Retroactive Remedial Tax Legislation and the Statute of Limitations - The Silenced Claimant v. I.R.S.

Raymond F. Sekula

Duquesne Law Review

Volume 9, Number 1, Fall 1970-1971

Retroactive Remedial Tax Legislation and the Statute of Limitations—The Silenced Claimant v. I.R.S.

*Raymond F. Sekula**

I. A History of the Problems Involved

This article is concerned with inequality in federal taxation, specifically the inequality in some of the retroactive tax relief statutes enacted by Congress. These statutes have retroactively applied to years which have been normally "closed" for purposes of refunds by the statute of limitations in Section 6511 of the Internal Revenue Code. At times, the Congress has mentioned in some of these statutes that the relief given did not apply to such closed years. When the legislation has been silent in that respect, the courts have had to decide whether the statute implicitly reopens the statute of limitations on claims for refunds.

Retroactive tax legislation is not new. As early as 1870 taxes of this nature had been enacted.[1] However, in the early years the problems involving retroactivity in taxation confined themselves to the validity of legislation which affirmatively, as well as retroactively, taxed transactions in years which had elapsed.[2] In recent tax legislation, retroactivity has been applied in a different manner. This new approach differs from the old application in that it does not involve the fresh

---

* B.S., B.A., J.D. Duquesne University; LL.M. University of Virginia; Associate Professor of Law, Duquesne University.

1. Act of July 14, 1870, ch. 255, § 17, 16 Stat. 261.
2. Stockdale v. Atlantic Ins. Co., 87 U.S. 323 (1874).

taxation of transactions which occurred in past years or periods, but rather gives certain taxpayers tax benefits which extend retroactively to transactions which have already occurred.

For example, Congress has enacted legislation which expanded in part the definition of a dependent from "a legally adopted child" to include a child for whom a petition for adoption has been filed and denied by an appropriate court because of the mental incapacity of a surviving natural parent to agree to such adoption.[3] This provision, adopted in 1953, was made applicable to years beginning after December 31, 1945. The problem which has developed out of this type of legislation concerns itself not with the relief given, but rather to whom it is given. In some of this legislation, such as the Act just mentioned, Congress has failed to say whether the statute of limitations pertaining to refunds is reopened for years previously barred by the passing of the limitations period.

Since 1953, at least forty-eight retroactive amendments to the revenue laws have been enacted by the United States Congress granting various forms of relief to taxpayers.[4] Of these forty-eight amendments, thirty-nine have contained substantive changes reducing taxes.[5] Some of these

3. The Act of August 7, 1953, ch. 346, § 3, 67 Stat. 471.

Sec. 3. (a) That the third sentence of section 25(b)(3) of the Internal Revenue Code, relating to the definition of dependent, is amended to read as follows: 'For the purposes of determining whether any of the foregoing relationships exist (1) a legally adopted child of a person or (2) a child for which petition for adoption was filed by a person in the appropriate court and denied because of mental incapacity of surviving natural parent to agree to such adoption, shall be considered a child of such person by blood.

(b) The provisions of subsection (a) shall be applicable to taxable years beginning after December 31, 1945.

Approved August 7, 1953.

4. Brief for Petitioner, at 15, United States v. Zacks, 375 U.S. 59 (1963). See, Section 30 of the Revenue Act of 1962, 76 Stat. 960, 1069; Section 27, *supra* 1067; Section 26, *supra* 1067; Section 23, *supra* 1065; Section 1 of the Act of October 23, 1962, 76 Stat. 1158; Section 2 of the Act of September 26, 1961, 75 Stat. 683; Section 1 of the Act of September 26, 1961, 75 Stat. 674; Sections 1 and 4 of the Act of June 27, 1961, 75 Stat. 120; Section 5 of the Act of September 14, 1960, 74 Stat. 1017, 1019; Section 4, *supra* 1018; The Dealer Reserve Income Adjustment Act of 1960, 74 Stat. 124; Section 5 of the Act of September 14, 1960, 74 Stat. 1010, 1013; Section 1 of the Act of September 16, 1959, 73 Stat. 563; Act of August 7, 1959, 73 Stat. 288; The Retirement-Straight-Line Adjustment Act of 1958, Section 94 of the Technical Amendments Act of 1958, 72 Stat. 1606, 1669; Section 103 of the Technical Amendments Act of 1958, 72 Stat. 1606, 1675; Section 100, *supra* 1673; Section 99, *supra* 1673; Section 98 of the Technical Amendments Act of 1958, 72 Stat. 1606, 1673; Section 96, *supra* 1672; Section 93, *supra* 1668; Section 92, *supra* 1667; Section 65, *supra* 1657; Section 63, *supra* 1649; Section 37 *supra* 1633; Section 29, *supra* 1626; Section 14, *supra* 1611; Act of February 11, 1958, 72 Stat. 4; Act of February 11, 1958, 72 Stat. 3; Act of August 1, 1956, ch. 857, 70 Stat. 917; Section 3 of the Act of June 29, 1956, ch. 464, 70 Stat. 405; Section 2 of the Act of June 29, 1956, ch. 464, 70 Stat. 404; Act of February 20, 1956, ch. 66, 70 Stat. 26; Section 1 of the Act of Februray 20, 1956, ch. 63, 70 Stat. 23; Act of February 15, 1956, ch. 36, 70 Stat. 15; Section 207 of the Technical Changes Act of 1953, 67 Stat. 623.

5. The nine that made no change in the substantive law extended, for varying periods

amendments eliminated the problem of whether or not refunds could be received by taxpayers involving years affected by the new legislation but which already had been barred by the statute of limitations.[6] This was done by including provisions which explicitly reopened the limitations period pertaining to refunds which would be sought because of the new legislation.[7] On the other hand, many enactments, while retroactively amending substantive law applicable to years in which refunds would in the normal course of events be barred by the statute of limitations, are silent on that point.[8] Thus, the problem which has arisen is whether a retroactive remedial statute, silent as to its procedural effects, implicitly reopens the applicable statute of limitations on claims for refund brought under the retroactive change in the law.

There have only been a few cases involving the above stated problem, and those courts which have been confronted with the issue have differed in their opinions concerning this issue.[9] The first decision was *Hollander v. United States*,[10] which involved an action to recover estate taxes which had been paid prior to the addition of Section 607 to the Internal Revenue Code of 1939.[11] In this case, it was proven that prior to his death on November 16, 1937, the decedent created an inter vivos trust in favor of his two nieces which was valued at $157,452.82. The

---

up to a year from the date of enactment, the time for filing a claim or suit for refund, *e.g.*, Technical Changes Act of 1953, ch. 512, § 211, 67 Stat. 625; Act of August 1, 1956, ch. 857, 70 Stat. 917; Technical Amendments Act of 1958, 72 Stat. 1657, 26 U.S.C. § 2011(c); Technical Amendments Act of 1958, §§ 96 and 98, 72 Stat. 1672, 1673.

6. These statutes provided that the general statute of limitations which would have normally barred certain years was to be extended to a specified period from the date of enactment so that those taxpayers who were barred from relief could be benefited by the new legislation.

7. *E.g.*, Revenue Act of 1962, §§ 26-27, 76 Stat. 1067; Act of September 14, 1960, § 5, 74 Stat. 1013; Technical Amendments Act of 1958, 72 Stat. 1611, 26 U.S.C. § 172; Technical Amendments Act of 1958, §§ 92, 93, 100, 72 Stat. 1667, 1668, 1673; Technical Changes Act of 1953, ch. 512, § 207, 67 Stat. 623, all extended the period for filing a claim for refund for a period of 6 months to 1 year after the date of enactment. *See also*, Act of February 15, 1956, ch. 36, 70 Stat. 15, which provided for a 7-year limitations extension.

8. *E.g.*, Revenue Act of 1962, § 30, 76 Stat. 1069; Act of June 27, 1961, §§ 1, 4, 75 Stat. 120; Act of September 14, 1960, § 5, 74 Stat. 1019; Technical Amendments Act of 1958, § 103, 72 Stat. 1675; Act of February 11, 1958, 72 Stat. 3; Act of February 11, 1958, 72 Stat. 4; Act of June 29, 1956, ch. 464, § 3, 70 Stat. 405; Act of February 20, 1956, ch. 66, 70 Stat. 26; Act of February 20, 1956, ch. 63, § 1, 70 Stat. 23; Act of August 9, 1955, ch. 808, 69 Stat. 693; Act of August 9, 1955, ch. 693, § 1, 69 Stat. 625; Technical Changes Act of 1953, ch. 512, § 203, 67 Stat. 624; Act of August 7, 1953, ch. 346, § 3, 67 Stat. 471.

9. *See*, Seigel v. United States, 84 Ct. Cl. 551 (1937) which dealt with a very similar problem.

10. 248 F.2d 247 (2d Cir. 1957).

11. Section 607. Transfers Conditioned Upon Survivorship. In the case of property transferred by a decedent dying after March 18, 1937, and before February 11, 1939, the determination of whether such property is to be included in his gross estate under section 302(c) of the Revenue Act of 1926 (44 Stat. 70) as a transfer intended to take effect in possession or enjoyment at or after his death shall be made in conformity with Treasury Regulations in force at the time of his death.

trust was to continue during the lives of the two nieces, but in the event that both died before the decedent, the corpus was to revert to him. The decedent was survived by his two nieces, and the trust corpus was included in the decedent's gross estate under Section 302(c) of the Revenue Act of 1926.[12]

Section 302(c) provided that the value of all property, "to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise . . . intended to take effect in possession or enjoyment at or after his death . . ." must be included in the decedent's gross estate. This section was for many years the source of fluctuating judicial interpretations not finally settled until 1949.[13] However, at the time of the decedent's death the existence of a possibility of reverter did not subject the property to the estate tax under the then existing Treasury Regulations.[14] Notwithstanding the regulations, the Internal Revenue Service held that the trust corpus was to be included in the decedent's gross estate.

In 1949, the United States Supreme Court in *Spiegel's Estate*[15] and in *Church's Estate*[16] decided that such possibilities of reverter were includable in the gross estate of the holder of such an interest. These decisions prompted the Congress to amend the Internal Revenue Code of 1939 retroactively to provide relief for certain estates prejudiced by the Supreme Court's change of position.[17] However, these new pro-

12. Revenue Act of 1926, ch. 27, § 302(c), 44 Stat. 70.

13. *See*, May v. Heiner, 281 U.S. 238 (1930); Klein v. United States, 283 U.S. 231 (1931); Helvering v. St. Louis Union Trust Co., 296 U.S. 39 (1935); Becker v. St. Louis Union Trust Co., 296 U.S. 48 (1935); Helvering v. Hallock, 309 U.S. 106 (1940); Fidelity-Philadelphia Trust Co. v. Rothensies, 324 U.S. 108 (1945); Commissioner of Internal Revenue v. Estate of Field, 324 U.S. 113 (1945); Commissioner of Internal Revenue v. Estate of Church, 335 U.S. 632 (1949); Estate of Spiegel v. Commissioner of Internal Revenue, 335 U.S. 701 (1949).

14. Treas. Reg. 80, Art. 17 (1937) provided:

Art. 17. Transfers conditioned upon survivorship.

The statutory phrase, 'a transfer . . . intended to take effect in possession or enjoyment at or after his death,' includes a transfer by the decedent (other than a bona fide sale for an adequate and full consideration in money or money's worth) whereby and to the extent that the beneficial title to the property (if the transfer was in trust), or the legal title thereto (if the transfer was otherwise than in trust), remained in the decedent at the time of his death and the passing thereof was subject to the condition precedent of his death. If the tax applies, it does so without regard to the time of the transfer, whether before or after the enactment of the Revenue Act of 1916.

On the other hand, if, as a result of the transfer, there remained in the decedent at the time of his death no title or interest in the transferred property, then no part of the property is to be included in the gross estate merely by reason of a provision in the instrument of transfer to the effect that the property was to revert to the decedent upon the predecease of some other person or persons or the happening of some other event. 248 F.2d 247, 249, n.7 (2d Cir. 1957).

