily grant a writ where the Supreme Court denies certiorari after a state court decision on the merits [application of the "prior court action" rule]; if those petitions be not treated as the equivalent of certiorari, the petition below for habeas corpus was properly denied since the remedies available under state law had not been exhausted [application of the exhaustion rule].

In the final analysis, the clash in judicial opinion on the habeas corpus power of federal district courts has its roots in the conflict between two opposing judicial philosophies. The present view of the Supreme Court tends to emphasize the necessity of zealously maintaining the traditional federal-state relationship as the safest method of preserving personal freedom. The opposing philosophy refuses to sacrifice individual rights merely to preserve a nebulous concept like the "proper federal-state relationship." Consequently, the former adheres to the rule that, ordinarily, only the highest federal tribunal should review actions of the highest state court. The latter deems it more important that a prisoner, who claims unlawful detention, be given a federal hearing and if found to be wrongfully detained, be released as quickly as possible by a court conversant with local law. This group also maintains that a state court should be compelled to tolerate a slight affront in order to safeguard the more fundamental interest of individual rights. Consequently, fluctuations in procedural rules probably will exist so long as these dissimilar philosophies are represented in force in the Supreme Court.

Bernard James McGraw

Robert A. Stewart

⁵⁸ 164 F. (2d) 881 (4th Cir. 1947).

⁵⁹ *Id.* at 882.

*Courts*MEMBERSHIP IN OR AFFILIATION WITH THE COMMUNIST
PARTY AS GROUNDS FOR DISBARMENT

On February 26, 1951, the American Bar Association adopted¹ the following resolution:²

Resolution III

BE IT RESOLVED, That the American Bar Association recommend that all State and Local Bar Associations or appropriate authorities immediately commence disciplinary actions of disbarment of all lawyers who are members of the Communist Party of the United States or who advocate Marxism-Leninism.

This resolution appears, in itself, to be an attack on the very civil liberties which require protection from abuse by Communists, since it would in effect, deprive a man of his livelihood in his chosen profession. It must be remembered, however, that a Communist is not merely a believer in the philosophy of Marx and Lenin, but an active worker toward world revolution.³ Confronted with this fact, some definite and affirmative action by responsible authority was necessary.⁴

The various departments of the Government, after long, careful, and complete investigations, have acted in the manner required to protect this nation against the Communist menace. In 1947, the Committee on Un-American Activities made its report to the House of Representatives on the purposes and ends of the Communist Party.⁵ The Committee pointed out that the Communist Party is not only a political society, but an organization whose ideology is incompatible with the American way of life, and which will not stop short of force or violence if those measures are necessary to further the scheme for world revolution. Basing its action on this and other reports of the Committee, Congress has enacted legislation restricting Communist activity in the United States.⁶ The Executive Depart-

¹ N. Y. Times, Feb. 27, 1951, p. 14, col. 4.

² Copy of REPORT OF THE SPECIAL COMMITTEE TO STUDY COMMUNIST TACTICS AND OBJECTIVES OF THE AMERICAN BAR ASSOCIATION.

³ See American Communications Ass'n, C. I. O. et al. v. Douds, 339 U. S. 382, 431, 70 S. Ct. 674, 94 L. Ed. 597 (1950) (concurring opinion).

⁴ See the discussion of the various restraints already imposed on Communists in REPPY, CIVIL RIGHTS IN THE UNITED STATES (1951); Cohen and Fuchs, *Communism's Challenge and the Constitution*, 34 CORN. L. Q. 182 (1948); Emerson and Hetfield, *Loyalty Among Government Employees*, 58 YALE L. J. 1 (1948); Notes, *May the States, by Statute, Bar Subversive Groups from the Ballot*, 25 NOTRE DAME LAW. 319 (1950), *Communism's Criminality*, 23 NOTRE DAME LAW. 577 (1948), *Constitutionality of State Legislation Affecting Public Employees*, 18 GEO. WASH. L. REV. 541 (1950).

⁵ H. R. REP. NO. 4581, 80th Cong., 1st Sess. (1947).

⁶ Pub. L. No. 831, 81st Cong., 2d Sess. (Sept. 22, 1950).

ment has taken steps to insure loyalty among its employees.⁷ In holding a refusal to answer questions about Communist affiliation to be contempt, one state court declared that "[communist] social and political theories are vastly different from those understood and supported by the loyal citizens of our democracy."⁸

The Court of Appeals of British Columbia has recently taken action similar to that proposed in the American Bar Association resolution by denying a Communist applicant admission to the bar of that province, observing in the course of its opinion that:⁹

It has come to be universally accepted in the Western nations that it is dangerous to our way of life to allow a known Communist or Communist sympathizer to remain in a position of trust or influence.

The rationale of the Canadian decision and the principle of the American Bar Association Resolution are essentially the same: membership in bench or bar is a position of trust and influence; Communists have convincingly demonstrated that they will take advantage of those positions to advance their cause, the destruction of free institutions; therefore, the courts, through their inherent powers, are entitled to protect themselves from internal enemies by denying Communists admission to or continuance in the practice of law.

The tactics that are to be employed by Communists in the courts have been vividly illustrated in a pamphlet entitled *Under Arrest*,¹⁰ published and distributed in 1934 by the International Labor Defense, an organization designated as Communistic.¹¹ The pamphlet advises its reader to ridicule the dignity and sanctity of the courtroom and to prostitute the trial so that it serves, not as an instrument of justice, but as a sounding board for Communist ideology. It instructs the "Party" to demonstrate in front of the courthouse, and to interfere in every conceivable way with the administration of judicial business.

A recent report to the House of Representatives by the Un-American Activities Committee quotes another pamphlet that briefly summed up the purposes of the Communist in courtrooms:¹²

A Communist must utilize a political trial to help on the revolutionary struggle. Our tactics in the public proceedings of the law courts are not tactics of defense but of attack. Without clinging to legal for-

⁷ Exec. Order No. 9835, 12 FED. REG. 1935 (1947); Note, *Constitutional Law—The President's Loyalty Order—Standards, Procedure and Constitutional Aspects*, 46 MICH. L. REV. 942 (1948).

⁸ *Fawick Airflex Co. v. United Electrical, Radio and Machine Workers of America*, Local 735, C. I. O. et al., 87 Ohio App. 371, 92 N. E. (2d) 436, 445, *appeal dismissed*, 154 Ohio St. 106, 93 N. E. (2d) 409 (1950).

⁹ *Martin v. The Law Society*, [1950] 3 D. L. R. 173 (B. C. Ct. of App.).

¹⁰ INTERNATIONAL LABOR DEFENSE PAMPHLET NO. 5, UNDER ARREST (1934).

¹¹ See 94 CONG. REC. 4850 (1948).

¹² H. R. REP. No. 3123, 81st Cong., 2d Sess. 5 (1950).

malities the Communist must use the trial as a means of bringing his indictments against the dominant capitalist regime and of courageously voicing the veiv of his party.

The most recent example of this interference with judicial proceedings was the ordeal of Judge Medina in the trial of the eleven Communists¹³ for violation of the Smith Act.¹⁴ The defense attorneys made little effort to exonerate their clients—the sole purpose of the trial was to make a mockery of American justice. These lawyers heaped abuse upon the United States, the court, and its officers, and made repeated efforts to fill the record with error so that the case would go through repeated appeals and be kept in the eyes of the public *ad infinitum*. The Communists who were being tried were to be martyrs for the party.

The foregoing examples of Communist courtroom tactics, actual and projected, raise the question whether the courts of this country must be subjected to these indignities before they can protect themselves, or whether they may take action against the Communist advocate before he steps into the courtroom. In almost every disbarment proceeding, mention is made of the fact that the power to disbar should be exercised with great caution, and that it should be used only where the attorney's continuance in practice would be subversive to the proper administration of justice and the integrity of the profession.¹⁵ It is with this thought in mind that the merits of Resolution III of the American Bar Association will be examined.

I.

The Court of Appeals of British Columbia recently upheld the Benchers of the Law Society of that province in their refusal to admit an avowed Communist to the practice of law.¹⁶ The Society concluded, upon an investigation of the ideological values, motives, and loyalties of an adherent of the alien philosophy of Communism, that a person of this belief was undesirable as a member of the bar. Although there was no affirmative evidence that the applicant had advocated the overthrow of the government by force or non-constitutional methods, or that he had been engaged in subversive activities, the court pointed out that the end of Communist activity is world revolution, and inferred that anyone who believes in Marxist teachings must necessarily advocate the destruction of all free governments.

The appellant expounded at great length upon freedom of expression, freedom of thought, freedom of the individual, and the protec-

¹³ See *United States v. Sacher et al.*, 182 F. (2d) 416 (2d Cir. 1950).

¹⁴ 18 U. S. C. § 2385 (Supp. 1950).

¹⁵ See *e.g.*, *In re Donaghy*, 402 Ill. 120, 83 N. E. (2d) 560 (1948).

¹⁶ *Martin v. The Law Society*, [1950] 3 D. L. R. 173 (B. C. Ct. of App.).

tion of minorities in arguing that he should not be denied the "right" to practice law. Commenting on this, the court stated:¹⁷

How these "freedoms" can be invoked on behalf of an avowed Communist to place him in a position where he could more effectively destroy them, is a paradox. But this type of paradox is consistent with the Communist plan of infiltration which disclosures in the United States in particular have made a matter of common knowledge in our day.

In future cases, a distinction may be attempted because of the fact that this was a case involving *admission* to the bar and not *disbarment*. But there is a great deal of authority to the effect that since national loyalty is an essential qualification for admission to practice, an attorney may be disbarred whenever he ceases to possess this quality.¹⁸ The court in the *Martin* case recognized this theory by way of dicta in stating:¹⁹

. . . if a well known lawyer member of the Liberal party or of the Progressive-Conservative party should publicly declare his belief in Marxist Communism, the Benchers of the Law Society might well find it their duty (after a proper hearing, of course) to disbar him from practice. Such action by the Benchers would not be directed toward his "political opinions" but toward beliefs of his inimical to his country and repugnant to the ancient and honorable profession of law. . . .

There is no reason to conclude that a higher standard of morals and ethics should be required of a person seeking admission to the bar than that required for one to remain a member. Both should be on an equally high plane.

Among the requisite qualities of a lawyer is loyalty to both state and federal governments; before a prospective attorney is admitted to practice, he is required to take an oath in which he swears to support both the state and federal constitutions. An oath of this nature is repugnant to the belief in Communist philosophy. In 1945, the United States Supreme Court, in the case of *In re Summers*, upheld a decision of an Illinois court in which a conscientious objector was refused admission to the Illinois Bar because the examiners thought his religious beliefs would be inconsistent with the obligations of an attorney.²⁰ The petitioner was willing to take the oath but the examiners felt that he could not do so in good faith. Undoubtedly, the Communists also would be most willing to take the oath, but past experience proves that an oath is meaningless to the Communist where he can further the ends of his Party.