15. 335 U.S. 701 (1949).

16. 335 U.S. 632 (1949).

17. Technical Changes Act of 1949, ch. 720, § 7, 63 Stat. 894.

visions only provided relief for estates of decedents dying after February 10, 1939. In 1951, Congress enacted retroactive relief for certain estates of persons dying between March 18, 1937 and February 11, 1939 which provided that such trusts were not to be included in the gross estate.[18] This remedial legislation, however, failed to provide for reopening or extending the statute of limitations concerning claims for refunds on previously closed years.

On the basis of the 1951 legislation, the taxpayer sued for a refund of $25,811.95 of estate taxes which had been previously paid. The Government defended on the ground that any right to a refund was barred by the three-year statute of limitations which had started to run from the date the estate tax was paid.[19] The United States Court of Appeals for the Second Circuit rejected the Government's position and held that the legislation would be an empty gesture and its purposes largely, if not completely, frustrated if the statute of limitations on refunds stood as a bar to this claim.

The Court felt that the legislation was designed to provide retroactive tax relief under circumstances where Congress must have known that the statute of limitations would probably nullify the promised relief, since it was patently unlikely that few, if any, estates of decedents dying between March 18, 1937 and February 11, 1939 would not have paid the estate tax more than three years before a claim for refund under the 1951 amendment could be presented. The failure to refer to the statute of limitations and provide explicitly for lifting its bar did not, in the Court's opinion, justify the Government's contention that section 607 was intended to remedy the hardship only in those cases still pending in the administrative process or in the Courts. With respect to the Statute of Limitations on Refund Claims, the Court stated that the legislative purpose of such a statute[20] is to achieve finality in the determination of a taxpayer's liability for a particular year. But the purpose of the 1951 legislation was exactly the opposite. It was designed to destroy the finality of the Tax Court decision, even after affirmance by the Supreme Court.[21]

In 1959, the United States Court of Claims was confronted with the same procedural problem in *Verckler v. United States*.[22] In this case,

18. Revenue Act of 1926, ch. 27, § 302(c), 44 Stat. 70.
19. *See* sections 910 and 911 of the INT. REV. CODE OF 1939, now sections 6511 and 6512 of Title 26 of the U.S.C. 26 U.S.C.A. §§ 6511, 6512.
20. *See* Elbert v. Johnson, 164 F.2d 421, 423 (2d Cir. 1947).
21. *Supra* note 10 at 250.
22. 170 F. Supp. 802 (1959).

Mrs. Verckler had died on February 25, 1952 which was within a period of two years prior to her husband's death. The federal estate tax was paid on her estate on May 21, 1953.[23] On February 20, 1956 Congress decided to add Section 814 to the Internal Revenue Code of 1939[24] which provided:

> . . . If the executor so elects, the tax imposed by sections 810[25] and 935[26] in the case of a decedent (but only if the decedent was a citizen of the United States at the time of death) dying after December 31, 1951, shall be credited with all or a part of the amount of Federal estate tax paid with respect to the transfer of property . . . to the decedent by or from a person . . . who was the spouse of the decedent at the time of such person's death and who died within two years before the decedent's death. . . .

Section 814 did not contain any provisions referring to years which were now affected by the new relief, but which had been closed for purposes of refund claims by the statute of limitations.

On September 19, 1956 the executor of the Estate of Mrs. Verckler filed a claim for refund based upon the credit given by Section 814. The Commissioner denied the claim[27] and the executor instituted suit. The Government contended that the claim was barred by Section 910 of the Internal Revenue Code of 1939 because the claim had been filed more than three years after the date of payment of the tax. The Government further contended that the taxpayer's failure to file his claim with the Commissioner within the proper time limitation barred the suit for refund under Section 7422(a) of the Internal Revenue Code of 1954 which provided:

---

23. The estate tax paid was $175,858.74. On April 23, 1956, a deficiency assessment was made against the estate in the amount of $2,194.65 with interest. This amount was paid on April 27, 1956.

24. Act of February 20, 1956, ch. 66, § 814, 70 Stat. 26.

25. Section 810 of the INTERNAL REVENUE CODE OF 1939 provided for the rate of tax which was to be applied to the taxable estate of citizens or residents of the United States. The 1954 Internal Revenue Code counterparts are Sections 2001, 2011 and 2012.

26. Section 935 of the INTERNAL REVENUE CODE OF 1939 provided:

> (a) In addition to the estate tax imposed by section 810 or 860, there shall be imposed upon the transfer of the net estate of every decedent dying after the date of the enactment of this title, whether a citizen or resident of the United States or a nonresident not a citizen of the United States, a tax equal to the excess of—(1) the amount of a tentative tax computed under subsection (b) of this section, over (2) the amount of the tax imposed by section 810, in the case of a citizen or resident of the United States, or 860, in the case of a non resident not a citizen of the United States, computed without regard to the provisions of this subchapter.

The tentative tax schedule followed this section. The INTERNAL REVENUE CODE OF 1954 counterparts to Section 935 are Sections 2001, 2052 and 2101.

27. The Commissioner allowed a refund for the amount of the deficiency which was paid on April 27, 1956. *See supra* note 23.

> No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected . . . or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof.

The Court of Claims decided that, neither Section 910 of the 1939 Internal Revenue Code nor Section 7422(a) of the 1954 Internal Revenue Code could be interpreted as a bar to the relief given by Section 814 because:

> Prior to the passage of the amending act, the action of the Commissioner in assessing and collecting estate taxes upon property previously taxed in the estate of decedent's spouse was both correct and legal. Therefore, no claim for refund could possibly be filed upon the grounds that there had been an erroneous or illegal collection of tax. In short, no cause of action existed. Certainly no authority exists for filing contingent claims based upon the possible action of Congress in passing remedial legislation. Not until February 20, 1956, when [Section 814] came into effect did the plaintiff have a right to claim and receive a refund of the tax. This was not a claim for taxes previously erroneously or illegally collected, but an election to receive the benefits of a relief statute.[28]

The Court of Claims felt that it is "commonly"[29] held that statutes intended to relieve persons of hardship should be construed in favor of those who are the intended beneficiaries. It was decided that a different interpretation in this case would completely negate in certain cases the relief intended under Section 814; would reward taxpayers who delay payment of their estate tax, and at the same time would deny similar treatment to those who have met their responsibilities with celerity.[30] Thus, the Court of Claims concluded that Section 814 created a new cause of action on which the statute of limitations did not begin to run until the date of the legislative enactment.[31]

---

28. The Court stated in footnote 2 of its opinion: "That [Section 814] was intended as a relief act is clearly borne out by S. REP. NO. 1402, 84TH CONG., 2D SESS., U.S. Code Cong. & Adm. News 1956, p. 2244."

29. The Court of Claims cited Hollander v. United States, as authority for this proposition. *See supra* note 11.

30. 170 F. Supp. 802, 805 (1959).

31. For other Court of Claims decisions holding the same with respect to the procedural problem raised in *Verckler, see* Lorenz v. United States, 296 F.2d 746 (1961); Zacks v. United States, 280 F.2d 829, overruled in 375 U.S. 59 (1963).

At the same time *Verckler* was being decided, the United States Court of Appeals for the Fifth Circuit was confronted with the identical procedural problem in *Tobin v. United States.*[32] In *Tobin,* the taxpayer brought an action for a tax refund concerning the treatment of income from the transfers of patents. In 1951, the taxpayer had transferred patent rights the gain from which was taxed as ordinary income.[33] In 1956, Congress enacted Section 117(q) of the Internal Revenue Code of 1939 which provided that all gains from the transfer of patents should be treated as capital gains beginning with any gains received after May 31, 1950.[34] However, Section 117(q) failed to make any reference to the statute of limitations on refunds concerning years that had already been barred.

Relying upon this new legislative relief, the taxpayer instituted an action for a refund on patent transfers occurring in 1951. At trial, the case was dismissed on the ground that the three-year statute of limitations of Section 322(b)(1) of the 1939 Internal Revenue Code had barred the taxpayer from any recovery.[35] On appeal, the taxpayer made the contention that Section 117(q) had impliedly reopened the period of limitations for filing claims and instituting suits for refunds. The Court adopted the Government's position that Section 117(q) merely confirmed the already existing right laid out in the case law. (It seems

---

32. 264 F.2d 845 (5th Cir. 1959).
33. Mim. 6490, 1950-1 CUM. BULL. 9.
34. Act of June 29, 1956, ch. 464, sec. 117(q), 70 Stat. 404. Section 117(q) provided:

(q) *Transfer of patent rights—*

(1) *General Rule*—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfers are—

(A) payable periodically over a period generally coterminous with the transferree's use of the patent, or

(B) contingent on the productivity, use, or disposition of the property transferred.

. . . .

(4) *Applicability*—This subsection shall apply with respect to any amount received, or payment made, pursuant to a transfer described in paragraph (1) in any taxable year beginning after May 31, 1950 regardless of the taxable year in which such transfer occurred.

35. Section 322(b)(1) and Section 910 of the INTERNAL REVENUE CODE OF 1939 are the same except that Section 322(b)(1) applies to income tax refunds and Section 910 applies to Estate Tax refunds.

The Sections are as follows:

Section 322(b)(1)—Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later.

Section 910—All claims for the refunding of the tax imposed by this subchapter alleged to have been erroneously or illegally assessed or collected must be presented to the Commissioner within three years next after the payment of such tax.

that the case law and the Commissioner's interpretation of the law differed at the time as to whether or not gains on transfers of patent rights were ordinary income or capital gains.)[36] The Court decided that the invoked statute did not create the right, it merely came to the aid of the taxpayer in rejecting as unwarranted and bringing under statutory control the Commissioner's vacillating and arbitrary action in regard to treatment of income from royalties.[37]

Under the view expressed in *Tobin* the right always existed. Therefore, the statute of limitations on refunds now barred the enforcement of that right. The Fifth Circuit so held even though the relief had been enacted after the applicable statute of limitations had run for the year involved.

The *Tobin* case was the first of a line of decisions concerning 117(q). Shortly after *Tobin* was decided, the Court of Appeals for the Sixth Circuit faced the identical situation in the case of *United States v. Dempster.*[38] Here, the taxpayer received royalties on transfers of patents in 1951 and 1952 and reported such income as ordinary income. Because of the enactment of Section 117(q), the taxpayer sought a refund for the taxes paid on these transfers. Relying on *Tobin's* rationale, the Court refused a refund on the grounds that the taxpayer was barred from recovery by Section 322(b)(1) of the Internal Revenue Code of 1939[39] and Section 7422(a) of the Internal Revenue Code of 1954.[40]

The last case to be decided before the United States Supreme Court rendered its decision on this problem was *Smith v. United States.*[41] Once again the taxpayer had paid taxes on patent royalties for the years 1951 and 1952, treating such gains as ordinary income pursuant to rulings of the Commissioner of Internal Revenue.[42]

Upon the passage of Section 117(q), the taxpayer filed his claim for refund on July 15, 1958 and upon the Commissioner not taking any action on the claim, suit was filed on February 20, 1959. The District Court[43] found in favor of the taxpayer, and upon appeal the Government defended on the same grounds annunciated in *Tobin* and

36. *See, infra* page 13 of text.
37. *Supra* note 32 at 846.
38. 265 F.2d 666 (6th Cir.), *cert. denied,* 361 U.S. 819 (1959).
39. *See, supra* note 35.
40. *See* p. 7 of the text *supra.*
41. 304 F.2d 267 (3rd Cir. 1962).
42. *Supra* note 33.
43. 192 F. Supp. 208 (1961).