Communists can be expected to rely upon every constitutional guarantee of individual freedom as a shield for their efforts to destroy

¹⁷ *Ibid.*

¹⁸ *People ex rel. Chicago Bar Ass'n v. Meyerovitz*, 278 Ill. 356, 116 N. E. 189 (1917); *Underwood v. Commonwealth*, 32 Ky. L. Rep. 32, 105 S. W. 151 (1907).

¹⁹ *Martin v. The Law Society*, [1950] 3 D. L. R. 173 (B. C. Ct. of App.).

²⁰ *In re Summers*, 325 U. S. 561, 65 S. Ct. 1307, 89 L. Ed. 1795 (1945).

the very institutions which guarantee these liberties. In the *Summers* case, the conscientious objector raised the issue of his constitutional right to freedom of religion. This was one of the few freedoms which was not invoked in the *Martin* case. If such an issue is ever raised in the future, the *Summers* decision should be controlling authority.

In *Cohen v. Wright*²¹ an attack was made on the constitutionality of a statute providing that attorneys should take an oath of allegiance as a condition precedent to admission to the bar. The court rejected this contention by stating:²²

The public have a right to demand that no person shall be permitted to aid in the administration of Justice whose character is tainted with dishonesty, corruption, crime, and we will add, disloyalty, or treasonable act. [Emphasis supplied.]

A brief review of cases of disbarment for disloyalty to the Government will give some insight into the problem at hand. In 1919, the Supreme Court of Texas held that it was not "dishonorable conduct" under the Texas disbarment statute for an attorney to say to another: "Germany is going to win the war and I hope she will."²³ It should be noted that the court in this case felt that it should be bound absolutely by the grounds for disbarment specifically listed in the disbarment statute. The judiciary in a minority of states feel themselves so bound.²⁴ However, the majority of the states' judiciary rightfully hold that the disbarment statutes are mere guides to the discretion of the courts.²⁵ Since an attorney is an officer of the court in the state wherein he is practicing, his conduct should be controlled by the judiciary, and legislative enactments should be considered only as an aid to the courts in the determination of the minimum standards required of an attorney.

In 1918, the Supreme Court of Idaho held that an attorney could be disbarred for violating the federal statute imposing punishment for making false reports with the intent to interfere with enlistments.²⁶ In 1920, this court once again came to the same conclusion on a similar set of facts.²⁷ In both instances, the court held that a violation of the Selective Service Act was the commission of a crime involving moral turpitude. Today, one who advocates the overthrow of the Government by force violates the Smith Act, an analogous situation.

²¹ 22 Cal. 293 (1863).

²² *Id.* at 320.

²³ *Lotto v. State*, 208 S. W. 563 (Tex. Civ. App. 1919).

²⁴ *Sullivan v. State Bar*, 28 Cal. (2d) 488, 170 P. (2d) 888 (1946); *State ex rel. Grievance Committee of Oregon State Bar Ass'n et al. v. Woerndle*, 109 Ore. 461, 220 Pac. 744 (1923); *In re Wells*, 121 Wash. 68, 208 Pac. 25 (1922).

²⁵ See e.g., *In re Cox*, 164 Kan. 160, 188 P. (2d) 652 (1949); *In re Taylor*, 309 Ky. 388, 217 S. W. (2d) 954 (1949).

²⁶ *In re Hofstede*, 31 Idaho 448, 173 Pac. 1087 (1918).

²⁷ *In re Kerl*, 32 Idaho 737, 188 Pac. 40 (1920).

A violation of this Act would certainly be a crime involving moral turpitude and would, consequently, be grounds for disbarment.

The case of *In re Margolis*,²⁸ decided whether an attorney could be disbarred for actively participating in an organization attempting to nullify a law, even though he had never been prosecuted for its violation and it could not be shown that he had made an actual attempt to obstruct the operation of the statute. It was held that the attorney could be disbarred on these grounds.

The defendant, Margolis, admitted that he was an anarchist, a syndicalist, a Communist, a Bolshevik, a member of the Industrial Workers of the World, and of an anarchistic organization known as the Union of Russian Workers. The lower court found that the aims of these various groups were in conflict with the principles of our country, and that persons supporting these theories could not uphold the constitution and the laws of the state and the United States. When the defendant claimed his right to freedom of speech, liberty, and so on, the court quoted from a previous case which had stated:²⁹

. . . all persons owing allegiance to the government, or residing within its jurisdiction, owe to it obedience to its Constitution and laws, and aid and support against all who seek its destruction. When the citizen or resident refuses to render this obedience and support; when he aids, assists, countenances, or encourages those who are struggling to overthrow the government—he no longer has a just claim to the aid of the government to enforce his rights.

The court further declared, in regard to the repugnancy between the advocacy of the overthrow of government by force and the oath taken by an attorney upon his admission to practice:³⁰

Such conduct as here shown, if indulged in by anyone, would tend to wrongdoing, but in the case of an attorney, whose duty it is to uphold the law, and not encourage a breach thereof . . . it constitutes a positive disregard of the official obligation which he solemnly entered into when he took his oath of office.

In the case of *In re Smith*,³¹ the attorney whose disbarment was sought had made public addresses advocating sabotage, syndicalism and general violation of the law as a step toward social reform under the auspices of the Industrial Workers of the World. The court sets out the purpose of the I.W.W. and quotes extensively from its literature to prove that the organization advocated anarchy by subtle sabotage. It was claimed that the I.W.W. literature introduced in evidence contained the earlier ideas of the organization, and that its later pronouncements denounced these doctrines. It was also contended

²⁸ 269 Pa. 206, 112 Atl. 478 (1921).

²⁹ *Cohen v. Wright*, 22 Cal. 293, 325 (1863).

³⁰ *In re Margolis*, 269 Pa. 206, 112 Atl. 478, 480 (1921).

³¹ 133 Wash. 145, 233 Pac. 288 (1925).

that these doctrines of sabotage were preached but never practiced. The court refused to accept this argument and concluded:³²

The defendant is freely conceded the right to advocate, either publicly or privately, changes in the present form of government, however great or however fundamental such changes may be, so long as his advocacy is confined to means sanctioned by law. But he oversteps permissible bounds when he advocates changes by criminal or other unlawful means. . . .

The dissenting opinion³³ pointed out that the attorney was not a member of the I.W.W. and that the record did not disclose any evidence that he had advocated the views expressed in the I.W.W. literature, in so far as they advocated sabotage, syndicalism, or actual violations of law. However, the majority felt that the attorney's association with the I.W.W. was sufficient to warrant his disbarment. The holding of this case is particularly significant in that the attorney was not a member of the I.W.W., but only associated with it. This makes his position analogous to a "fellow traveler" of the Communist Party.

II.

Underlying each decision examined is the idea that a lawyer is an officer of the court, and that he is, and rightly should be, subject to regulation and control by the judicial system which he serves, whether state or federal. Although an early decision has held that the practice of law is a property right,³⁴ the great weight of authority properly classifies it as a privilege. In the words of the Kentucky court:³⁵

This license, a personal privilege, is burdened with pre-existing as well as subsequent conditions calculated to uphold and maintain the dignity of the court, the ethics of the profession and the welfare of all concerned with the administration of justice.

As a logical derivative of this characterization, the courts generally do not construe a disbarment proceeding in the nature of a criminal action, or the disbarment itself as a punishment,³⁶ but, as stated in *In re Keenen*:³⁷

Its purpose is to exclude from the office of an attorney in the courts for the preservation of the purity of the courts and the protection of the public, one who has *demonstrated* that he is not a proper person to hold such office. [Emphasis supplied.]

³² *Id.*, 233 Pac. at 291.

³³ *Ibid.*

³⁴ *Ex parte Steinman and Hensel*, 95 Pa. 220 (1880).

³⁵ *In re Taylor*, 309 Ky. 388, 217 S. W. (2d) 954, 957 (1949).

³⁶ *In re Rothrock*, 16 Cal. (2d) 449, 106 P. (2d) 907 (1940); *In re Keenan*, 310 Mass. 166, 37 N. E. (2d) 516 (1941). *But see In re Stolen*, 193 Wis. 602, 214 N. W. 379, 386 (1927).

³⁷ 310 Mass. 166, 37 N. E. (2d) 516, 519 (1941).

A prediction whether the word "demonstrated" refers only to overt acts depends upon the analysis of the law dealing with the source and extent of the power which regulates the privileges of membership in the bar. The legislature, by use of its police power, may govern the privilege of practicing law.³⁸ For the public good, the legislature may prescribe minimum educational³⁹ and character qualifications;⁴⁰ it may punish the practice of law without a license;⁴¹ it may compel a lawyer to accept the fee stipulated in the state workman's compensations law;⁴² it may prescribe oaths designated to exclude those who served the Confederacy from practicing within the state,⁴³ and oaths which require the candidate to swear that he will defend the United States and the state in which he will practice law.⁴⁴ Could not to this be added a statute refusing the privilege to a Communist? Certainly the good of the public is no better served by protecting the worker from excessive lawyer's fees, or by oaths which, in effect, prevented ex-sympathizers of the Confederacy and conscientious objectors from practicing law, than it would be by the denial of the privilege to those who designate "the capitalist court as a class enemy."⁴⁵

It must be noted, however, that the legislature's power over the practice of law extends only to the limits of its police power.⁴⁶ Even in England, Parliament, which incorporates the powers of all branches of government, merely regulated but did not seek to control absolutely the admission of attorneys.⁴⁷ In the United States, with the separa-

³⁸ *Brydonjack v. State Bar of California*, 208 Cal. 439, 281 Pac. 1018 (1929); *People ex rel. Chicago Bar Ass'n v. Goodman*, 366 Ill. 346, 8 N. E. (2d) 941, *cert. denied*, 302 U. S. 728, 58 S. Ct. 49, 82 L. Ed. 562 (1937); *Lowell Bar Ass'n et al. v. Loeb et al.*, 315 Mass. 176, 52 N. E. (2d) 27 (1943); *In re Opinion of Justices*, 279 Mass. 607, 180 N. E. 725 (1932); *Detroit Bar Ass'n et al. v. Union Guardian Trust Co.*, 282 Mich. 216, 276 N. W. 365 (1937); *Clark v. Austin*, 340 Mo. 467, 101 S. W. (2d) 977 (1937); *Judd et al. v. City Trust & Savings Bank et al.*, 133 Ohio St. 81, 12 N. E. (2d) 288 (1937); *Nelson et al. v. Smith et al.*, 107 Utah 382, 154 P. (2d) 634 (1944); *Application of Levy*, 23 Wash. (2d) 607, 161 P. (2d) 651 (1945); *Integration of Bar Case*, 244 Wis. 8, 11 N. W. (2d) 604 (1943).

³⁹ *Institute of Metropolis v. University of the State of New York*, 249 App. Div. 33, 291 N. Y. Supp. 893 (3d Dep't 1936), *aff'd without opinion*, 274 N. Y. 504, 10 N. E. (2d) 521 (1937).

⁴⁰ *In re Applicants for License*, 143 N. C. 1, 55 S. E. 635 (1906).

⁴¹ *Berk v. State ex rel. Thompson*, 225 Ala. 324, 142 So. 832 (1932).

⁴² *Yeiser v. Dysart et al.*, 267 U. S. 540, 45 S. Ct. 399, 69 L. Ed. 775 (1925); *Buckler v. Hilt et al.*, 209 Ind. 541, 200 N. E. 219 (1936).

⁴³ *Cohen v. Wright*, 22 Cal. 293 (1863); *Ex parte Quarrier and Fitzhugh*, 4 W. Va. 210 (1870); *Ex parte Hunter et al.*, 2 W. Va. 122 (1867).

⁴⁴ *In re Summers*, 325 U. S. 561, 65 S. Ct. 1307, 89 L. Ed. 1795 (1945).

⁴⁵ INTERNATIONAL LABOR DEFENSE, *op. cit. supra* note 10, at 7.

⁴⁶ *State ex rel. Ralston v. Turner*, 141 Neb. 556, 4 N. W. (2d) 302 (1942); *Application of Levy*, 23 Wash. (2d) 607, 161 P. (2d) 651 (1945).

⁴⁷ *In re Day et al.*, 181 Ill. 73, 54 N. E. 646, 648 (1899).

tion of powers into three branches of government, the courts reserved to themselves, as a corollary of their exclusive right to administer justice, regulation of the admission and discipline of attorneys.⁴⁸ The courts designate this reservation as an "inherent power,"⁴⁹ one that is necessarily implied for the performance of their functions. Consequently, a court construes any valid exercise of the legislature's police power as a limitation on the applicant rather than a limitation on the court's power.⁵⁰ A court, then, will not tolerate any legislation on the subject that it deems an unreasonable exercise of police power, or which it regards as an infringement upon its inherent rights. For this reason, legislation setting the standards under which a veteran might be admitted to the bar was held not to control where it conflicted with a court rule on the subject,⁵¹ and a statute designating acceptable law schools was held unconstitutional as an usurpation of the court's inherent power.⁵² The legislature may not vacate an order for disbarment,⁵³ or reinstate a lawyer once he has been disbarred.⁵⁴ A statute declaring that the handling of personal injury claims is not the practice of law, and therefore open to the layman, was held invalid as an indirect attempt to regulate the admission of attorneys and beyond the legislative power.⁵⁵ While state courts respected an oath prescribed by the legislature preventing citizens of the Confederacy from practicing law within the state as a reasonable exercise of the state police power,⁵⁶ the Supreme Court of the United States did not so regard an oath prescribed by Congress directed toward those practicing in federal courts. It was declared unconstitutional as an *ex post facto* law and bill of attainder.⁵⁷

A serious question, then, is presented as to whether any statute designed to exclude Communists from the practice of law would exceed the limits of the legislatures' power in the states and in the Federal Government. Naturally, this question need not be answered

⁴⁸ *Laughlin v. Clephane et al.*, 77 F. Supp. 103 (D. D. C. 1947); Application of Kaufman et al., 69 Idaho 297, 206 P. (2d) 528 (1949), 25 NOTRE DAME LAW. 143 (1949); *In re Day et al.*, 181 Ill. 73, 54 N. E. 646 (1899); *Lowell Bar Ass'n et al. v. Loeb et al.*, 315 Mass. 176, 52 N. E. (2d) 27 (1943); *State ex rel. Ralston v. Turner*, 141 Neb. 556, 4 N. W. (2d) 302 (1942); *Ruckenbrod v. Mullins et al.*, 102 Utah 548, 133 P. (2d) 325 (1943); *State ex rel. Laughlin v. Washington State Bar Ass'n*, 26 Wash. (2d) 914, 176 P. (2d) 301 (1947); Application of Levy, 23 Wash. (2d) 607, 161 P. (2d) 651 (1945); *In re Cannon*, 206 Wis. 374, 240 N. W. 441 (1932); see case in Note, 144 A. L. R. 150 (1943).

⁴⁹ See note 48 *supra*.

⁵⁰ *In re Cannon*, 206 Wis. 374, 240 N. W. 441, 450 (1932).

⁵¹ Application of Levy, 23 Wash. (2d) 607, 161 P. (2d) 651 (1945).

⁵² *State ex rel. Ralston v. Turner*, 141 Neb. 556, 4 N. W. (2d) 302 (1942).

⁵³ *In re Phillips*, 17 Cal. (2d) 55, 109 P. (2d) 344 (1941).

⁵⁴ *In re Cannon*, 206 Wis. 374, 240 N. W. 441 (1932).

⁵⁵ *Meunier v. Bernich et al.*, 170 So. 567 (La. App. 1936).

⁵⁶ See note 43 *supra*.

⁵⁷ *Ex parte Garland*, 4 Wall. 333, 18 L. Ed. 366 (U. S. 1867).

in the same way in every state or in the federal courts. Witness the divergence on the validity of the test oaths pointed out above.

This question could be avoided, however, if the courts, state and federal, would see fit to exclude Communists from the practice of law. Appropriate action could be taken under the courts' present rules governing the requirements of moral fitness and loyalty of lawyers. The Canadian "Bencher" acted in this manner to deny a Communist applicant the privilege of practicing law,⁵⁸ and the Supreme Court of Illinois, holding that a conscientious objector could not honestly take an oath to support and defend the Constitution of the United States and of Illinois, denied his admission.⁵⁹ If a conscientious objector could be refused admittance to the bar by a state court, the argument for refusing admission or disbarring a Communist is even stronger. If the courts of the several states determined that their present rules were insufficient to accomplish this result, they might be prevailed upon to issue new rules to eliminate the dangers that the practicing Communist lawyer creates. Certainly, action by the court upon rules of its own making is to be preferred over a statute. Such a rule could be fashioned by the court to meet its own needs, and would be far more flexible than a statute. The evil created by the Communist lawyer is directed toward the court, and as long as the court has the power to protect itself, the method should be its to choose.

The Supreme Court of the United States would have jurisdiction to review the results of either the statute or the court rule. Although the practice of law has consistently been held to be neither a privilege nor immunity of a citizen of the United States within the purview of the Fourteenth Amendment,⁶⁰ nor a property right,⁶¹ the fact remains that the Supreme Court has reviewed cases concerning the subject of disbarment.

Although the cases are not clear, the basis for review is that the practice of law is a liberty, within the definition of the Fourteenth Amendment, that cannot be denied without due process of law. This conclusion is borne out by the fact that each time the Supreme Court

⁵⁸ *Martin v. The Law Society*, [1950] 3 D. L. R. 173 (B. C. Ct. of App.).

⁵⁹ *In re Summers*, 325 U. S. 561, 65 S. Ct. 1307, 89 L. Ed. 1795 (1945).

⁶⁰ *Yeiser v. Dysart*, 267 U. S. 540, 45 S. Ct. 399, 69 L. Ed. 775 (1925); *Ex Parte Lockwood*, 154 U. S. 116, 14 S. Ct. 1082, 38 L. Ed. 929 (1894); *Bradwell v. Illinois*, 16 Wall. 130, 21 L. Ed. 442 (U. S. 1873); *Mitchell v. Greenough et al.*, 100 F. (2d) 184, (9th Cir. 1938); *Brents v. Stone et al.*, 60 F. Supp. 82 (E. D. Ill. 1945); *State ex rel. Ralston v. Turner*, 141 Neb. 556, 4 N. W. (2d) 302 (1942); *Ruckenbrod v. Mullins et al.*, 102 Utah 548, 133 P. (2d) 325 (1943).

⁶¹ *Wernimont v. State ex rel. Little Rock Bar Ass'n*, 101 Ark. 210, 142 S. W. 194 (1911); *In re Taylor*, 309 Ky. 388, 217 S. W. (2d) 954 (1949); *accord*, *Yeiser v. Dysart*, *supra* note 60; *Laughlin v. Clephane et al.*, 77 F. Supp. 103 (D. D.C. 1947).

has considered the question, it has reasserted that the practice of law is a state-created "right" (contrary to the general holding of state courts that it is a privilege⁶²) which is subject to reasonable restrictions.⁶³ While the Supreme Court has yet to find that any action by the state is unreasonable, the very fact that reasonableness is required would give rise to the inference that the practice of law is a liberty within the meaning of the Fourteenth Amendment. True enough, the Supreme Court at one time determined that congressional action respecting the practice of law in the form of a test oath was an *ex post facto* law and a bill of attainder,⁶⁴ but this decision was based on a determination that disbarment was a punishment. Disbarment is no longer considered a punishment,⁶⁵ in the absence of which there cannot be an *ex post facto* law or bill of attainder. This test oath was distinguished from the non-Communist oath required by the Taft-Hartley law on the grounds that the test oath applied to past actions while in the non-Communist oath, ". . . they are subject to possible loss of position only because there is substantial ground for the congressional judgment that their beliefs and loyalties will be transformed into *future* conduct."⁶⁶

The conclusion at which the Supreme Court may arrive on the constitutionality of the suggested statutes or court rules will best be based on the results of the most recent cases on the subject. As outlined before, the *Summers* case⁶⁷ stands for the proposition that a conscientious objector may be denied the privilege to practice law by the state, if the state requires all applicants to take an oath to defend the constitution of that state. This was a five-four decision, with a strong dissent⁶⁸ by Mr. Justice Black on the grounds that a man was being denied his religious liberty.

Whether the dissent would have been as strong if it were a Communist that was being deprived of the privilege is a matter of conjecture. The Court in dealing with the non-Communist oath of the Taft-Hartley Act, declared that Congress could reasonably find that the Communist is not a proper person to be a leader in a union which is to have the privilege of being an exclusive bargaining agent.⁶⁹ Justice Jackson in the same case, in a concurring opinion,⁷⁰ declared

⁶² *In re Taylor*, 309 Ky. 388, 217 S. W. (2d) 954 (1949).

⁶³ See, e.g., *Yeiser v. Dysart*, 267 U. S. 540, 541, 45 S. Ct. 399, 69 L. Ed. 775 (1925).

⁶⁴ *Ex parte Garland*, 4 Wall. 333, 18 L. Ed. 366 (U. S. 1867).

⁶⁵ See note 36 *supra*.

⁶⁶ *American Communications Ass'n C. I. O. et al. v. Douds*, 339 U. S. 382, 413, 70 S. Ct. 674, 94 L. Ed. 925 (1950).

⁶⁷ *In re Summers*, 325 U. S. 561, 65 S. Ct. 1307, 89 L. Ed. 1795 (1945).