Dempster. The Third Circuit Court of Appeals did not agree with the government's defense. Although it did not state that a new cause of action was created by the enactment of Section 117(q), the analysis used by the Court would seem to indicate that this theory was adopted. The Court decided that the decisions[44] which have held that sections like Section 117(q) created a new cause of action have also created a constructive payment of the tax as of the date of legislative enactment. Under this theory, the limitations of Section 322(b)(1) for the filing of a refund claim within two years from the time the tax was paid began to run on June 29, 1956 [date of the enactment of 117(q)], and expired on June 28, 1958. The taxpayer had not filed his claim for refund until July 15, 1958 and therefore, the Court held that even if a new cause of action was created at the date of legislative enactment, the taxpayer's claim for refund would still have been filed too late.[45] This reasoning indicates that the Third Circuit also believed that the statute of limitations on refunds had been extended by implication.

The above cases reveal that the courts were split on the question of whether or not a retroactive relief provision, silent as to its procedural effect, impliedly repealed or modified the applicable statute of limitations on claims for refunds. The Court of Appeals for the Second Circuit and the United States Court of Claims believed that the statute of limitations had been reopened and ran from the date of legislative enactment. The Court of Appeals for the Fifth and Sixth Circuits believed that the right to relief should not be granted to claims barred under the statute of limitations unless the new retroactive legislation explicitly reopened the limitations period. Although not explicit, the opinion of the Third Circuit in *Smith* indicates that it would also hold that the limitations period was reopened on the date of legislation.

In 1960, following the decisions in *Tobin*,[46] and *Dempster*[47] and prior to *Smith*,[48] the case of *Zacks v. United States*[49] was decided by the

44. The Court of Claims holds to the view that Section 117(q) creates a new cause of action: Lorenz v. United States, 296 F.2d 746 (1961); Zacks v. United States, 280 F.2d 829 (1960); while the United States Court of Appeals for the Fifth Circuit, in Tobin v. United States, 264 F.2d 845 (1959) and that of the Sixth Circuit, in United States v. Dempster, 265 F.2d 666 (1959), *cert. denied* 361 U.S. 819, . . . subscribe to a contrary view. *See also* Vaughn v. United States, 181 F. Supp. 386 (S.D. Cal. 1959) 304 F.2d 267, 269, n.7, *supra* note 41.
45. 304 F.2d 267, *supra* note 41.
46. *Supra* note 32.
47. *Supra* note 38.
48. *Supra* note 41.
49. 150 Ct. Cl. 814, 280 F.2d 829, *rev'd*, 375 U.S. 59 (1963).

United States Court of Claims. This case again involved Section 117(q). Zacks, an inventor,[50] received royalties of thirty-seven thousand dollars in 1952 for the transfer of certain patent rights. Because of the prevailing administrative rules, these royalties were reported as ordinary income.[51] However, at the same time there were a number of court decisions which held that such income should be treated as capital gains.[52] Nevertheless, the Internal Revenue Service required that its interpretation be followed and required that such income be taxed as ordinary income.[53] After Congress added Section 117(q) to the 1939 Code, Zacks filed a refund claim for the overpayment of taxes for 1952. The claim was filed on June 23, 1958, and no action having been taken by the Commissioner; suit was commenced.

Again the Government raised the defense that no claim for refund was filed within the statutory period, and therefore, the claim was barred.[54] The Court granted the taxpayer's motion to strike the defense and entered judgment for Zacks. In so doing, the Court said that it was well settled, needing no citation of authority, that Zacks was bound to follow the interpretation of the law by the agency charged with its administration. The taxpayer had no choice but to report the patent royalties as ordinary income. The Court further stated that if the taxpayer believed that the interpretation of the Internal Revenue Service was incorrect, she had a right to file a claim for refund and undertake to convince the Service of its error, and, in default thereof, she could bring suit to test the matter before the courts as others had done. However, the Court felt that the failure of others to secure a reversal of the Service's ruling caused the taxpayer to acquiesce and to pay the taxes accordingly.

The Court took the position that Section 117(q) created a right which the taxpayer had not had prior to this enactment. At the very least, it gave Zacks a right which the Internal Revenue Service persistently said she did not have. Furthermore, the Court felt that Congress must

---

50. During this period there was a distinction between "professional" and "amateur" inventors with regard to the tax treatment of royalties received in exchange for patents. Florence Zacks was a professional inventor and thus properly reported her income from patent royalties as ordinary income. Edward C. Meyers, 6 T.C. 258, 266 (1946).

51. Mim. 6490, 1950-1 CUM. BULL. 9; Revenue Ruling 55-58, 1955-1 CUM. BULL. 97.

52. Edward C. Meyers, 6 T.C. 258 (1946): Kronner v. United States, 110 F. Supp. 730, 126 Ct. Cl. 156 (1953); United States v. Carruthers, 219 F.2d 21 (9th Cir. 1950); Commissioner of Internal Revenue v. Celanese Corp., 140 F.2d 339 (1944); and Commissioner of Internal Revenue Service v. Hopkinson, 126 F.2d 406 (2d Cir. 1942).

53. *Supra* note 51.

54. See text of the Statute of Limitations (Section 322(b) (1) of the INTERNAL REVENUE CODE OF 1939) at *supra* note 35.

have intended to give some taxpayers a right which it must have known had long been barred by the statute of limitations since Section 117(q) was passed on June 29, 1956 and applied to all taxable years beginning after May 31, 1950. In response to the Government's contention that Congress intended Section 117(q) to apply to those taxpayers who had filed claims for refund prior to the passing of the limitations period, the Court stated that there was no express limitation in the statute itself and that the legislative history showed no such intention.[55] The act was held applicable to barred years without restriction.[56]

The Court concluded that insofar as taxable years barred by the statute of limitations are concerned, Section 117(q) gave taxpayers a right which they did not have before. Otherwise, it was an idle gesture to have made the section applicable to years as far back as 1950.[57] In so holding, the Court followed its own precedent established in the *Verckler* case.[58]

Because of the decision in *Zacks*,[59] a conflict developed between the Court of Claims and the Courts of Appeals for the Fifth and Sixth Circuits on how Section 117(q) should be interpreted.[60] In opposition to the writ of certiorari filed by the Government, the taxpayer contended that Section 117(q) gave professional inventors rights which they never had prior to 1956.[61] This point was conceded by the Government.[62] The taxpayer also argued that it was unrealistic to think that Congress would enact remedial legislation retroactively for the years 1950 through 1954, and at the same time intend that the benefits of these changes would be barred by the statute of limitations. Lastly, the taxpayer argued that it was farfetched to answer this interpretation by saying that Congress intended to benefit only the litigious taxpayers and not those who followed the administrative rulings.

The taxpayer in her brief in response[63] also pointed out that although there was a conflict of opinion between the courts and the

55. The United States Supreme Court differed with the Court of Claims' interpretation of the legislative history behind Section 117(q) of the INTERNAL REVENUE CODE OF 1939. For a discussion of the United States Supreme Court's interpretation, see pp. 15-21, *infra*.
56. 280 F.2d 829, 831 (1960), citation at note 49, *supra*.
57. 280 F.2d 829, 831 (1960), citation at note 49, *supra*.
58. *Supra* note 22.
59. The Court of Claims applied the same interpretation to the identical situation to Lorenz v. United States, 296 F.2d 746 (1961).
60. Both *Tobin* and *Dempster* had ruled the other way.
61. Brief for the respondent in opposition, pp. 5-6, United States v. Zacks, 375 U.S. 59 (1963).
62. Brief for the petitioner, p. 14, n.10, *supra* note 4.
63. *See*, *supra* note 61.

Commissioner of Internal Revenue concerning the treatment of royalty payments, this conflict had been confined to amateur inventors. Mrs. Zacks, who was a professional inventor, had never been affected by the opinions of either the courts or the Commissioner. Thus, the taxpayer argued that the amending statute did more than rectify the inconsistent positions that had existed. The Government admitted that the statutory change made in Section 117(q) gave (1) professional inventors, for the first time, the right to qualify patent royalties as long-term capital gains; and (2) it allowed all inventors to treat their qualifying patent royalties as long-term capital gain even though the property had not been held for six months.[64] From this, the taxpayer concluded that as a professional inventor she did not sleep on any rights which were available prior to 1956, because there were, in fact, no rights on which to sleep.

In making its determination the Supreme Court looked first to the administrative and legislative background of the enactment. The administrative history revealed that in 1946 the Commissioner had agreed in *Edward C. Meyer*,[65] that as to amateur inventors[66] a transfer by exclusive license of all substantial rights under a patent was a sale or exchange of a capital asset and thus entitled to capital gains treatment. This position was reversed by the Commissioner on March 20, 1950, and it was announced that royalties would be treated as ordinary income.[67] The effective date of the ruling was May 31, 1950. Although the Commissioner adhered to this ruling in the years following the announcement, the courts had rejected this interpretation.[68] In 1954, Congress enacted Section 1235 of the Internal Revenue Code of 1954[69]

64. Brief for petitioner, pp. 10-11 and 15, *supra* note 4.
65. *Supra* note 50; 1946-1 Cum. Bull. 3.
66. "One not engaged in holding patent rights 'primarily for sale to customers in the ordinary course of his trade or business.' 6 T.C. 266, as distinguished from a 'professional' inventor who is engaged," in the business of selling patent rights. 375 U.S. 59, 62 (1963).
67. Mim. 6490, 1950-1 Cum. Bull. 9.
68. *See*, Kronner v. United States, 126 Ct. Cl. 156, 110 F. Supp. 730 (1953); Allen v. Werner, 190 F.2d 840 (5th Cir. 1951). The Commissioner's position was sustained by the United States Court of Appeals for the Second Circuit in Bloch v. United States, 200 F.2d 63 (1952). Prior to 1946, several courts had taken the same position. *See*, Commissioner v. Celanese Corp., 140 F.2d 339 (1944); Commissioner v. Hopkinson, 126 F.2d 406 (2d Cir. 1942).
69. Section 1235 of the Internal Revenue Code of 1954 provides:

> A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—
>
> (1) payable periodically over a period generally coterminous with the transferee's use of the patent, or
>
> (2) contingent on the productivity, use, or of the property transferred.

which made such income taxable at the capital gains rate. This section operated only prospectively.

In 1955, the Commissioner announced that he would continue to adhere to the 1950 ruling for the tax years beginning after May 31, 1950 and prior to 1954.[70] Because of the position taken by the Commissioner, a gap existed between May 31, 1950 and 1954 in which royalties were to be treated as ordinary income. The Supreme Court admitted that this history by itself did not reveal which group of taxpayers should benefit from Section 117(q)—all taxpayers, or only those taxpayers who did not follow the Commissioner's ruling concerning this matter.

The Supreme Court next examined the legislative history behind Section 117(q). The Court cited Representative Cooper, then Chairman of the House Ways and Means Committee, who had stated on the floor of the House:

> The relief provided by section 1235 [of the 1954 Code] is available only with respect to amounts received in any taxable year to which the 1954 Code applies. As the result of this and the announced policy of the Internal Revenue Service to continue its insistence on its position for years beginning after May 31, 1950, and prior to the effective date of the 1954 Code taxpayers are still confronted with litigation for taxable years falling in this period in order to secure the rights to which the courts, with practical unanimity, have held they are entitled.[71]

Section 1235 provided relief for all taxpayers, both professional and amateur. Representative Cooper made reference to the fact that the years 1950 through 1953 involved litigation does not necessarily mean that it was the sole intention of Congress that only litigious taxpayers should benefit from Section 117(q). The statement made by Representative Cooper was only to the effect that there was litigation involving the years 1951 through 1953, and in no way did it indicate that the relief given under Section 117(q) should be limited to one specific group of taxpayers. Further, Section 1235 of the Internal Revenue Code of 1954 and Section 117(q) of the Internal Revenue Code of 1939 are identical and the two sections provide relief not only for amateur inventors but for all inventors. Thus, the wording of Section

70. Rev. Ruling 55-58, 1955-1 CUM. BULL. 97.
71. 101 Cong. Rec. 12708 (Aug. 1, 1955).

117(q) was sufficient to include not only the litigious inventor but also the non-litigious amateur and professional inventor.