⁶⁸ *Id.*, 325 U. S. at 573.

⁶⁹ *American Communications Ass'n C. I. O. et al. v. Douds*, 339 U. S. 382, 70 S. Ct. 674, 94 L. Ed. 597 (1950).

⁷⁰ *Id.*, 339 U. S. at 422.

that Communism is more than a mere matter of belief; it is a dynamic force which seeks a world revolution by force and violence if necessary. The Communist himself is the implement by which this end is to be obtained. If Congress has the power to condition any right or privilege of an American citizen by oath it certainly could act in this instance.

Conclusion

On this authority then, it appears that state action against Communists in the practice of law should be held reasonable. The practice of law does not exist for the purpose of a world revolution, and the use of the privilege to abuse the courts and ridicule justice is not proper. The position of a lawyer, whose function is to serve the courts and preserve their dignity, when held by a Communist becomes a dangerous weapon in the hands of an organization whose aims and ideals are incompatible with democratic government. It is reasonable, then, to deny that weapon to that organization. As stated by the Canadian court:⁷¹

. . . the principles of constitutional democracy upon which free society is established, cannot be based upon pragmatic values, determinable by circumstances and consequently variable. They must be based on certain absolute values, justice, truth and reason. That is why inalienable rights were written into the United States Constitution. That is why we have Magna Carta. Hence freedom of expression must have some limitations—it cannot be used to destroy our free society, to destroy democracy itself. Freedom of expression cannot be given to Communists to permit them to use it to destroy our constitutional liberties, by first poisoning the minds of the young, the impressionable, and irresponsible. Freedom of expression is not a freedom to destroy freedom.

Sidney Baker

Maurice J. Moriarty

Taxation

INCOME TAX EVASION

In order that a taxpayer may not mistake his duty, the Internal Revenue Code is greatly detailed with respect to what is taxable income. Nevertheless, his right to plan his transactions and carry them out in a manner most advantageous, tax-wise, to himself is recognized. The exercise of the right is "avoidance," which must be within the terms of the code, regulations, and their interpretations. The particular method of avoidance may, of course, be questioned by the Bureau,

⁷¹ Martin v. The Law Society, [1950] 3 D. L. R. 173 (B. C. Ct. of App.).

necessitating interpretation of the statute. Unfortunately, the permissible end of lowering taxes is frequently sought through illegal means. This is evasion. Unlike avoidance, it is a shirking of one's duty to the Government. Just as Congress has specifically provided for the production of revenue, it has also provided for the disposition and punishment of evaders.

While the penal provisions themselves are clear, the type of illegal activity to which they apply is not. Evasion may take the form of criminal fraud, civil fraud, or negligence. Where criminal fraud is found, it may be either a felony or a misdemeanor. Where no crime is found, the act may be fraudulent or negligent.

I.

Preliminary Considerations

The Internal Revenue Code provides that a wilful attempt to evade or defeat the tax is a felony punishable by a fine of ten thousand dollars, and/or imprisonment for not more than five years.¹ This penalty also applies to any person who wilfully aids, assists, procures, counsels, or advises the preparation of a false or fraudulent return under the internal revenue laws, whether or not the person authorized or required to present the return has knowledge of or consents to the misstatement.² A wilful failure to pay the tax, to make a return, or to keep records and supply information as required by the Code and the regulations, is a misdemeanor punishable by fine of ten thousand dollars and/or imprisonment for not more than one year.³

The Code also contains civil sanctions. A fifty percent penalty is assessed when any part of a deficiency is caused by fraud with intent to evade tax.⁴ But if a deficiency is due to negligence or intentional disregard of rules and regulations without intent to defraud, five percent of the total amount of the deficiency, in addition to the deficiency, is assessed.⁵ A five percent penalty is imposed for any failure to make and file a return required by the internal revenue laws. It increases five percent every thirty days from the date of failure, to a maximum of twenty-five percent;⁶ this is in addition to the fraud or negligence penalties where these are applicable.⁷

¹ INT. REV. CODE § 145(b).

² INT. REV. CODE § 3793(b)(1).

³ INT. REV. CODE § 145(a).

⁴ INT. REV. CODE § 293(b). Comparable penalties are found in § 1019(b), for the gift tax and in § 3612(d)(2), for all other taxes.

⁵ INT. REV. CODE § 293(a). Minor exceptions to the negligence penalty are found in §§ 272(i), 292.

⁶ INT. REV. CODE § 291.

⁷ *Roerich v. Helvering*, 115 F. (2d) 39 (D. C. Cir.), *cert. denied*, 312 U. S. 700, 61 S. Ct. 740, 85 L. Ed. 1134 (1940). The taxpayer is also liable for six

Limitation of Actions:

The imposition of these penalties is subject to statutes of limitations. There is a six-year period of limitations applicable to felonies,⁸ while the penalty imposed for a misdemeanor under Section 145(b) is subject to a three year period of limitations.⁹ These statutes begin to run when the wilfulness occurs.¹⁰ In instances of civil fraud, negligence, or simple deficiency, an action may be brought by the Government at any time.¹¹

Burden of Proof:

Crime or fraud is not presumed. Rather, the taxpayer is deemed to act in good faith in his dealings with the Government and the burden of proof lies with the Commissioner.¹² For criminal fraud, like all other criminal actions, the Commissioner has the burden of proving the guilt of the taxpayer beyond a reasonable doubt.¹³ But in so doing, he does not have to prove an evasion of the whole deficiency charged in the indictment; the proof is sufficient if it shows "any substantial portion" of the tax liability to have been wilfully evaded.¹⁴ In a civil action a mere preponderance of evidence is insufficient to prove tax fraud.¹⁵ The Commissioner must establish his case by clear and convincing proof.¹⁶

percent annual interest on any deficiency, regardless of the reason for the deficiency, INT. REV. CODE § 292; in addition, the expense of detection and punishment of fraud may be assessed, INT. REV. CODE § 3792.

⁸ INT. REV. CODE §§ 3748(a)(2), (3).

⁹ INT. REV. CODE § 3748(a).

¹⁰ *Capone v. United States*, 51 F. (2d) 609 (7th Cir.), *cert. denied*, 284 U. S. 669, 52 S. Ct. 44, 76 L. Ed. 566 (1931); *Arnold v. United States*, 75 F. (2d) 144 (9th Cir. 1935).

¹¹ INT. REV. CODE § 276(a). In these situations it is considered that a false, fraudulent, or deficient "return" is no return at all; hence, a statute of limitations could not begin to run. *Duncan C. McCrea*, P-H 1948 TC MEM. DEC. ¶ 48,159 (1948), *aff'd*, 184 F. (2d) 842 (6th Cir. 1950); *Demos Mandis*, P-H 1950 TC MEM. DEC. ¶ 50,149 (1950).

¹² INT. REV. CODE § 1112; *George L. Rickard*, 15 B. T. A. 316 (1929). This burden was placed upon the Commissioner in Section 601 of the Revenue Act of 1928. 45 STAT. 872 (1928).

¹³ *United States v. Murdock*, 290 U. S. 389, 54 S. Ct. 223, 78 L. Ed. 381 (1933); *Paddock v. United States*, 79 F. (2d) 872 (9th Cir. 1935).

¹⁴ *Himmelfarb v. United States*, 175 F. (2d) 924 (9th Cir.), *cert. denied*, 338 U. S. 860, 70 S. Ct. 103, 94 L. Ed. 527 (1949); *United States v. Rosenblum*, 176 F. (2d) 321 (7th Cir.), *cert. denied*, 338 U. S. 893, 70 S. Ct. 239, 94 L. Ed. 548 (1949); *Cave v. United States*, 159 F. (2d) 464 (8th Cir.), *cert. denied*, 331 U. S. 847, 67 S. Ct. 1732, 91 L. Ed. 1856 (1947); *Tinkoff v. United States*, 86 F. (2d) 868 (7th Cir. 1936), *cert. denied*, 301 U. S. 689, 57 S. Ct. 795, 81 L. Ed. 1346 (1937). *United States v. Koppelman*, 61 F. Supp. 1007 (M.D. Pa. 1945) (\$12,000 omitted from a \$3,500,000 partnership not substantial). What constitutes a "substantial portion" will vary with the individual case.

¹⁵ *Estate of James H. Snowden*, P-H 1947 TC MEM. DEC. ¶ 47,231 (1947).

What amounts to clear and convincing proof is not susceptible to facile definition. In one case the Commissioner was required to submit evidence to prove that fraud existed even though the taxpayer offered no evidence whatsoever and, in fact, did not appear.¹⁷ Yet, in other cases it was held that the Commissioner had sustained the burden of proof where there was a showing of a failure to report income without a reasonable excuse.¹⁸ The burden of proof is not necessarily a positive one. For example, a failure to testify has been held to create a presumption of fraud.¹⁹ Where deficiencies are "too many, too varied, too continuous and too excessive to be plausibly attributed to inadvertence or carelessness . . ." ²⁰ the Government has demonstrably proved its case clearly and convincingly.

Methods of Detection:

Since a fraudulent deficiency can seldom be established by direct proof when income is concealed,²¹ the Bureau must prove the amount by approximation. The two most common methods used by the Bureau are the "analysis of bank deposits" method and the "net worth" method. Under the former, the taxpayer's bank statements are examined in order to determine his approximate income. If no adequate explanation is offered of the source of the deposits, their total may be treated as income.²² Under the net worth method the Bureau reconstructs the net worth of the taxpayer at the beginning and end of the year in question, treating the increase in net worth, plus the taxpayer's

¹⁶ Griffiths v. Commissioner, 50 F. (2d) 782 (7th Cir. 1931); A. W. Mellon, 36 B.T.A. 977 (1937); Joseph Talbot, P-H 1950 TC MEM. DEC. ¶ 50,179 (1950); Estate of Fred Arbogast, P-H 1948 TC MEM. DEC. ¶ 48,047 (1948); Ellwood M. Rabenold, P-H 1947 TC MEM. DEC. ¶ 47,250 (1947).

¹⁷ Miller-Pocahontas Coal Co., 21 B. T. A. 1360 (1931).

¹⁸ Rogers v. Commissioner, 111 F. (2d) 987 (6th Cir. 1940); A. Harry Wyman, P-H 1950 TC MEM. DEC. ¶ 50,172 (1950); Florian J. Bryloski, P-H 1949 TC MEM. DEC. ¶ 49,222 (1949); Joseph S. Loparo, P-H 1949 TC MEM. DEC. ¶ 49,214 (1949).

¹⁹ Max Cohen, 9 T. C. 1156 (1947); Wichita Terminal Elevator Co., 6 T. C. 1158 (1946).

²⁰ Halle v. Commissioner, 175 F. (2d) 500, 503 (2d Cir. 1949).