The Supreme Court recognized this point stating:

> A more difficult question is presented by the fact that section 117(q) goes beyond the problem created by the Commissioner's vacillation affecting tax years between 1946 and 1954. By treating royalty payments as capital gains without regard to whether the patent rights transferred were capital assets, section 117(q) made the favorable treatment available to professional as well as amateur inventors.[72] In addition, all royalties are treated as long-term capital gains whether or not the rights transferred had been held for the requisite period. These provisions made clear changes in the law as it was in 1950 and subsequent years up to 1954. Insofar as they are applicable to years for which most claims for refund were barred in 1956, the Government's position renders the provision without effect.[73]

The Court realized that it had a duty to give effect to all portions of the statute.[74] However, it felt that two considerations overrode the application of this general principle. First, the administrative and legislative history of Section 117(q) compelled it to rule otherwise, and the selection of May 31, 1950 as the operative date left no doubt that Congress was primarily concerned with the settlement of the large volume of pending litigation arising out of the Commissioner's 1950 position, which was reaffirmed in 1955.[75] Second, the Court felt that there was an explanation for the inclusion of the additional provisions in Section 117(q). It felt that Section 117(q) traced the language of Section 1235 of the Internal Revenue Code of 1954 because it was wholly natural for the Congress to adopt in 1956 the language of the

72. "Such rights would not be capital assets if the patents were held for sale in the ordinary course of business. INT. REV. CODE OF 1954, § 1221, 26 U.S.C. § 1221, 68A Stat. 321.

The taxpayer makes much of the asserted fact that Mrs. Zacks was a professional inventor, reasoning therefrom that, as to her at least § 117(q) clearly establishes a new right. *Cf.* Lorenz v. United States, 155 Ct. Cl. 751, 296 F.2d 746 (1961). The Court of Claims made no finding as to whether Mrs. Zacks was an amateur or professional inventor. Whatever may be the validity and significance in other contexts of the distinction between creation or new rights and clarification of existing rights, we think that distinction is not controlling here, since Congress has evidenced its intent more directly." 375 U.S. 59, 69 n.9 (1963).

73. 375 U.S. 59, 68 (1963).

74. Citing "*E.g.*", United States v. Menasche, 348 U.S. 528, 538-39 (1955).

75. "The existence of a substantial amount of such litigation is not questioned in this case. Some of it has been collected at pages 35-36 of the Government's brief." 375 U.S. 59, 69 n.10 (1963).

1954 Code to deal with the pre-1954 period on the same basis.[76] The Court believed that it was a fair inference to conclude that, but for the Commissioner's "obduracy" respecting amateur inventors, Section 117(q) would not have been conceived.

The Court found nothing to indicate that Congress passed the 1956 legislation because of some second thoughts about its failure in 1954 in not making Section 1235 retroactive. In reference to this point, the Court went on to say, "[That] to give the provisions in question the controlling weight, that is claimed for them on the issue before us, would allow the tail to wag the dog. *Of course, all of the amendatory provisions* of Section 117(q) are fully effective with respect to years and claims not barred."[77] From this statement, it is obvious that all litigious inventors both amateur and professional would benefit from Section 117(q).

The Court relied heavily upon the fact that Congress has frequently provided for lifting the statute of limitations in retroactive relief measures. The Court referred to Section 14 of the Technical Amendments Act of 1958,[78] the Act of August 9, 1955,[79] and Section 2 of the Act of June 29, 1955.[80] The latter is a provision of the Act which included Section 117(q). From this, it concluded that this was "striking evidence . . . all but conclusive" that Congress did not intend to open years which had been barred by the statute of limitations.

Lastly, and most importantly, the Court rejected the crux of this article. The taxpayer argued that unless the statute of limitations was deemed waived, a premium would be placed on opposition to administrative rulings since only those taxpayers who contested the Commissioner's position would be able to claim a refund. The Court answered that this problem had always attended retroactive legislation of this type, and acceptance of the taxpayer's argument would lead to the automatic waiver of the statute of limitations in every case.

76. Citing H.R. REP. No. 1607, 84th CONG., 1ST SESS. 1-2 (1955).
77. 375 U.S. 59, 70 (1963).
78. 26 U.S.C. § 172(f)(3)-(4), 72 Stat. 1611 (1958). This statute provided a 6-month limitation period during which an otherwise barred claim could be asserted under new rules for computing net operating loss deductions promulgated in the same act. The limitation provision was added to the House Bill by the Senate. S. REP. No. 1983, 85TH CONG., 2D SESS. (1958).
79. 67 Stat. (1953). This act provided a 1 year limitations period for filing otherwise barred claims based on § 345 of the Revenue Act of 1951, 65 Stat. 517, a substantive relief measure. The limitations period was enacted to correct legislative oversight. H.R. REP. No. 1438, 84TH CONG., 1st Sess. 1-2 (1955).
80. Ch. 464, 70 Stat. 404 (1956) relating to taxation of certain payments received prior to 1950 from the United States for construction of Armed forces facilities expressly provides for a 1-year special limitations provision.

"Whether or not this should be done is a matter for Congress to decide. Where Congress has decided otherwise, this Court has but one course."[81]

It is true that when Congress decides otherwise, the Court has no course but to follow the provisions of the legislative act. However, in this case Congress had failed to mention what it had decided in regards to the statute of limitations because Section 117(q) contained no reference to barred years which had been affected by the new legislation. Notwithstanding this point, the Supreme Court when confronted with the problem relied upon tenuous grounds, rather than basing its decision upon what would be the most equitable interpretation under the circumstances. The argument that Congress's failure to expressly mention the statute of limitations reopens by implication previously closed years is as valid as the position adopted by the Supreme Court. And certainly, the former interpretation would be more the more equitable.

As a result of this decision, the only taxpayers who received relief from Section 117(q) in years which were normally barred by the statute of limitations but affected by the legislative relief were: (1) those whose returns remained open by implied or express agreement, such as a waiver or extension; (2) those who filed returns contrary to law (if they were in a "trade or business") or contrary to the prevailing Treasury viewpoint (if they were "nonprofessional" patent holders); (3) those who filed no return for the years involved; (4) those who filed returns, but paid no taxes; (5) those who managed to be beneficiaries of special legislation; (6) and lastly, those who benefited merely fortuitously.[82]

However, the *Zacks* decision did not in any way overrule the "new right" theory which was applied in *Hollander*[83] and in *Verckler*.[84] The Supreme Court decided that the legislative and administrative history "compelled" it to interpret Section 117(q) as not impliedly reopening the limitations. The "new right" theory may still be applied when a court finds the legislative history behind a retroactive relief act to be unclear.

Since *Zacks*, only one decision[85] involving a procedurally silent retroactive tax relief statute has been decided. In *New York, Chicago and*

81. 375 U.S. 59, 70 (1963).
82. 63 MICH. L. REV. 390 (1964).
83. *Supra* note 10.
84. *Supra* note 22.
85. For similar case, involving retroactivity of relief other than remedial legislation see: 330 F.2d 637 (1964).

St. Louis Railroad v. United States,[86] (hereinafter referred to as the *Nickel Plate* case), the taxpayer sued for a refund because of an overpayment of World War II excess profits taxes for the years 1943 and 1944. In 1943 the Interstate Commerce Commission ordered the major railroads to change from the retirement method to the straight-line method of accounting for depreciable railroad properties.[87] The railroads then requested permission from the Internal Revenue Service to make the same change for purposes of tax depreciation. The Service agreed, but only on the condition that the railroads accept so called "terms letters"[88] under which the roads were to establish depreciation reserves of 30% of original cost and reduce accumulated earnings and profits by the same amount. This requirement had two effects: (1) it reduced the basis of the road's assets below what it otherwise would have been, reducing the amount of depreciation deductions available for taxable years beginning in 1943 and thereafter; (2) it reduced the amount of investment capital available to the roads; thereby reducing the excess profits tax investment credit and increasing the excess profits taxes paid during the years 1943 and 1944. In September of 1944, the taxpayer accepted the limitations of the Commissioner's terms letter. The taxpayer's excess profits taxes for the years 1943 and 1944 were calculated accordingly and a return was filed along with payment of the taxes.

Fourteen years later, Section 94 (referred to as the Retirement Straight Line Act of 1958) of the Technical Amendments Act of 1958 was enacted[89] which permitted taxpayers who had switched from the retirement method of depreciation to the straight-line method (subject to the terms letter conditions) to elect to reduce the 30% reserve for

86. 331 F.2d 865 (1964).

87. Under the straight-line method of depreciation a deduction is taken yearly for depreciation expense. The amount of depreciation is computed by dividing the cost of the property less its salvage value by the estimated life of the property.

Under the retirement method of depreciation no deduction for depreciation expense is taken until the property is taken out of operation. The amount of the deduction is the cost of the property less the amount received for salvage.

88. A "terms letter" is nothing more than the conditions under which a taxpayer must agree in order to change his accounting method. Sec. 1.446(e)(2)(i) and (3) of the Treasury Regulations of the INTERNAL REVENUE CODE OF 1954 provides:

> . . . a taxpayer, who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner.
>
> . . . .
>
> Permission to change a taxpayer's method of accounting will not be granted unless the taxpayer and the Commissioner agree to terms, conditions, and adjustments under which the change will be effected.

89. 72 Stat. 1606, 1669-1671.

pre-1913 depreciation. Section 94 permitted an election to recompute excess profits taxes retroactively as of the change-over date, and as of the beginning of each taxable year thereafter. The effective date of the section was December 31, 1940. This section is silent with respect to any years which had been previously closed by the statute of limitations on refunds.

The taxpayers elected to take the benefit under Section 94 and made claim for a refund on August 1, 1960 (this was within two years of the date of the enactment of Section 94). Upon rejection of the claim by the Internal Revenue Service, the taxpayer filed suit for a refund of $1,600,000 in the United States Court of Claims. The taxpayer contended that Section 94, because of its retroactive nature, created a new cause of action permitting the otherwise closed years of 1943 and 1944 to be opened for a recomputation of the excess profits tax.

The Government defended that because the statute of limitations had never been mentioned in the enactment of Section 94, it was only retroactive to those years which had remained open. The Government contended that Section 94 did not extend, revive, or open the ordinary limitations period on refunds. Thus, the same procedural problem as in *Zacks* and the prior decisions was again at issue. The Court of Claims in deciding the case held that it would follow the principle put forth in the *Zacks* case; its "sole concern . . . [was] . . . the intent of Congress in adding this section of the Code."[90]

After an examination of the administrative negotiations and the legislative history, it was concluded that the legislation was only a settlement of those years held open by a handful of taxpayers. As a result, it was held that any years of the taxpayer which were previously closed remained closed with respect to any claim under Section 94.[91] The end

90. 331 F.2d 865, 869 (1964), court citing the Supreme Court in the *Zacks* decision.

91. The Court of Claims relied heavily upon the statements of Congressman Mills, Chairman of the House Ways and Means Committee when he told the House:

> . . . that this amendment [Section 94] is interpreted by the membership of the Committee on Ways and Means as legislating into law a settlement. Frankly, that is what I interpret it to be.
>
> Since that time [the changeover date from the retirement method of depreciation to the straight line method of depreciation] a number of court decisions have dealt with the tax effects of the retirement method of computing depreciation and with the tax effects in changing from this method. These decisions relate to a number of different issues. They involve widely varying factual situations and relate, of course, to a very complicated subject. In general, they have thrown doubt upon the validity of the 30-percent reserve requirement imposed upon railroads under the terms letters. As a result of these decisions, the railroads and the Internal Revenue Service have been engaged in a continuing controversy over the tax effects of this change in method of computing depreciation. *The proposed amendment is, in essence, a settlement of this controversy. We are, in effect, legislating into law this settlement.* (Emphasis Added) 104 Cong. Rec. 1222 (1958).

result was that only twelve of the fifty railroads affected by Section 94 benefited from this decision.

There is no doubt that the legislative history behind Section 94 indicated that the relief was meant to apply only to years that had been kept open. However, the importance of *Nickel Plate* is not the Court of Claims' interpretation of the legislative history behind Section 94, but rather, the principles applied by the Court in deciding the case.