²¹ Myres v. United States, 174 F. (2d) 329 (8th Cir. 1949); Paschen v. United States, 70 F. (2d) 491 (7th Cir. 1934); United States v. Commerford, 64 F. (2d) 28 (2d Cir. 1933).

²² Chadick v. United States, 77 F. (2d) 961 (5th Cir.), *cert. denied*, 296 U. S. 609, 56 S. Ct. 126, 80 L. Ed. 432 (1935); Guzik v. United States, 54 F. (2d) 618 (7th Cir.), *cert. denied*, 285 U. S. 545, 52 S. Ct. 395, 76 L. Ed. 937 (1932) (taxpayer reported \$60,240 as against \$1,044,353 determined by the Commissioner); Halle v. Commissioner, 175 F. (2d) 500 (2d Cir. 1949); Arthur M. Slavin, 43 B. T. A. 1100 (1941), *aff'd*, 129 F. (2d) 325 (8th Cir. 1942); Russell C. Mauch, 35 B. T. A. 617 (1937), *aff'd*, 113 F. (2d) 555 (3rd Cir. 1940); Leonard B. Willits, 36 B. T. A. 294 (1937). *But cf.* C. J. Kowkabany, P-H 1949 TC MEM. DEC. ¶ 49,191 (1949), where petitioner's determination of income was sustained over the Bureau's after accountants spent 1400 man hours in making the determination; William Neth, P-H 1949 TC MEM. DEC. ¶ 49,012 (1949).

living expenses, as income.²³ The taxpayer then has the burden of rebutting the presumption that the Government's determination is correct.²⁴

Where the nature of the taxpayer's business permitted, the Bureau has added the taxpayer's average mark-up to his purchases to arrive at gross sales in the reconstruction of a profit and loss statement.²⁵ Another method used is to introduce testimony by witnesses with the same occupation as the taxpayer.²⁶ The income of an individual also may be approximated by totaling expenditures where the source of the funds used is unexplained.²⁷ Frequently more than one of the foregoing methods are used in the same investigation.²⁸ However, the method of detection used must be that which clearly reflects the taxpayer's income; ²⁹ if the Commissioner's determination is arbitrary or unreasonable, the courts will set it aside.³⁰

II.

Criminal Fraud

Fraud is defined by Webster as an intentional perversion of the truth for the purpose of obtaining some valuable thing or promise from another. However, exactly what constitutes criminal fraud is not so clear. At least this much is discernible from the Internal Rev-

²³ Frank M. Wiseley, 13 T. C. 253 (1949), where the Commissioner used bank records, mortgage records, etc., consulted with taxpayer's accountant, and determined that the taxpayer had a net worth of \$46,774 at the beginning of the year and \$63,578 at the end. From this increase in net worth \$1686 was subtracted as allowable deductions, and \$3600 was added as living expenses to arrive at net income. See also *United States v. Chapman*, 168 F. (2d) 997 (7th Cir.), *cert. denied*, 335 U. S. 853, 69 S. Ct. 82, 93 L. Ed. 401 (1948); *Kenney v. Commissioner*, 111 F. (2d) 374 (5th Cir. 1940).

²⁴ *Halle v. Commissioner*, 175 F. (2d) 500 (2d Cir. 1949); *Sherman F. Little*, P-H 1947 TC MEM. DEC. ¶ 47,291 (1947).

²⁵ *T. F. Green*, P-H 1948 TC MEM. DEC. ¶ 48,054 (1948) (Commissioner used an average mark-up of 33-1/3 percent).

²⁶ *Roberts v. Commissioner*, 176 F. (2d) 221 (9th Cir. 1949); *Cesanelli v. Commissioner*, 8 T. C. 776 (1947) (ten percent of sales was a fair estimate of tips received by a waiter).

²⁷ *Max Cohen*, 9 T. C. 1156 (1947) (sums expended for personal use or investment during the year, after the elimination of known non-income sources of the funds invested, were treated as income). See also *G. A. Comeaux*, 10 T. C. 201 (1948); *Robert L. Carnahan*, 9 T. C. 1206 (1947).

²⁸ *Everett M. Bratcher*, P-H 1949 TC MEM. DEC. ¶ 49,158 (1949) (bank account and personal expenses); *William Neth*, P-H 1949 TC MEM. DEC. ¶ 49,012 (1949); *T. M. Stanton*, P-H 1947 TC MEM. DEC. ¶ 47,251 (1947).

²⁹ *INT. REV. CODE* § 41; *James T. Bennett*, P-H 1950 TC MEM. DEC. ¶ 50,027 (1950) (net worth method approved).

³⁰ *Helvering v. Taylor*, 293 U. S. 507, 55 S. Ct. 287, 79 L. Ed. 623 (1935) (amount was susceptible of correct determination); *National Lumber & Tie Co. v. Commissioner*, 90 F. (2d) 216 (8th Cir. 1937) (but the taxpayer's evidence was insufficient to establish the correct charge).

enue Code: ³¹ in order for the tax fraud to be criminal, either as a misdemeanor or a felony, the acts of the taxpayer must have been "wilful." This word usually connotes an act which is intentional or voluntary, as distinguished from accidental. It has been said that "wilful" conduct, when used in a criminal statute: ³²

. . . generally means an act done with a bad purpose; without justifiable excuse; . . . stubbornly, obstinately, perversely; . . . without ground for believing it is lawful, or conduct marked by careless disregard whether or not one has the right so to act.

In determining whether the crime is a felony or a misdemeanor, recourse to the statute is of little avail. Section 145(a) states that "wilful failure" to do certain acts is a misdemeanor, while Section 145(b) declares a felony to be a "wilful attempt" to evade or defeat the tax.³³ Theoretically at least, a distinction can be made on the basis that Congress has provided for a more severe punishment for the one act than for the other. It is contended that such a manifestation should not go for aught.³⁴ A more practical basis, however, is that in order for an act of criminal fraud to be a felony, the taxpayer must perform some affirmative act or acts.³⁵ Passive neglect of the statute, even though it is "wilful," is only a misdemeanor.³⁶

An important aspect of this distinction is that an individual may be guilty of a misdemeanor even though he owes no tax; ³⁷ in order to be prosecuted for a felony, tax liability must be alleged and proved.³⁸ Merely because an attempt to evade the tax is unsuccessful does not

³¹ INT. REV. CODE §§ 145(a), (b).

³² *United States v. Murdock*, 290 U. S. 389, 394, 54 S. Ct. 223, 78 L. Ed. 381 (1933); *United States v. Venuto*, 182 F. (2d) 519 (3rd Cir. 1950); *Buttermore v. United States*, 180 F. (2d) 853 (6th Cir. 1950); *Battjes v. United States*, 172 F. (2d) 1 (6th Cir. 1949).

³³ INT. REV. CODE §§ 145(a), (b).

³⁴ *Jones v. United States*, 164 F. (2d) 398 (5th Cir. 1947). In employing the word "attempt" to embrace the gravest of offenses against the revenue laws, Congress intended some wilful commission in addition to the wilful omission that makes up the test of a misdemeanor.

³⁵ *Spies v. United States*, 317 U. S. 492, 63 S. Ct. 364, 87 L. Ed. 418 (1943); *United States v. Capone*, 93 F. (2d) 840 (7th Cir. 1937), *cert. denied*, 303 U. S. 651, 58 S. Ct. 750, 82 L. Ed. 1112 (1938).

³⁶ *Cave v. United States*, 159 F. (2d) 464 (8th Cir.), *cert. denied*, 331 U. S. 847, 67 S. Ct. 1732, 91 L. Ed. 1856 (1947). While the failure to file a return constitutes an omission, and is therefore only a misdemeanor, the omission of income from a return which has been filed is treated as a commission, and therefore constitutes a felony.

³⁷ *O'Brien v. United States*, 51 F. (2d) 193 (7th Cir.), *cert. denied*, 284 U. S. 673, 52 S. Ct. 129, 76 L. Ed. 569 (1931). See *Spies v. United States*, 317 U. S. 492, 63 S. Ct. 364, 87 L. Ed. 418 (1943).

³⁸ *Rose v. United States*, 128 F. (2d) 622 (10th Cir.), *cert. denied*, 317 U. S. 651, 63 S. Ct. 47, 87 L. Ed. 524 (1942); *United States v. Schenck*, 126 F. (2d) 702 (2d Cir.), *cert. denied sub nom.* *United States v. Moskowitz*, 316 U. S. 705, 62 S. Ct. 1309, 86 L. Ed. 1773 (1942); *Paschen v. United States*, 70 F. (2d) 491 (7th Cir. 1934).

relieve the taxpayer from prosecution under Section 145(b). The felony is complete when the taxpayer wilfully and knowingly files a fraudulent return with intent to evade any part of the tax due.³⁹ For the same reason, an assessment of a deficiency is not necessary to a criminal prosecution for wilful attempt to defeat and evade the income tax.⁴⁰ Contrawise, criminal prosecution does not relieve the taxpayer from civil penalties,⁴¹ nor does payment of the civil penalty bar a criminal action.⁴²

Those acts which constitute a misdemeanor are wilful failure to file a return,⁴³ wilful failure to pay the tax,⁴⁴ and wilful failure to keep records and supply information as required by law or regulations.⁴⁵ While the Code specifies what conduct constitutes a misdemeanor, no such limitation is made with respect to felonious actions. The scope of the statute was intimated in the case of *Spies v. United States*,⁴⁶ where the court said:

By way of illustration, and not by way of limitation, we would think affirmative wilful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal.

This enumeration is by no means an exaggeration.⁴⁷

³⁹ *Guzik v. United States*, 54 F. (2d) 618 (7th Cir.), *cert. denied*, 285 U. S. 545, 52 S. Ct. 395, 76 L. Ed. 937 (1932); *United States v. Croissant*, 178 F. (2d) 96 (3rd Cir.), *cert. denied*, 339 U. S. 927, 70 S. Ct. 626, 94 L. Ed. 1348 (1949).

⁴⁰ *United States v. Commerford*, 64 F. (2d) 28 (2d Cir.), *cert. denied*, 289 U. S. 759, 53 S. Ct. 792, 77 L. Ed. 1502 (1933); *Guzik v. United States*, *supra* note 39.

⁴¹ *Spies v. United States*, 317 U. S. 492, 63 S. Ct. 364, 87 L. Ed. 418 (1943); *Helvering v. Mitchell*, 303 U. S. 391, 58 S. Ct. 630, 82 L. Ed. 917 (1938); *John R. Hanby*, 26 B. T. A. 670 (1932), *aff'd*, 67 F. (2d) 125 (4th Cir. 1933).

⁴² *United States v. McCormick*, 67 F. (2d) 867 (2d Cir.), *cert. denied*, 291 U. S. 662, 54 S. Ct. 438, 78 L. Ed. 1054 (1934); *Slick v. United States*, 1 F. (2d) 897 (7th Cir. 1924); *United States v. LaFontaine*, 54 F. (2d) 371 (D. Md. 1931).