After discussing the Supreme Court's reliance upon the "direct indicia of Congressional intent" the Court of Claims stated:

> For cases like *Zacks* and this one, the [Supreme] Court thus neutralized the prior doctrines of the lower courts laying down general principles. We have been directed, rather, to search for the answer in the materials bearing directly and pointedly on the enactment claimed to reopen the barred years. If we cannot find that Congress had that aim, we must continue to apply the normal limitations statute.[92]

This approach places a heavy burden upon the taxpayer. It establishes a presumption *against* implied reopenings of the statute of limitations, which can be rebutted only by an affirmative showing of Congressional intent to reopen closed years. Under this view, if the legislative history is merely ambiguous, the taxpayer does not have resort to the "new right" theory or an argument based upon equal treatment.

The validity of this presumption may be questioned because of the Supreme Court's statement in *Zacks* in which the Court held that the "new right" and the equality arguments were not available because Congress had affirmatively indicated its intent not to reopen the closed years. However, even the Supreme Court's language supports an inference that where Congress's intent is not as clear as in *Zacks,* resort may be had to these two arguments. The Supreme Court made this clear in the footnotes of the *Zacks'* opinion. In these notes which were apparently directed at the railroads, the Court stated:

> Contrary to fears seemingly entertained by one of the *amici* in this case (presumably the Nickel Plate Railroad), we do not suggest that congressional practice in this regard gives rise to a presumption that where Congress has not provided expressly for a special limitations period in a retroactive tax statute, the general statute of limitations was intended to apply. The significance of

92. 331 F.2d 865, 869-870 (1964).

> such congressional silence is to be judged on a case-by-case basis, as with all questions of statutory interpretation.[93]

It is clear from this statement that the Supreme Court did not intend to create a presumption in favor of applying the statute of limitations in all situations where closed years were not expressly reopened. Under the directions laid down in *Zacks* it is still necessary for the government to show, at least as clearly as appeared in the *Zacks* case, that Congress did not intend to reopen closed years.

Unfortunately, the Court of Claims went beyond these directions in *Nickel Plate* by establishing a presumption in favor of applying the statute of limitations.[94] Whether other courts will apply this presumption remains to be seen.

II. The Operation and Purpose of the Statute of Limitations on Claims for Refund

The complexities of the problem described in Part I cannot be appreciated without some understanding of the operation of the Statute of Limitations on Claims for Refund. This part will be concerned only with those portions of the statute which deal with this problem.

Congress has provided for the taxpayer's protection in the case of an overpayment of taxes, Section 6402 of the Internal Revenue Code of 1954 provides:

> (a) General Rule—In the case of any overpayment, the Secretary or his delegate, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an Internal Revenue Tax on the part of the person who made the overpayment and shall refund any balance to such person.[95]
>
> (b) Credits Against Estimated Tax—The Secretary or his delegate is authorized to prescribe regulations providing for the crediting against the estimated income tax for any taxable year of the amount determined by the taxpayer or the Secre-

93. 375 U.S. 59 (1963).

94. It should be pointed out that the outcome in *Nickel Plate* would have been the same without the application of a presumption in favor of applying the statute of limitations because of the clarity of the legislative history.

95. The source of this subsection is Section 3770(a)(1), (4), (5) of the Internal Revenue Code of 1939.

> tary (or his delegate) to be an overpayment of the income tax for a preceding taxable year.[96]

The aforementioned cases, however, indicated that retroactive relief measures, which are silent in reference to the statute of limitations often cause unequal tax treatment. Specifically, certain taxpayers are able to reap the benefits given by the remedial legislation, whereas others are barred from a refund even though they claim relief for the same tax year involving an identical tax transaction.[97] It is unfortunate that unequal tax treatment should arise in such situations because the sole purpose of the statute of limitations on claims for refunds is only to protect the Internal Revenue Service from "stale claims."[98] This limitation period was intended to put all taxpayers on an equal footing in their efforts to enforce a tax refund, but the reverse has occurred in these cases.

The problem lies in the time limitation in which claims for refund[99] can be enforced. Under Section 6511 of the Internal Revenue Code of 1954, a claim for refund must be made before whichever date is later:[100]

---

96. The source of this subsection is Section 322(a)(3) of the INTERNAL REVENUE CODE OF 1939.

97. Williams, *Retroactivity in the Federal Tax Field*, U. So. Cal. 1960 Tax Inst. 79, 100.

98. *See*, United States v. Memphis Collen Oil Co., 288 U.S. 62, 71 (1932); Scharpf v. United States, 157 F. Supp. 434, 438 (D.C. Or. 1956), *affirmed per curiam*, 250 F.2d 744 (9th Cir. 1957); Cumberland Portland Cement Co. v. United States, 104 F. Supp. 1010, 1013 (1952); Smale & Robinson, Inc. v. United States, 123 F. Supp. 457, 461 (1954).

99. Whenever the term refund is used, the author is referring to "credit or refund" unless stated otherwise.

100. Section 6511 provides in part:

> (a) Period of Limitations on Filing Claim—Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid.
>
> (b) Limitation on Allowance of Credit and Refunds—
>
> (1) Filing of Claim Within Prescribed Period—No credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in subsection (a) for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.

"Although, except as noted herein, the 1954 Code provisions represent a re-enactment of the 1939 Code relating to claims for refund of income tax, the provisions of the 1939 Code respecting claim for refund of estate and gift taxes have been eliminated, under the 1954 Code, in favor of a uniform time limitation upon the filing of claims for credit or refund of an overpayment of any tax imposed under Title 26 of the United States Code. Under the 1939 Code the period for claiming refund of estate and gift taxes was as to each tax three years from the date of payment; See IRC (1939) Secs. 910 and 1027(b); Fawcett v. U.S., 164 F.2d 696 (CCA 9th 1947); Rogas v. Taylor, 136 F.2d 598 (CCA 9th 1943); First Nat. Bank of Greenville, S.C. v. U.S., 131 F. Supp. 647 (D.C.S.C. 1954).

As previously noted, the limitations provisions of the 1954 Code are applicable, with

(1) Three years after the return was filed,[101] or

(2) Two years after the tax was paid.[102]

The failure of one to file a return has the effect of only applying the two year limitation period from the date of payment.[103] Conversely, the late filing of a return extends the three year period for filing a claim since it runs from the date of payment.[104]

Section 6511 of the Internal Revenue Code of 1954 also provides for keeping open the limitations period by express agreement. Section 6511(c) of the 1954 Internal Revenue Code provides:

> (c) Special Rules Applicable In Case of Extension of Time by Agreement—if an agreement under the provisions of Section 6501

---

respect to estate taxes, only to estate of decedents dying after the enactment of said Code, and with respect to gift taxes only for the calendar year 1955 and subsequent years. IRC (1954) Sec. 7851(a)(2), (6)." Casey, 3 Federal Tax Practice § 10.5, n.30 (1955). Treasury Regulations § 301.6511(a)-1(1), (2) of the INTERNAL REVENUE CODE OF 1954 provides:

> (1) If a return is filed, a claim for credit or refund of an overpayment must be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods was later [and]
>
> (2) If no return is filed, the claim for credit or refund of an overpayment must be filed by the taxpayer within 2 years from the time the tax was paid.

101. As stated in the Code, a claim for credit or refund of overpaid taxes must be filed within three years from the time the tax return was filed. For purposes of deciding the date of filing, a return filed before the due date is considered filed on the date it is due. Section 6513 of the INTERNAL REVENUE CODE OF 1954 provides:

> (a) Early Returns . . . .—For purposes of section 6511, any return filed before the last day prescribed for the filing thereof shall be considered as filed on such last day.

102. As to what is considered the date of payment, it has been interpreted previously by case law and now by Section 6513 of the Internal Revenue Code of 1954 that any tax paid before the due date, including withheld or estimated income tax paid during the taxable year, will be considered paid on the due date.
Section 6513 of the INTERNAL REVENUE CODE OF 1954 provides:

> 6513(a)— . . . Advance Payment of Tax.—For purposes of Section 6511(b)(2) and (c) and section 6512, payment of any portion of the tax made before the last day prescribed for the payment of the tax shall be considered made on such last day. For purposes of this subsection, the last day prescribed for filing the return or paying the tax shall be determined without regard to any extension of time granted the taxpayer and without regard to any election to pay the tax in installments.
>
> (b) Prepaid Income Tax.—For purposes of section 6511 or 6512, any tax actually deducted and withheld at the source during any calendar year under Chapter 24 shall, in respect to the recipient of the income, be deemed to have been paid by him on the 15th day of the fourth month following the close of his taxable year with respect to which such tax is allowable as a credit under section 31. For purposes of section 6511 or 6512, any amount paid as estimated income tax for any taxable year shall be deemed to have been paid on the last day prescribed for filing the return under section 6012 for such taxable year (determined without regard to any extension of time for filing such return).

For prior law, *see*: Plankinton v. United States, 164 F. Supp. 912, *aff'd.* 267 F.2d 278 (1959); Schmidt v. Commissioner, 272 F.2d 423 (1959).

103. *Supra* note 99.

104. Shepard, *Statute of Limitations,* N.Y.U. 24th Inst. On Fed. Tax, 45 (1966).

> (c)(4) extending the period for assessment of a tax imposed by this title is made within the period prescribed in subsection (a) for filing of a claim for credit or refund—
>
> (1) Time For Filing Claim—The period for filing a claim for credit or refund or for making credit or refund if no claim is filed, provided in subsection (a) and (b)(1), shall not expire prior to 6 months after the expiration of the period within which an assessment may be made pursuant to the agreement or any extension thereof under Section 6501(c)(4).

Section 6501(c)(4) of the 1954 Internal Revenue Code provides:

> (c)(4) Limitation on Assessment And Collection—Extension by agreement—where, before the expiration of the time prescribed in this section for the assessment of any tax imposed by this title, except the estate tax provided in Chapter 11, both the Secretary or his delegate and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

Because of the varying periods in which the statute of limitations is measured, unequal tax treatment occurs when a procedurally silent tax relief measure is construed to apply only to open years. The following example clearly illustrates this point.

The most common example of unequal tax treatment concerning retroactive tax relief measures and the statute of limitations involves the extension by agreement procedure.[105]

Assume the following facts: In 1954 the X Corporation files a tax return making full disclosure and stating that $1,000,000.00 is the federal income tax due for the year. There are at least a hundred different items covered in the return. Normally, certain doubtful questions are interpreted by the Corporation in its favor. At the desk audit the federal revenue agent feels that these doubtful questions should be interpreted in favor of the government. Because of the shortage of field agents, the X Corporation will be requested to sign a waiver extending the time in which the Service can perform an audit on the books of the Corporation.

Note that at this point the Corporation has little choice but to sign the waiver because in doing otherwise, the agent will immediately

105. *See supra* note 28 for Section 6511(c) of the INTERNAL REVENUE CODE OF 1954.

assess the Corporation for the tax he feels is due. The Corporation is thereby placed in a weak position since there is a presumption that the assessment of the government is correct.[106]

Assume further that in 1958, a retroactive tax relief measure silent with respect to its procedural aspects is enacted affecting a transaction performed by the X Corporation in 1954. During this period the X Corporation and the government have kept open the statute of limitations in order for the field audit to be performed. Thus, in 1958 the X Corporation will be able to claim a refund or credit for the 1954 transaction affected by the new relief measure. If the legislation is construed to apply only to open years, all equally situated corporate taxpayers who had failed to keep open the year 1954 by signing a waiver[107] or by some other technique will be barred from effectuating a claim for refund for 1954. This is not a farfetched example because in the *Nickel Plate* case, this is how twelve of the fifty railroads received refunds under the Retirement-Straight-Line Adjustment Act of 1958 for the years 1943 and 1944.[108]

There are other ways in which the statute of limitations can be kept open, for example: (1) the failure of one to pay his tax on time causes the statute of limitations to run from the date of payment no matter how late the payment occurs; (2) the failure of one to file his return along with a failure to pay his tax liability also causes the statute of limitations to run from the date of payment no matter how late; (3) and the filing of a return contrary to the existing law or contrary to the existing Treasury interpretation of the law will cause a deficiency assessment, the payment of which will be the starting date of the statute of limitations to run for a refund on the additional amount paid. These examples illustrate how the time limitation on refunds can fluctuate, thereby causing identically situated taxpayers to be treated unequally when a retroactive relief measure which is silent with regard to the statute of limitations is interpreted to apply only to open years. This type of legislation carries the potential of violating the over-all policy equality of taxation. Further, it contains the peculiar feature of benefiting the uncooperative and litigious, penalizing the taxpayer who cooperates with the system.

---

106. Fuller v. Commissioner of Internal Revenue Service, 313 F.2d 73 (1963).
107. Form 872 is used for this type of assessment extension.
108. *See supra* pp. 17-19 of text for the facts of the Nickel Plate case where 12 railroads kept the statute of limitations open for 18 years.

III. Constitutional Limitations on Retroactive Tax Relief Measures

Because we are disposed to think that the Constitution lays down the ultimate standards for what is right and just, there is a natural tendency to think first of the constitutionality of retroactive tax legislation which only applies or is construed to apply to open years. Notwithstanding this tendency to think in terms of constitutional limitations on retroactive legislation, as a practical matter, it is legislative restraint which lays down the outer limits of retroactive tax legislation.[109]

The Constitution expressly provides that the federal government shall not pass any bills of attainder or ex post facto laws and the states shall not pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts.[110] However, there is no reference made specifically or generally which prohibits the enactment of retroactive tax laws.

An ex post facto law imposes a punishment for an act which was not punishable at the time it was committed, or a punishment in addition to that then prescribed.[111] This interpretation has been limited to criminal statutes.[112] Bills of attainder are legislative acts which inflict punishment without a judicial trial.[113] Thus, it is clear that neither of these provisions prohibit the enactment of retroactive tax legislation.

Because the Constitution lacks an express prohibition, there have been two provisions of the Constitution which have been considered

109. "However, this legislative self-restraint is not a hard and fast inflexible principle. In the field of income taxation, a limited degree of retroactivity is the rule rather than the exception and a substantial degree of retroactivity may be found in a substantial number of particular instances. Although constitutional considerations and the decisions of the Supreme Court doubtless have influenced the Congress, nevertheless, the somewhat flexible standards against retroactivity which Congress seems to have set for itself, and which, in the main, the Executive Branch has encouraged, are so much stricter than the constitutional standards which the courts seldom have had occasion to find retroactive tax legislation unconstitutional, thereby leaving retroactivity in tax legislation largely colored and controlled by the legislative standards." Williams, *Retroactivity in the Federal Tax Field*, U. So. Cal. 12th Tax Inst. 79 (1960).

110. Art. I, §§ 9 and 10.

111. *Supra* note 109.

112. "Every ex post facto law must necessarily be retrospective; but every retrospective law is not an ex post facto law: The former only are prohibited. Every law that taxes away or impairs, rights vested, agreeably to existing laws, is retrospective, and is generally unjust, and may be offensive; and it is a good general rule, that a law should have not been retrospective; but there are cases in which laws may justify, and for the benefit of the community, and also of individuals, relate to a time antecedent to their commencement as statutes of oblivion or of pardon." Calder v. Bull, 3 U.S. (3 Dall.) 386, 391 (1798).

113. *Supra* note 109.

as possibly imposing limitations on retroactive tax legislation in an indirect manner. The first provision is the due process clause of the Fifth Amendment.[114] The second, is Article I, Section 9, Clause 4, of the Constitution which provides that direct taxes must be apportioned among the states according to population.[115] Unfortunately, all the cases involving the constitutionality of retroactive tax legislation have been concerned with instances where the Congress has enacted legislation which increased the tax burden. There have been no decisions involving the constitutionality of retroactive tax legislation which has conferred relief to certain taxpayers. The reason being that while it may be considered improper for the government to increase a tax burden retroactively, there can be no objection if the government chooses to give tax relief retroactively.[116]

Notwithstanding the fact that all the decisions have involved retroactive tax legislation which have increased the tax burden, an examination of these decisions will be quite informative since it is the contention of this writer that retroactive remedial tax legislation which applies only to open years, indirectly increases the tax burden on some taxpayers because it relieves identically situated taxpayers from the same tax burden involving an identical transaction occurring during the same tax year.

There has only been one case concerning the direct tax argument in considering the constitutionality of a retroactive federal tax law.[117] This argument appeared in *Brushaber v. Union Pacific Railroad Co.*[118] In substance, the argument follows along these lines: The Sixteenth Amendment[119] only eliminated the necessity of apportionment in the

114. The Fifth Amendment provides in part:
"No person shall be . . . deprived of . . . property, without due process of law; . . . ."

115. Article I, Section 9, Clause 4 provides:
"No capitation, or other direct Tax, shall be laid, unless in proportion to the Census or Enumeration herein before directed to be taken."

116. "Needless to say, this is the area where the Treasury representatives most vigorously argue for the principle of non-retroactive tax legislation, for they must consider the loss of revenue which might result from even meritorious retroactive tax legislation, and as a practical matter are the sole spokesmen for the general mass of taxpayers to whom, in greater or lesser degree, a greater tax burden is shifted by such legislation." *Supra* note 109.

117. There have been five cases involving the constitutionality of retroactive income tax legislation: Stockdale v. Atlantic Ins. Co., 87 U.S. 323 (1874); Brushaber v. Union Pacific R.R. 240 U.S. 1 (1916); Cooper v. United States, 280 U.S. 409 (1930); Reinecke v. Smith, 289 U.S. 172 (1933); and United States v. Hudson, 299 U.S. 498 (1937).

118. 240 U.S. 1 (1916).

119. The Sixteenth Amendment of the United States Constitution provides:
The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the States, and without regard to any census or enumeration.

case of income taxes. It in no other way extended the scope of Congress's power to tax. Therefore, if income from a prior period has been accumulated and has become capital, a direct tax upon such capital would today be constitutional only if levied in proportion to the states.[120] The problem centers around the question of when or if ever accumulated income ceases to be income and becomes capital so that a tax thereon must be levied in proportion to the population among the several states.[121]

In *Brushaber* one of the arguments put forth was that the income tax provisions of the Tariff Act of October 3, 1913,[122] were unconstitutional because it was retroactive as of March 1, 1913. Therefore it was a direct tax on income which had become accumulated capital, and thus, violated Article I, Section 9, Clause 4 of the United States Constitution. The Act had been enacted on October 3, 1913, and by its terms was retroactive as of March 1, 1913.

The argument that sums which the taxpayer had received prior to October 3, 1913 were no longer income but had become capital, was rejected by the Supreme Court. The Court held that the Act was not inconsistent with the Sixteenth Amendment because the date of the retroactivity did not extend beyond the time when the Sixteenth Amendment was operative and that Congress possessed the power to enact income taxes for the period involved without apportionment by way of the Sixteenth Amendment.[123]

Whether it can be said that there is a point after which accumulated income becomes capital has not been made clear in *Brushaber*. That issue was never considered by the Court. Since this argument was not adopted in *Brushaber*, it probably will never be adopted since there is too much difficulty in arriving at a time limitation without being arbitrary. More than likely, the courts will shy away from the argument and rely mainly upon the due process clause when they decide the constitutionality of a retroactive tax law.[124]

No other argument involving the constitutionality of a retroactive tax statute has been relied upon more often than the due process

120. Williams, *Retroactivity in the Federal Tax Field*, U. So. Cal. 12th Tax Inst. 81 (1960).
121. *Id.*
122. Section 2, ch. 16, 38 Stat. 166.
123. There are other arguments raised in this case involving the due process clause of the Fifth Amendment which will be discussed later in this paper.
124. For a further discussion on this point see, Novich and Petersberger, *Retroactivity in Federal Taxation*, 34 TAXES 407 (1959).

clause of the Fifth Amendment. Despite retroactive taxes normally being regarded as unfair, any argument based upon the due process clause has generally met with a lack of success. In the context in which due process is used in this area, the term does not have a procedural connotation, but rather the emphasis is upon the improper taking of property without justice and fair play.[125]

The first of several cases involving the validity of a retroactive federal income tax law was *Stockdale v. Atlantic Insurance Co.*[126] This case was concerned with the validity of Section 17 of the Act of July 14, 1870[127] which provided that sections 120, 121, 122 and 123 of the Internal Revenue Act of 1864, which taxed dividends of insurance corporations, should be construed to impose the taxes therein mentioned to the first day of August, 1870. Prior to the Act of July 14, 1870, the Internal Revenue Act of 1864 had expired on December 31, 1869. The Court, in deciding the question of due process and retroactive tax legislation, concluded that:

> . . . the right of Congress to . . . [impose] . . . this tax by a new statute, although the measure of it was governed by the income of the past year, cannot be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed. The joint resolution of July 14, 1864, imposed a tax of five per cent upon all income of the previous year [1863], although one tax on it had already been paid, and no one doubted the validity of the tax or attempted to resist it.[128]

Although the decision in *Stockdale* applied solely to the validity of the 1870 law which was retroactive only to the beginning of the current year, there is sufficient dicta in the above quoted paragraph to indicate that the Court would uphold a retroactive tax upon income for a previous year.

The second case, *Brushaber v. Union Pacific Railroad,*[129] which has already been discussed in connection with the direct tax argument contained a second argument which was based upon the due process clause of the Fifth Amendment. Although the Court dealt mainly with the

125. Williams, *Retroactivity in the Federal Tax Field,* U. So. Cal. 12th Tax Inst. 83 (1960).
126. 87 U.S. 323 (1874).
127. 16 Stat. 261 (1870).
128. 87 U.S. 323, 331 (1874).
129. *Supra* note 118.

direct tax argument in this decision, it had this to say about due process:

> So far as the due process clause of the Fifth Amendment is relied upon, it suffices to say that there is no basis for such reliance since it is equally well settled that such clause is not a limitation upon the taxing power conferred upon Congress by the Constitution; in other words, that the Constitution does not conflict with itself by conferring upon the one hand a taxing power and taking the same power away on the other by the limitation of the due process clause.[130]

However, the Court went on to say that this doctrine would have no application where the act complained of was so arbitrary that it amounted to a confiscation of property rather than an exertion of taxation.

In *Cooper v. United States*,[131] a taxpayer received shares of stock as a gift from her husband on November 1, 1921. She derived a gain from the sale of these shares by selling some of them to a bank on November 7, 1921 for an amount equal to their fair market value. On November 23, 1921 the Revenue Act of 1921[132] was enacted retroactively to January 1, 1921. The Act recognized a gain to a taxpayer in an amount equal to the difference between the cost basis of the stock to the donor and the sales price. Prior to this enactment, no gain was recognized on such a transaction.[133] The taxpayer contended that if the Act were construed to apply in situations where the gift and sale were consummated before the enactment, then the section was arbitrary and capricious and was therefore in conflict with the due process clause of the Fifth Amendment.

In a very brief opinion, the Court rejected this argument stating that the provision was not in conflict with the Constitution merely because it required gains from prior but recent transactions to be

130. 240 U.S. 1, 24 (1916).
131. 280 U.S. 409 (1930).
132. The Revenue Act of 1921, ch. 136, 42 Stat. 227, 229 provides in part:

Sec. 202(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that— . . .
(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have been in the hands of the donor or the last preceding owner by whom it was not acquired by gift . . . . In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition. . . .