⁴³ INT. REV. CODE § 145(a); *Bowles v. United States*, 73 F. (2d) 772 (4th Cir.), *cert. denied*, 294 U. S. 710, 55 S. Ct. 506, 79 L. Ed. 1245 (1934); *O'Brien v. United States*, 51 F. (2d) 193 (7th Cir.), *cert. denied*, 284 U. S. 673, 52 S. Ct. 129, 76 L. Ed. 569 (1931); *United States v. Miro*, 60 F. (2d) 58 (2d Cir. 1932).

⁴⁴ *United States v. Murdock*, 290 U. S. 389, 54 S. Ct. 223, 78 L. Ed. 381 (1933); *United States v. McCormick*, 67 F. (2d) 867 (2d Cir. 1933), *cert. denied*, 291 U. S. 662, 54 S. Ct. 438, 78 L. Ed. 1054 (1934); *United States v. Commerford*, 64 F. (2d) 28 (2d Cir.), *cert. denied*, 289 U. S. 759, 53 S. Ct. 792, 77 L. Ed. 1502 (1933); *United States v. Schuermann*, 79 F. Supp. 247 (E. D. Mo. 1948), *aff'd*, 174 F. (2d) 397 (8th Cir.), *cert. denied*, 338 U. S. 831, 70 S. Ct. 69, 94 L. Ed. 46 (1949); *United States v. Sullivan*, 98 F. (2d) 79 (2d Cir. 1938).

⁴⁵ INT. REV. CODE § 145(a).

⁴⁶ *Spies v. United States*, 317 U. S. 492, 499, 63 S. Ct. 364, 87 L. Ed. 418 (1943).

III.

Civil Fraud

The majority of tax fraud cases are civil rather than criminal. The Internal Revenue Code provides for a fifty percent penalty where any part of the deficiency "is due to fraud with the intent to evade tax."⁴⁸ Neither the income tax regulations nor the Tax Court have defined this phrase. Nor have they specifically stated what characteristics are essential to constitute civil fraud. Perhaps, an exact definition would defeat the purpose of the statute, since the variety of situations from which civil fraud could arise are, like criminal fraud, practically limitless. Any limitation by definition, then, would leave a fertile field for tax avoidance outside the exact limits specified. What is civil fraud can best be said to depend upon the particular situation.

While discussing these situations it must be kept in mind that, as previously pointed out, the Commissioner has the burden of proving that a deficiency is due to fraud, whether it be criminal or civil.⁴⁹

⁴⁷ See *e.g.*, *United States v. Ragen*, 314 U. S. 513, 62 S. Ct. 344, 86 L. Ed. 383 (1941) (failure to keep records usual for similar transactions); *United States v. Rosenblum*, 176 F. (2d) 321 (7th Cir.), *cert. denied*, 338 U. S. 893, 70 S. Ct. 239, 94 L. Ed. 548 (1949) (concealment of income obtained from sale of whiskey above ceiling prices); *Himmelfarb v. United States*, 175 F. (2d) 924 (9th Cir.), *cert. denied*, 338 U. S. 860, 70 S. Ct. 103, 94 L. Ed. 527 (1949) (failure to report income from sale of meat above ceiling prices); *United States v. Chapman*, 168 F. (2d) 997 (7th Cir.), *cert. denied*, 335 U. S. 853, 69 S. Ct. 82, 93 L. Ed. 401 (1948) (concealment of assets from the sale of meat at overceiling prices); *Locke v. United States*, 166 F. (2d) 449 (5th Cir.), *cert. denied*, 334 U. S. 837, 68 S. Ct. 1495, 92 L. Ed. 1763 (1948) (formation of alleged partnerships, trusts, and purported corporations for the purpose of evading income tax); *Steinberg v. United States*, 162 F. (2d) 120 (5th Cir.), *cert. denied*, 332 U. S. 808, 68 S. Ct. 108, 92 L. Ed. 386 (1947) (filing false and fraudulent tax returns); *Maxfield et al. v. United States*, 152 F. (2d) 593 (9th Cir.), *cert. denied*, 327 U. S. 794, 66 S. Ct. 821, 90 L. Ed. 1021 (1946) (special set of books kept for exhibition purposes); *Shinyu Nor et al. v. United States*, 148 F. (2d) 696 (5th Cir.), *cert. denied*, 326 U. S. 720, 66 S. Ct. 25, 90 L. Ed. 426 (1945) (one set of books kept in English and another in Japanese); *Garland v. United States*, 182 F. (2d) 801 (4th Cir. 1950); *Buttermore v. United States*, 180 F. (2d) 853 (6th Cir. 1950) (covering up sources of income); *Jelaza v. United States*, 179 F. (2d) 202 (4th Cir. 1950); *Lurding v. United States*, 179 F. (2d) 419 (6th Cir. 1950) (signing a false return made by an accountant for the taxpayer); *Gaunt v. United States*, 184 F. (2d) 284 (1st Cir. 1950) (filing a false and fraudulent return); *United States v. Potson*, 171 F. (2d) 495 (7th Cir. 1948) (concealment of gambling winnings); *United States v. Lange*, 161 F. (2d) 699 (7th Cir. 1947) (taxpayer made false entries, alterations and invoices); *Yoffe v. United States*, 153 F. (2d) 570 (1st Cir. 1946) (destruction of books and records); *United States v. Vassallo*, 4 P-H 1950 FED. TAX SERV. ¶ 72,583 (D. Del. 1949) (concealment of assets); *United States v. Parker*, 4 P-H 1950 FED. TAX SERV. ¶ 72,556 (M. D. N. C. 1949) (concealment of sources of income).

⁴⁸ INT. REV. CODE § 293(b).

⁴⁹ INT. REV. CODE § 1112; *Harris v. Commissioner*, 174 F. (2d) 70 (4th Cir. 1949).

But the Commissioner's determination of the existence and amount of the deficiency has the support of a presumption of correctness.⁵⁰ The taxpayer then has the burden of rebutting his determination; however, his failure to do so raises no presumption of fraud.⁵¹

A common source of an assessment for a deficiency is the failure to file a return. Frequently, failure to file is fraudulent, and the fifty percent fraud penalty, as well as the five to twenty-five percent penalty for failure to file,⁵² is imposed.⁵³ However, fraud is not necessarily present in such a case⁵⁴—the taxpayer may have believed his income was insufficient to require filing.

A determination of "an intent to evade the tax"—which can exist only in the taxpayer's mind—is practically impossible to prove directly; most often it must be inferred from circumstantial evidence.⁵⁵ For example, where the Government proved that receipts were substantial and the taxpayer offered only flimsy reasons for his delinquency, the situation constituted "affirmative and convincing evidence that such failure was fraudulent."⁵⁶

The Commissioner has a strong case of civil fraud where the taxpayer files a return and specifically omits an income producing transaction.⁵⁷ Of course, no civil fraud penalty will accrue where the taxpayer has made no attempt to conceal the transaction;⁵⁸ or where he has made an innocent⁵⁹ or honest⁶⁰ mistake; or where he has reasonably considered an exchange to be non-taxable.⁶¹ One who

⁵⁰ *Welch v. Helvering*, 290 U. S. 111, 54 S. Ct. 8, 78 L. Ed. 212 (1933); *Commissioner v. Volunteer State Life Insurance Co.*, 110 F. (2d) 879 (6th Cir.), *cert. denied*, 310 U. S. 636, 60 S. Ct. 1080, 84 L. Ed. 1405 (1940); *John Kehoe*, 34 B. T. A. 59 (1936); *John Kennedy*, 16 B. T. A. 1372 (1929) (negligence).

⁵¹ *Arthur M. Godwin*, 34 B. T. A. 485 (1936); *A. W. Minyard*, P-H 1947 TC MEM. DEC. ¶ 47,283 (1947).

⁵² INT. REV. CODE § 291.

⁵³ *Roerich v. Helvering*, 115 F. (2d) 39 (D. C. Cir. 1940), *cert. denied*, 312 U. S. 700, 61 S. Ct. 740, 85 L. Ed. 1134 (1941); *James T. Bennett*, P-H 1950 TC MEM. DEC. ¶ 50,027 (1950) (gambler's failure to report income or keep records prompted by the illegal nature of his chosen profession).

⁵⁴ *W. L. Harris*, P-H 1948 TC MEM. DEC. ¶ 48,235 (1948).

⁵⁵ See *J. William Schultze*, 18 B. T. A. 444 (1929).

⁵⁶ *Robert G. Tyson*, P-H 1950 TC MEM. DEC. ¶ 50,060 (1950).

⁵⁷ *George J. Klevenhagen*, P-H 1950 TC MEM. DEC. ¶ 50,120 (1950). Where the taxpayer failed to report a sale of slot machines because, as he testified, he thought they had been fully depreciated. The court accepted his testimony, which made the basis of the assets zero, and held the entire sales price to be income. *C. R. Rich*, 6 B. T. A. 822 (1927).

⁵⁸ *National Land Co.*, 10 B. T. A. 527 (1928).

⁵⁹ *William W. Kellett*, 5 T. C. 608 (1945).

⁶⁰ *Earl H. Snow*, P-H 1949 TC MEM. DEC. ¶ 49,180 (1949) (incompetence in the handling and keeping of books); *John E. Hoover*, P-H 1945 TC MEM. DEC. ¶ 45,193 (1945) (ignorance of the law).

⁶¹ *Bronson v. Commissioner*, 183 F. (2d) 529 (2d Cir. 1950) (taxpayer's view of the law was erroneous, but reasonable).

positively conceals illegal income has little chance of escaping the fraud penalty.⁶² The fact that concealed income was illegally obtained, while not conclusive of the fact of fraud, may influence the court adversely,⁶³ but the fact alone is insufficient to raise a presumption of intent to evade.⁶⁴ The fraud penalty more likely will be imposed if the court finds a gross understatement of income.⁶⁵

While failure to file a return, or omission of an income producing transaction, may constitute civil fraud, a clearer case is presented where there is a deliberate omission of income with full realization of tax consequences.⁶⁶ A patently lame and untenable excuse for failure to report income has been in itself evidence of a fraudulent purpose.⁶⁷ The nature of excessive deductions may also suggest that purpose.⁶⁸ The basis of a deliberate omission may be the keeping of false records. A fraud case is made out where fictitious records are proved to have been kept, and the return is proved to have been based on them.⁶⁹ There is a more difficult case when an individual's business records are only inaccurate or inadequate. While a strong suspicion of vincible ignorance or of guilty knowledge may be created by this, it is not sufficient as proof of fraud;⁷⁰ however, a consideration of the surrounding circumstances may prompt the court to find more than mere negligence.⁷¹ Reporting fictitious transactions is in itself evidence of bad faith and a fraudulent intent to evade tax.⁷²

⁶² See *Heyman v. Commissioner*, 176 F. (2d) 389 (2d Cir. 1949), *cert. denied*, 338 U. S. 904, 70 S. Ct. 306, 94 L. Ed. 557 (1950).