133. There is no statutory provision on this point to show that gain was not recognized in such situations.

treated as part of the gross income of the taxpayer. The Court further held that there had been no serious doubt about this point since *Brushaber v. Union Pacific Railroad Co.*

In *Reinecke v. Smith,*[134] the taxpayer created five trusts in 1922 which made him the trustee with the power to revoke the trusts at will. On June 2, 1924 the Revenue Act of 1924[135] was enacted, part of which provided that income from a trust was taxable to a grantor who had the power alone or in conjunction with another person other than a beneficiary to revoke the trust. This section was made retroactive to January 1, 1924. On October 22, 1924 the taxpayer resigned as trustee and gave up his right to revoke the trusts. The Commissioner sought to tax the taxpayer (grantor) for income attributable to the trusts for the period beginning January 1, 1924 and ending October 22, 1924. The taxpayer attacked the retroactive aspects of the Act as being in violation of the due process clause of the Fifth Amendment.

The Court found that the due process clause had not been violated because of the Act's retroactive effect. Rather, the Court felt that although the Act was passed June 2, 1924 the imposition of the tax on income received or accrued from the beginning of the year had been previously held objectionable.[136]

The final case dealing with a retroactive income tax law was *United States v. Hudson*[137] which concerned the constitutionality of the retroaction provisions of the Silver Purchase Act of June 19, 1934.[138] The taxpayer had purchased silver bullion futures on May 3, 1934. On May 23 and 29, 1934 these futures were sold. The Silver Purchase Act provided for the taxing of profits on transfers of interests of silver at the rate of 50%. This Act was enacted on June 19, 1934, and was made retroactive 35 days to May 15, 1934.

The taxpayer contended that the retroactive aspect of the law was in violation of the due process clause of the Fifth Amendment. Once more the Court rejected this argument by stating:

As respects income tax statutes it has long been the practice of

134. 289 U.S. 172 (1933).
135. Section 219(g), 43 Stat. 253, 277 (1924). The pertinent part of the Revenue Act of 1924 provided:

> Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust for such taxable year shall be included in computing the net income of the grantor.

136. The Court cited Cooper v. United States, 280 U.S. 409, 411 (1930).
137. 299 U.S. 498 (1937).
138. Ch. 674, § 8, 48 Stat. 1178 (1934).

> Congress to make them retroactive for relatively short periods so as to include profits from transactions consummated while the statute was in process of enactment, or within so much of the calendar year as preceded the enactment; and repeated decisions of this Court have recognized this practice and sustained it as consistent with the due process clause of the Constitution.[139]

Thus, the Supreme Court has never found a retroactive income tax law in violation of the due process clause of the Fifth Amendment because of its retroactive provisions. However, these decisions have only dealt with income tax laws which were limited to current year retroactivity.[140] Whether this will be true for income tax laws which are retroactive for more than a year is questionable.

The area of estate, gift and excise tax differs from the field of income tax in that the direct tax argument is not applicable because each of these taxes is a tax upon a separate event.[141] In addition, the area of estate and gift taxes is the only area in which the taxpayer has had any success in the Supreme Court in attacking the constitutionality of retroactive federal tax laws.

The first case in which a taxpayer met with success was *Nichols v. Coolidge*[142] which involved the retroactivity of a federal estate tax. The facts disclosed that tranfer of property was made by the decedent and her husband to their children in 1917 with no consideration given in return. Under the then existing law, such a transfer was not a taxable transaction.[143] On February 24, 1919, Section 402 of the Revenue Act of 1918[144] was enacted which required the inclusion in the gross estate property transferred before death where the conveyance was not a bona fide sale and was intended to take effect in possession or enjoyment at or after death.[145] The retroactive aspect of Section 402 was

139. The Court cited *Stockdale, Brushaber* and *Cooper* as authority for this point. 299 U.S. 498, 500 (1937).

140. "The area of state income taxes, however (where, incidentally, the direct tax argument is not available) may be significant. The Supreme Court has allowed states to impose income taxes retroactively beyond the current year retroactivity. *See, e.g.* Welch v. Henry, 305 U.S 134 (1938) where it was held that the due process clause of the 14th Amendment was not violated by a Wisconsin statute enacted on March 27, 1935 and made retroactively applicable for the years 1933 and 1934 so as to tax dividends received in 1933. There two calendar years of retroactivity beyond the current year was not deemed in violation of due process." Williams, *Retroactivity in the Federal Tax Field*, U. So. Cal. 12th Tax Inst. 79, 87-88 (1960).

141. *Id.*

142. 274 U.S. 531 (1927).

143. Act of September 8, 1916, ch. 463, 39 Stat. 756.

144. Act of February 24, 1919, ch. 18, 40 Stat. 1057, 1096, 1097, 1149 and 1150.

145. The Court also found that an absolute conveyance of realty by deed without consideration to the grantor's children is an absolute transfer and does not fall into

attacked as being in violation of the due process clause of the Fifth Amendment. The Supreme Court agreed with the taxpayer stating:

> The Court has recognized that a statute purporting to tax may be so arbitrary and capricious as to amount to confiscation and offend the Fifth Amendment.[146] And we must conclude that § 402(c) of the statute here under consideration, is so far as it required that there shall be included in the gross estate the value of property transferred by a decedent prior to its passage merely because the conveyance was intended to take effect in possession or enjoyment at or after his death, is arbitrary, capricious and amounts to confiscation.[147]

The next two cases were gift tax cases which struck down retroactive gift tax laws. In *Blodgett v. Holden*,[148] the taxpayer made an outright gift of property in January of 1924. On June 2, 1924 Congress enacted the Revenue Act of 1924,[149] which provided that any gift within the year 1924 or thereafter was taxable. The taxpayer attacked the retroactivity of the section as being in violation of the due process clause of the Fifth Amendment. Once again the Supreme Court agreed with the taxpayer. The Court relying upon the *Nichols* decision held that a statute purporting to lay a tax may be arbitrary and capricious and that its enforcement would amount to the taking of property without due process. The Court concluded further that:

> As to the gifts which Blodgett made during January 1924 . . . the challenged enactment is arbitrary and for that reason invalid. It seems wholly unreasonable that one who, in entirely good faith and without the slightest premonition of such consequences made absolute disposition by gifts should thereafter be required to pay a charge for so doing.[150]

The second case, *Untemeyer v. Anderson*,[151] held that a gift tax was unconstitutional because of its retroactive aspects even though the gift was made while the gift tax was under consideration by the Congress. In *Untemeyer*, the facts were the same as the facts in *Blodgett* with the one exception that Untemeyer had made his gifts on May 23, 1924,

---

the area of those transfers which are to take effect in possession or enjoyment at or after the grantor's death as put forth in section 402.

146. Court citing Brushaber v. Union Pacific R.R., 240 U.S. 1, 24 (1916); Barclay & Co. v. Edwards, 267 U.S. 442, 450 (1924).
147. 274 U.S. 531, 542 (1927).
148. 275 U.S. 142 (1927).
149. Ch. 234, 43 Stat. 313 (1924).
150. 275 U.S. 142, 147 (1927).
151. 276 U.S. 440 (1928).

three months after the provisions for the Revenue Act of 1924 were presented and while the conference report upon the bill was pending. Nevertheless, the Court decided that the mere fact that the gift was made while the bill was in its last stages in Congress was not enough to differentiate the present case from the arbitrary character of the Act as described under the facts in *Blodgett*. The Court held that to accept the contrary rule would put too great a burden on the taxpayer.

> The taxpayer may justly demand to know when and how he becomes liable for taxes he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken.[152]

Since these three cases, decisions involving the validity of retroactive estate taxes have been rendered against the taxpayer. In 1929, in the case of *Reinecke v. Northern Trust Co.*,[153] the Supreme Court held that Section 402 of the Revenue Act of 1921[154] did not violate the due process clause because of its retroactive provisions. In *Reinecke*, the facts showed that the testator had established seven trusts during the period between 1903 and 1919.[155] Each trust provided in its terms that the power of revocation was reserved to the settlor (testator). The settlor (testator) died May 30, 1922, and the Revenue Service sought to include the seven trusts in the testator's gross estate under Section 402(c) of the Revenue Act of 1921 which provided that the value of trusts which were to take effect in possession or enjoyment at or after the decedent's death ". . . whether such transfer or trust is made or created before or after the passage of the Act . . ."[156] were to be included in the gross estate. The taxpayer argued that the retroactive provision of the Act violated the due process clause because all of the trusts were created before the enactment of the Revenue Act of 1921.

The Supreme Court concluded that the tax was not a gift tax but one which taxed a transfer at death. Because of the right of revocation, the Court reasoned that the transfer did not occur until death and therefore the tax was not retroactive and thus not in violation of the due process clause.

152. 276 U.S. 440, 446 (1928).
153. 278 U.S. 339 (1929).
154. Ch. 136, 42 Stat. 227 (1921).
155. Some of these trusts were enacted before there was any estate tax provisions. The first estate tax was enacted in 1916.
156. *Supra* note 154.

In *Milliken v. United States*[157] the decedent made a gift to his children of certain shares of stock. The decedent died in 1920. At the time the gifts were made, Section 202 of the Revenue Act of 1916[158] was in effect and provided for the inclusion of gifts made in contemplation of death in the decedent's gross estate. On February 24, 1919 the Revenue Act of 1918[159] embraced Section 202 of the 1916 Act into Section 402 of the 1918 Act. The only difference in the provisions of the Act was that under the Revenue Act of 1918 the rate of tax was higher. The Act of 1918 was made retroactive and the new rate now applied to any gift made in contemplation of death. The taxpayer argued that this was a denial of due process because by being retroactive the statute reached a gift made before its enactment and its measured the tax by rates not in force when the gift was made.

The Supreme Court rejected this argument saying that although it recognized that a statute can be palpably arbitrary and unreasonable thereby infringing on the due process clause, the retroactive section of this tax did not do this.[160]

Gwinn v. Commissioner of Internal Revenue[161] followed *Milliken.* This case involved jointly purchased property by Gwinn and his mother in 1915 by equal contributions, holding it as joint tenants with the right of survivorship. On June 2, 1924, the Revenue Act of 1924 was passed providing Section 302[162] which included in the decedent's estate the value of joint property in proportion to the amount of consideration furnished by the decedent. On October 5, 1924, Gwinn's mother died and the Commissioner sought to include the value of her share of the joint property in her gross estate. One of the arguments raised by Gwinn was that subsection (h) of Section 302 of the Revenue Act of 1924 which stated that the Section shall apply to the "interests" described "whether made, created, arising, existing, exercised, or re-

---

157. 283 U.S. 15 (1931).
158. Act of September 8, 1916, ch. 463, 39 Stat. 756.
159. Act of February 24, 1919, ch. 18, 40 Stat. 1057, 1096, 1097, 1149 and 1150.
160. The Court also made reference to the doctrine of equality of taxation, which will be referred to later in this paper, saying:

> . . . and we hold, as this Court has several times intimated, that the inclusion of this type of gift in a single class with decedent's estates to secure *equality of taxation,* and prevent evasion of estate taxes, is a permissible classification of an appropriate subject of taxation. *See* Nichols v. Coolidge, 274 U.S. 531, 542; Tyler v. United States, 281 U.S. 497, 505; Corliss v. Bowers, 281 U.S. 376, 378; Taft v. Bowers, 278 U.S. 470, 480; cf. Schlessinger v. Wisconsin 270 U.S. 230, 239." (Emphasis Added.)

283 U.S. 15, 20 (1931).
161. 287 U.S. 224 (1932).
162. *Supra* note 149.

linquished *before* or after the enactment of this Act," did not mean that the Section applied to an interest created before the first estate tax enacted in 1916.

The Supreme Court disagreed and said that Section 302 did apply to any interest even before 1916 and in a very brief statement went on to say that the decisions in *Nichols* and *Untemeyer* were inapplicable to this case.

Very shortly after the *Gwinn* case was decided, the Supreme Court affirmed the decision of the Court of Appeals for the First Circuit in *Third National Bank and Trust Co. of Springfield v. White*.[163] The case involved the same arguments as were raised in *Gwinn* with the exception that instead of a joint tenancy being involved, a tenancy by the entirety was involved. Here the tenancy by entirety was created in 1915 and the decedent died in February of 1926. The Court found the property to be subject to the estate tax imposed by the Revenue Act of 1924.