⁶³ See *Estate of Nitto*, 13 T. C. 858 (1949) (omission of extortion receipts); *Gust Pouroudis*, P-H 1950 TC MEM. DEC. ¶ 50,031 (1950).

⁶⁴ *Frank J. Moore*, 37 B. T. A. 378 (1938) (gambler); *J. William Schultze*, 18 B. T. A. 444 (1929) (bootlegger).

⁶⁵ *Frank A. Weinstein*, 33 B. T. A. 105 (1935) (return so incorrect as to compel a conclusion of deliberate falsity); *Edward Wall*, P-H 1950 TC MEM. DEC. ¶ 50,103 (1950) (income understated by almost 100 percent with no plausible explanation).

⁶⁶ *George Herberger*, P-H 1950 TC MEM. DEC. ¶ 50,165 (1950).

⁶⁷ *Bennie Wolf*, P-H 1950 TC MEM. DEC. ¶ 50,254 (1950). *But cf. Mitchell v. Commissioner*, 118 F. (2d) 308 (5th Cir. 1941); *James Nicholson*, 32 B. T. A. 977, *aff'd*, 90 F. (2d) 978 (8th Cir. 1937).

⁶⁸ *Joseph H. Imeson*, 14 T. C. 1151, P-H 1950 TC REG. DEC. ¶ 14.130 (1950) (cost of extensive pleasure trips reported as traveling expense).

⁶⁹ *William Wiener*, 12 T. C. 701 (1949) (two sets of books kept, tax return based on false set); *Florian J. Brylaski*, P-H 1949 TC MEM. DEC. ¶ 49,222 (1949).

⁷⁰ *Walter M. Ferguson*, 14 T. C. 846, P-H 1950 TC REP. DEC. ¶ 14.103 (1950) (errors due to carelessness).

⁷¹ *A. Brigham Rose*, P-H 1949 TC MEM. DEC. ¶ 49,005 (1949).

⁷² *Henry H. Schallman*, B. T. A. MEM. DEC. ¶ 36,242, *dismissed*, 34 B. T. A. 1313 (1936), *aff'd*, 102 F. (2d) 1013 (6th Cir. 1939); *Harry F. Canelo*, 41 B. T. A. 713 (1940); *D. C. Clarke*, 22 B. T. A. 314 (1931); *Max Freifeld*, P-H 1949 TC MEM. DEC. ¶ 49,018 (1949).

In any of the above instances, if a joint return were filed, both taxpayers would be liable for the civil penalty, though the fraudulent intent of only one party is proved.⁷³ The rationale of this is the statutory provision holding the parties to a joint return jointly and severally liable for the tax.⁷⁴ Also, the penalty provisions themselves provide that the penalties are to be collected as part of the tax.⁷⁵ However, where a wife has a community interest in unreported income of a business, the fraudulent intent to evade taxes is not necessarily imputed to her.⁷⁶

Ordinarily in civil actions a principal is liable for the acts of his agent if committed in the course of his employment and within the scope of his authority; for a principal to be liable for the civil fraud penalty, he must have an intent to evade the tax.⁷⁷ The requisite intent on his part may not be present where he has acted with the advice of a lawyer or an accountant.⁷⁸ Where the taxpayer acts on the advice of reputable counsel, he should not be held guilty of fraud⁷⁹—indeed, the very fact that he seeks advice should indicate that he is acting in good faith⁸⁰—but he cannot fully escape liability by simply entrusting the making of his return to another. He will be liable, for example, where he has knowledge of an understatement of income;⁸¹ likewise, if he signs a return which he should have known to be false.⁸² Where a taxpayer mistakenly hired a dishonest tax consultant, who filed the return without the taxpayer having seen or signed it, no penalty was imposed.⁸³

⁷³ *Howell v. Commissioner*, 175 F. (2d) 240 (6th Cir. 1949) (wife had signed); *Roe Ziller*, P-H 1948 TC MEM. DEC. ¶ 48,227 (1948) (wife was negligent).

⁷⁴ INT. REV. CODE § 51(b).

⁷⁵ See INT. REV. CODE § 293(a): the penalty "shall be assessed, collected, and paid in the same manner as if it were a deficiency. . . ."

⁷⁶ *George Herberger*, P-H 1950 TC MEM. DEC. ¶ 50,165 (1950).

⁷⁷ INT. REV. CODE § 293(b); *George W. Schoenhut*, 45 B. T. A. 812 (1941).

⁷⁸ *Davis et ux. v. Commissioner*, 184 F. (2d) 86 (10th Cir. 1950), (excessive depreciation computed by accountant); *Rogers Recreation Co. of Connecticut v. Commissioner*, 103 F. (2d) 780 (2d Cir. 1939) (honest erroneous deduction); *Jemison v. Commissioner*, 45 F. (2d) 4 (5th Cir. 1930).

⁷⁹ *Briggs-Weaver Machinery Co.*, 14 B. T. A. 1351 (1929). *But cf. William F. Pohlen*, P-H 1947 TC MEM. DEC. ¶ 47,056 (1947), where the court said, "Taxpayers must, of course, assume responsibility for their returns even though they employ others to prepare them."

⁸⁰ *C. R. Lindbach Foundation*, 4 T. C. 652, *aff'd*, 150 F. (2d) 986 (3rd Cir. 1945).

⁸¹ *Wickham v. Commissioner*, 65 F. (2d) 527 (8th Cir. 1933).

⁸² *Joseph H. Imeson*, 14 T. C. 1151, P-H 1950 TC REP. DEC. ¶ 14,130 (1950). Here the deductions were obviously false but the taxpayer hoped to protect himself by accepting the opinion of a tax "expert."

⁸³ *Dale R. Fulton*, P-H 1950 TC REP. DEC. ¶ 14,169 (1950). The tax "expert" in this case was the same dishonest one employed by Imeson, upon whom the penalty was imposed. See note 82 *supra*.

The poet who said: ⁸⁴

I want men to remember
When gray Death sets me free

can rest assured the tax collector will grant his wish—it is well settled that the civil fraud penalty survives death. It may be assessed and approved subsequent to the taxpayer's death.⁸⁵

IV.

Negligence

“Negligence” (not here used in the technical sense of the law of Torts), like civil fraud, is a broad term difficult to define for practical tax purposes, although a definition has been attempted by the Bureau: ⁸⁶

. . . Negligence is attributable to the taxpayer if he computes the tax in disregard of the instructions on the return form or otherwise incorrectly, unless he can show that his error was due to an honest misunderstanding of the facts or the law of which an average reasonable man might be capable. . . .

This section places upon the taxpayer the duty of knowing and understanding such parts of the regulations as are applicable to the submission of his return. . . .

Section 293(a) concerns deficiencies emanating from negligence and intentional disregard of rules and regulations without fraudulent intent.⁸⁷ Fraud and negligence penalties cannot be applied to the same deficiency.⁸⁸ The two embrace the same act, but in fraud there is an “intent to evade” while in negligence there is not. Consequently, the terms are mutually exclusive. Unlike criminal or civil fraud, where the Commissioner assesses a negligence penalty he is presumed to be correct; to escape the penalty the taxpayer must prove that the deficiency was not caused by his negligence.⁸⁹

⁸⁴ John Bennett, *I Want an Epitaph* in BARTLETT, FAMILIAR QUOTATIONS 774 (11th ed. 1938).

⁸⁵ *Helvering v. Mitchell*, 303 U. S. 391, 58 S. Ct. 630, 82 L. Ed. 917 (1938); *Reimer's Estate v. Commissioner*, 180 F. (2d) 159 (6th Cir. 1950); *Kirk v. Commissioner*, 179 F. (2d) 619 (1st Cir. 1950).

⁸⁶ 1919-20: A. R. M. 23, 2 CUM. BULL. 231 (1920). Query: Is not a reasonable man capable of *misunderstanding* the bulk of the tax statutes?

⁸⁷ INT. REV. CODE § 293(a).

⁸⁸ 1919-20: O.1028, 2 CUM. BULL. 233 (1920). Frequently the Commissioner pleads negligence as an alternative to fraud. See *Lucian T. Wilcox*, 44 B. T. A. 373 (1941); *L. E. Meraux*, 38 B. T. A. 200 (1938); *Watson-Moore Co.*, 30 B. T. A. 1197 (1934).

⁸⁹ *Anne Humphrey*, P-H 1946 TC MEM. DEC. ¶ 46,004 (1946), *aff'd sub. nom.* *Humphrey v. Commissioner*, 162 F. (2d) 853 (5th Cir.), *cert. denied*, 332 U.S. 817, 68 S. Ct. 157, 92 L. Ed. 394 (1947); *W. R. Davis*, P-H 1948 TC MEM. DEC. ¶ 48,089 (1948); *Charles Goodman et al.*, P-H 1946 TC MEM. DEC. ¶ 46,300 (1946). *But cf.* *Bruce E. and Katherine Gentry*, P-H 1951 TC MEM.

The courts have not been as ready to find negligence as the Commissioner has under the regulation cited above.⁹⁰ In *R. Shad Bennett*,⁹¹ the Tax Court sustained the Commissioner in finding negligence for the failure to keep books and records which would properly reflect profit and loss. The court of appeals reversed this decision saying:⁹²

A finding that the return is incorrect, or that the taxpayer did not keep proper or complete books of account, or that his calculations are confusing is not enough [to sustain the negligence penalty]. . . .

The Commissioner's allegations of negligence were refuted when the deficiency was declared to be due to accident,⁹³ clerical error,⁹⁴ honest difference of opinion,⁹⁵ honest doubt as to taxability of an item,⁹⁶ and honest mistake.⁹⁷ In contrast, the negligence penalty has been imposed for omissions from income without plausible explanation;⁹⁸ for omissions of transactions of sale;⁹⁹ for the failure to keep adequate, proper and sufficient records;¹⁰⁰ and for overstating deductions.¹⁰¹

DEC. ¶ 51,034 (1951) (negligence penalty was imposed by the court where the taxpayer's pleadings merely failed to allege error).

⁹⁰ 1919-20: A. R. M. 23, 2 CUM. BULL. 231 (1920).

⁹¹ P-H 1942 TC MEM. DEC. ¶ 42,576 (1942).

⁹² *Bennett et ux. v. Commissioner*, 139 F. (2d) 961, 966 (8th Cir. 1944); *Wilson Bros. & Co. v. Commissioner*, 124 F. (2d) 606 (9th Cir. 1941); *James F. X. O'Brien*, P-H 1945 TC MEM. DEC. ¶ 45,069 (1945).

⁹³ *Harry P. Dilkes*, P-H 1950 TC MEM. DEC. ¶ 50,157 (1950) (accountant's accidental omission of 10 percent of business income from returns did not justify negligence penalty).

⁹⁴ *Claire L. Canfield*, 7 T. C. 135 (rebates found in an account entitled "reserves" and included in the return of income held to be a clerical error), *rev'd on other grounds sub. nom.* *Canfield v. Commissioner*, 168 F. (2d) 907 (8th Cir. 1946).

⁹⁵ *A. M. Standish*, 4 T. C. 995 (1945), *aff'd sub. nom.* *Standish v. Commissioner*, 154 F. (2d) 1022 (9th Cir. 1946) (whether or not a certain trust violated the rule against perpetuities).

⁹⁶ *Charlotte L. Andrews*, 46 B. T. A. 607 (1942) (failure of taxpayer to include certain interest bearing script received in lieu of accrued interest on other obligations held by her), *rev'd on other grounds sub nom.* *Andrews v. Commissioner*, 135 F. (2d) 314 (1943).

⁹⁷ *C. B. Wilcox*, 27 B. T. A. 580 (1933) (failure to report \$50,000 income upon the mistaken belief that it was a gift).

⁹⁸ *Bertha Kirkpatrick*, P-H 1944 TC MEM. DEC. ¶ 44,403 (1944).

⁹⁹ *Gouldman v. Commissioner*, 165 F. (2d) 686 (4th Cir. 1948) (profits unreported from sale of lots, and value of property received in part payment for sale of interest in business not included in computing profit on sale); *Oscar G. Joseph*, 32 B. T. A. 1192 (1935) (failure to report stock profit said to have been mistakenly reported on wife's return); *Thomas J. Avery*, 11 B. T. A. 958 (1928) (real estate transactions that taxpayer claimed did not result in taxable gain were omitted).

¹⁰⁰ *Roy A. Fellows et al.*, P-H 1950 TC MEM. DEC. ¶ 50,014 (1950) (failure to keep proper records); *Fred Zeller et al.*, P-H 1950 TC MEM. DEC. ¶ 50,010 (1950); *W. R. Davis*, P-H 1948 TC MEM. DEC. ¶ 48,089 (1948).

¹⁰¹ *John T. Scurlock*, P-H 1950 TC MEM. DEC. ¶ 50,009 (1950); *Mildred P. Rensler et al.*, P-H 1950 TC MEM. DEC. ¶ 50,008 (1950); *Lambert F. Richtig*

Generally, ignorance and negligence are distinguished. While "ignorance of the law is not an excuse for wrongful acts . . . it is distinguishable from negligence. . . ." ¹⁰² But negligence, rather than ignorance, has been found despite the fact that the taxpayer was a widow with little formal education, and with no business experience. ¹⁰³

The negligence penalty does not attach if the taxpayer makes full disclosure of all the pertinent facts. ¹⁰⁴ It has been held that no negligence is present where there is sufficient information contained in the return to apprise the Commissioner of an omission. ¹⁰⁵

V.

Policy and Procedure of the Bureau

By way of Bureau policy and statutory provision the Government enables a taxpayer to escape some or all of the penalties imposed by law. The first of these methods is voluntary disclosure. If the taxpayer freely and willingly admits to the Government that he is guilty of fraud, usually there will be a recommendation by the Bureau not to prosecute. The disclosure must be made to some responsible official of the Treasury Department before an investigation of the matter has commenced. An investigation has commenced when an agent or deputy collector is assigned to examine a particular return, or when the return has been questioned by an examining officer; it probably begins when a "jacket" against a taxpayer is opened in the Intelligence Unit. ¹⁰⁶ It follows that a voluntary disclosure made after an investigation has begun is of no avail to the taxpayer. ¹⁰⁷ However, a taxpayer was recently allowed immunity from criminal prosecution upon his voluntary disclosure of fraud when he was yet ignorant of the fact that an investigation had begun. ¹⁰⁸

et al., P-H 1950 TC MEM. DEC. ¶ 50,001 (1950); John Sito et al., P-H 1949 TC MEM. DEC. ¶ 49,300 (1949).

¹⁰² Bennett et ux. v. Commissioner, 139 F. (2d) 961, 967 (8th Cir. 1944).

¹⁰³ Lena M. Buchwach, P-H 1950 TC MEM. DEC. ¶ 50,229 (1950). The tax court found as a fact that taxpayer was aware of her duty to keep adequate records. See also Lottie Lobello Clayton, P-H 1948 TC MEM. DEC. ¶ 48,112 (1948).

¹⁰⁴ 1922: A. R. R. 1167, 2 CUM. BULL. 211 (1922); Davis Regulator Co., 36 B. T. A. 437 (1937).

¹⁰⁵ Pullman, Inc., 8 T. C. 292 (1947).

¹⁰⁶ United States v. McCormick, 67 F. (2d) 867 (2d Cir. 1933), cert. denied, 291 U. S. 662, 54 S. Ct. 438, 78 L. Ed. 1054 (1934).

¹⁰⁷ United States v. Weisman, 78 F. Supp. 979 (D. Mass. 1948).

¹⁰⁸ *In re Liebster*, 91 F. Supp. 814 (E. D. Pa. 1950). Upon petition by the taxpayer, the court permitted evidence given to a special agent, influenced by a promise of immunity, to be suppressed as a violation of the Fifth Amendment of the Constitution.

While a timely, repentant evader escapes criminal prosecution,¹⁰⁹ the Treasury Department will relentlessly levy all other penalties.¹¹⁰ This is in keeping with the Bureau's policy of collecting its just due; its patronly forgiveness of the crime is to encourage the evader to pay. The reason for this policy is best explained by the statement:¹¹¹

In excusing the man from criminal prosecution, we are merely taking a sensible step to produce the revenue called for by law with the minimum cost of investigation.

It must be emphasized that a voluntary disclosure is only a policy of the Treasury Department. It cannot be said that it bars, as a matter of law, a subsequent criminal prosecution.¹¹²

The other policy of the Treasury Department authorized by Congress is the "compromise."¹¹³ This provision permits, but does not require, a compromise to be made of any civil or criminal case arising under the internal revenue laws. Before a case is presented to the Department of Justice for prosecution or defense, the Commissioner, with the approval of the Secretary, Under Secretary, or Assistant Secretary of Treasury, may effect a compromise. After it has been referred to the Department of Justice, however, the authority is within the discretion of the Attorney General only. To be binding there must be a strict compliance with the statute;¹¹⁴ informal agreements, promises of agents, or arrangements with agents or collectors, do not constitute such compliance.¹¹⁵ This, too, is only a policy. There is no statutory compulsion on the Treasury Department to accept any compromise of either criminal or civil penalties. But through it, both Government and taxpayer are spared the expense of inconvenience of litigating sharply contested issues of law or fact involving "fraud," "intent," "wilfulness," and others.

The Intelligence Unit of the Treasury Department, with regional units throughout the country, is in charge of investigating tax fraud. A special agent of the regional office, together with an internal revenue agent, will carry on the investigation of the particular case. If he concludes prosecution should be undertaken, that fact is reported to

¹⁰⁹ Wenchel, *Tax Frauds and Voluntary Disclosures*, 25 TAXES 485, 488 (1947).

¹¹⁰ See Garden City Feeder Co., 27 B. T. A. 1132 (1933).

¹¹¹ Wenchel, *supra* note 109, at 488.

¹¹² For a full discussion see Frazier, *Is a Voluntary Disclosure a Legal Defense to a Criminal Prosecution?*, 28 TAXES 1071 (1950).

¹¹³ INT. REV. CODE § 3761(a). The Code gives only the power to "compromise any civil or criminal case arising out of the internal revenue laws."

¹¹⁴ INT. REV. CODE § 3761(a); *Botany Worsted Mills v. United States*, 278 U. S. 282, 49 S. Ct. 129, 73 L. Ed. 379 (1928); *United States v. Lustig et al.*, 67 F. Supp. 306 (S. D. N. Y. 1946), *aff'd*, 163 F. (2d) 85 (2d Cir. 1947).

¹¹⁵ INT. REV. CODE § 3761(a); *Hughson v. United States*, 59 F. (2d) 17 (9th Cir. 1932), *cert. denied*, 287 U. S. 630, 53 S. Ct. 82, 77 L. Ed. 546 (1932).

the Special Agent in Charge of the regional office, upon whose approval and recommendation the case is forwarded to the Chief of the Intelligence Unit, and then to the Penal Division of the Chief Counsel's Office in the Bureau, where an attorney is assigned to the case. At this point the taxpayer is given a chance to confer. If the case is considered a proper one for prosecution, a statement or report is prepared for consideration by the head of the Penal Division, Chief Counsel of the Bureau, and the Commissioner. Upon their recommendation the entire file is transmitted to the Tax Division of the Department of Justice where the Assistant Attorney General in Charge will examine the case and make a recommendation. This is reviewed by the head of the Criminal Section of the Tax Division, by the Principal Assistant to the Assistant Attorney General and finally by the Assistant Attorney General himself. The taxpayer is again given an opportunity to confer or submit additional information to the Department of Justice. If it is decided to prosecute, an indictment is drawn and the case is submitted to the appropriate United States attorney. Regardless of whether or not prosecution is rejected, the case is returned to the local office for determination of civil penalties and deficiencies, at which time a compromise may be effected.¹¹⁶

Conclusion

Extensive interpretation of the penalty provisions of the Code has, in a practical sense, added little to its clarification. Undoubtedly, Congress intended to create a distinction between a misdemeanor and a felony under the criminal penalty provision, but it is difficult to visualize a situation which constitutes a misdemeanor that could not be called a felony. An ingenious distinction between the two was made in the *Spies* case,¹¹⁷ where the Court spoke of "wilful but passive neglect" and "wilful and positive attempt to evade"—the former being a misdemeanor, the two combined a felony. But the statutory provision for felonies speaks of *any* wilful attempt to evade the tax. For practical purposes, what manner of "wilful omission" (the misdemeanor rule) is not a deliberate attempt to evade the tax? Nevertheless, the distinguishing phraseology of the criminal fraud section exists, and if a taxpayer wilfully fails to file a return, he will be guilty of a misdemeanor. But if he wilfully files a false or fraudulent return, he will be guilty of a felony.

For a fraudulent act to be penalized criminally, it must be "wilful"; for it to be penalized civilly, there must be "intent to evade." How

¹¹⁶ Much of the above discussion has been gleaned from the following sources: Rothwicks, *Criminal Tax Prosecutions*, 1 THE AMERICAN UNIVERSITY TAX INSTITUTE LECTURES 269 (1948); SURREY & WARREN, FEDERAL INCOME TAXATION: CASES AND MATERIALS 48 (1950).

¹¹⁷ *Spies v. United States*, 317 U. S. 492, 499, 63 S. Ct. 364, 87 L. Ed. 418 (1943).