United States v. Jacobs[164] also involved the validity of the estate tax under Section 302(h) of the Revenue Act of 1924.[165] Here the decedent purchased property in 1909 and made his wife a joint tenant although she did not furnish any of the consideration. In 1924 when the decedent died, the Commissioner sought to include all of the value of this property in the gross estate. The taxpayer contended that only half should be included in the gross estate, and the tax as so applied was retroactive and therefore violated the due process clause of the Fifth Amendment. The taxpayer reasoned that a one-half interest in the joint property had been transferred to and vested in the wife in 1909; that the tax only applied to transfers; and therefore, the one-half interest transferred to the wife in 1909 could not later be taxed in 1924 as part of the decedent's gross estate without retroactively applying to the 1909 transfer.

The Court did not agree with this argument and reasoned that the tax was not levied on the 1909 transfer and for that reason was not retroactive. The transfer was at the decedent's death, and the transfer to a single ownership was made the occasion for an excise. The court held that the tax did not operate retroactively merely because some

163. 287 U.S. 577 (1932), *aff'd per curiam* 58 F.2d 1085 (1st Cir. 1932), which *aff'd per curiam* 45 F.2d 911 (D. Mass. 1930).
164. 306 U.S. 363 (1939).
165. *Supra* note 149.

of the facts or conditions upon which its application depended came into being prior to the enactment of the tax.

In the companion case,[166] the question involved the validity of the Revenue Act of 1926[167] which was substantially identical to the Revenue Act of 1924. Here a joint tenancy was created by husband and wife prior to 1916. A portion of the purchase price was contributed by the wife. The property which she had used as consideration had been previously given to her as a gift by her husband. In 1930 the husband died and the full value of the property was included in his gross estate. It was contended that the Revenue Act of 1926 violated the due process clause of the Fifth Amendment. The Court disagreed holding that such a contention was without merit for the same reasons as expressed in the *Jacobs* case.[168]

In the excise tax field, there is seldom an attempt to enact a retroactive tax. However on occasion there has been retroactive legislation passed in order to ratify prior unlawful collections or to validate prior laws of doubtful validity.[169]

After the Philippine Islands came under the military control of the United States, the President, on July 12, 1898 issued an order providing for the enforcement by the military power in those islands of a system of tariff duties. This tariff went into operation in November 1898 and was expressly approved by Congress in March of 1902.[170] On December 2, 1901 the United States Supreme Court held that because of the Senate's ratification of a peace treaty with the Philippines,[171] it had ceased to be foreign within the meaning of the tariff laws.[172] As a result, the imposition of this system of duties was declared unlawful.[173]

166. Dimock, Substituted Executor V. Corwin, Late Collector of Internal Revenue, 306 U.S. 363 (1939).
167. 44 Stat. 9.
168. Justices, McReynolds, Butler and Roberts dissented to this part of the opinion asserting that, "Congress cannot retroactively tax, as testamentary, a transfer consummated in accordance with existing law before the adoption of a system of estate taxation, and where the parties, at the time of the transaction, had no notice of intent to tax it . . . ." 306 U.S. 363. 373 (1939).
". . . and that Congress may not retroactively apply such a measure (i.e. inclusion of value of joint tenancy property) to an estate created at a time when its creators had no reason to expect that such a tax would be laid in view of the settled rules of property." 306 U.S. 363, 375 (1939).
169. Williams, *Retroactivity in the Federal Tax Field,* U. So. Cal. 12th Tax Inst. 79 (1960).
170. 32 Stat. 54 (1902).
171. The peace treaty was signed on December 10, 1898, and ratified by the Senate on April 11, 1899.
172. *See,* Fourteen Diamond Rings, 183 U.S. 176 (1901).
173. The cases of *Lincoln v. United States* and *Warner, Barnes & Co., Limited v. United States,* 197 U.S. 419 (1905) affirmed the decision in the *Fourteen Diamonds* case.

To remedy the situation, Congress in June, 1906, passed an act containing a provision that read:[174]

> That the tariff duties, both import and export, imposed by the authorities of the United States or of the provisional military government thereof in the Philippine Islands prior to March eight, nineteen hundred and two, at all ports and places in said island, upon all goods, wares, and merchandise imported into said islands from the United States, or from foreign countries, or exported from said islands, are hereby legalized and ratified, and the collection of all such duties prior to March eight, nineteen hundred and two, is hereby legalized and ratified and confirmed as fully to all intents and purposes as if the same had by prior act of Congress been specifically authorized and directed.

In *United States v. Heinszen & Co.*,[175] the taxpayer contended that this provision because of its retroactivity was in violation of the Fifth Amendment. The Supreme Court held that:

> . . . when the duties were illegally exacted in the name of the United States, Congress possessed the power to have authorized their imposition in the mode in which they were enforced, and hence from the very moment of collection a right in Congress to ratify the transaction, if it saw fit to do so, was engendered.[176]

In *Rafferty v. Smith, Bell & Co.*,[177] the Collector of Internal Revenue for the Philippine Islands collected a one percent tax on Philippine exports under a statute enacted in 1916 by the Philippine Legislature,[178] but when this act was passed, the Philippine Legislature did not possess the authority to enact such legislation.[179] Therefore, in June of 1920 the United States Congress ratified this act as of its date of origin, February 24, 1916.[180] The taxpayer attacked the retroactivity

174. 34 Stat. 636 (1906).
175. 206 U.S. 370 (1907).
176. Id. at 386.
177. 257 U.S. 226 (1906).
178. February 24, 1916, Section 1614, Act 2657:
All merchants not herein specifically exempted shall pay a tax of one per centum on the gross value in money of the commodities, goods, wares, and merchandise sold, bartered, exchanged, or consigned abroad by them, such tax to be based on the actual selling price or value at which the things in question are disposed of or consigned, whether consisting of raw material or of manufactured products, and whether of domestic or foreign origin . . . .
179. This is not explained in the opinion.
180. Act of June 5, 1920, 41 Stat. 1025.
The taxes imposed by the Philippine Legislature in section 1614 of the act numbered 2657, enacted by that body on February 24, 1916, are legalized and ratified and the collection of all such taxes made under or by authority of such Act of the Philippine Legislature is legalized, ratified and confirmed as fully to all intents and

of the act. In denying relief to the taxpayer, the Court cited the decision in *United States v. Heinszen & Co.*,[181] as authority for Congress to pass such an act.

Another case in this area, *Hecht v. Malley*,[182] involved the illegal taxation of Massachusetts Trusts under the Revenue Act of 1916.[183] In 1918, Section 1000 of the Revenue Act of 1918[184] retroactively made these taxes due and payable. Although the retroactivity question had not been argued, the Court answered it saying that Congress did have the power to tax these trusts retroactively.[185]

From a reading of the above-mentioned cases, it is possible for retroactive tax relief legislation which only applies to open years to be in violation of the due process clause of the Fifth Amendment. This conclusion is based upon the action of the Supreme Court in striking down the taxes in *Nichols, Blodgett* and *Untemeyer* because of insufficient notice of an unforeseen retroactive tax. In cases involving legislation which retroactively confers benefits on normally closed years, the taxpayer whose tax years are closed does have notice that he is going to be taxed, but he doesn't have notice that if he pays the tax on time he may not benefit from the relief which will be retroactively enacted at a later date. In many instances, the retroactive relief operates unfairly because it gives benefits to taxpayers who could not have received these benefits had they not fortuitously or intentionally kept their tax years open. For this reason, it is submitted that such a classification can be construed to be arbitrary and capricious and, therefore, in violation of the due process clause of the Fifth Amendment.

For example, could Zacks have foreseen in 1950 when she paid ordinary income tax rates on patent royalties that in 1956 there would be legislation which would make royalties subject to capital gains tax rates? The answer is an emphatic "No." As a result, Zacks and others like her were treated unfairly. It is true that one can say that the remedial legislation discussed in the previous section of this paper was not arbitrary and capricious but was based upon reasonable grounds—for example, the removal of pending legislation. Notwithstanding this

purposes as if the same had by prior Act of Congress been specifically authorized and directed.

181. *Supra* note 175.
182. 265 U.S. 144 (1924).
183. 39 Stat. 789 (1916).
184. 40 Stat. 1126 (1919).
185. *See also*, First National Bank of Dallas v. United States, 420 F.2d 725 (1970).

point, it is the contention of many that the criteria laid down as to what constitutes due process in the retroactive tax legislation area is as follows:

> Retroactive application of a tax law is permitted only when it would not operate unfairly by attaching consequences to an act by a taxpayer which he could not have reasonably foreseen.[186]

This being the criteria, it is the contention of this writer that when a retroactive relief measure such as Section 117(q) of the Revenue Act of 1956 is passed and is interpreted to apply only to years which are not closed, the non-benefiting taxpayer, who is identically situated as the benefited taxpayer, with the exception that the statute of limitations has run on his right to a refund, is denied due process of law under the Fifth Amendment.

No discussion involving due process would be complete without considering whether or not equal protection as stated in the Fourteenth Amendment can be considered part of the due process clause of the Fifth Amendment.[187] In earlier years, a number of decisions have considered this point. *Labelle Iron Works v. United States*,[188] involved a claim for refund of taxes alleged to have been erroneously assessed and exacted as an excess profits tax under Title II of the Revenue Act of 1917.[189] Title II provided for the levying of "War Excess Profits Tax" upon individuals, partnerships and corporations. As applied to corporations, the Act provided for a deduction from income,

> . . . equal to the same percentage of invested capital for the taxable year which the average amount of the annual net income of the trade or business during the pre-war period (the years 1911, 1912 and 1913) was of the invested capital for that period. . . .[190]

The dispute centered around the interpretation of the term "invested capital." The taxpayer purchased ore lands in 1904 for approximately $190,000.00. Between that time and 1912 extensive explorations and development had been done on the land so that the actual

186. Novich and Petersberger, *Retroactivity in Federal Taxation*, 37 TAXES 407, 422, n.101 (1959); Neuhoff, *Retrospective Tax Laws*, 21 ST. LOUIS L. REV. 1, 2 (1935).
187. "No state shall . . . deny to any person within its jurisdiction the equal protection of the laws." 14th Amendment, Clause 4 of the United States Constitution. It should be noted that the 14th Amendment could not apply to the type of remedial statutes discussed in this paper because the 14th Amendment only applies to the states and not the federal government.
188. 256 U.S. 377 (1921).
189. 40 Stat. 300, 302.
190. *Id.* at Section 207.

cash value was approximately $10,000,000.00. The taxpayer used the $10,000,000.00 figure as part of his invested capital in order to compute the corporation's excess profits tax. The Commissioner disallowed this computation and stated that the $190,000.00 figure should be used and assessed the taxpayer for a deficiency. The taxpayer in turn argued that to construe the term invested capital as original cost of the property instead of its present value, had the effect of making the Act, "glaringly unequal" and of doubtful constitutionality. The taxpayer contended that the due process clause of the Fifth Amendment had been violated and that equal protection had been denied him under this interpretation of invested capital. To this, the Supreme Court replied:

> Reference is made to cases under the equal protection clause of the Fourteenth Amendment,[191] but clearly they are not in point. The Fifth Amendment has no equal protection clause; and the only rule of uniformity prescribed with respect to duties, imports, and excises laid by Congress is the territorial uniformity required by Article I § 8.[192]

Steward Machine Co. v. Davis,[193] involved payments made under Title IV of the Social Security Act[194] which provided for no taxes on an employer of less than eight nor did it apply to agricultural labor, domestic service in a private home or similar services. The taxpayer contended that the tax was arbitrary and discriminating because of these exceptions. The Supreme Court answered that the Fifth Amendment was unlike the Fourteenth because it had no equal protection clause. Thus, the Court decided that the argument based upon equal protection was not valid.[195]

The case of *Helvering v. Lerner Stores Corporation*,[196] involved, in part, the question of the validity of Sections 105 and 106 of the Reve-

191. Court citing Southern R.R. v. Greene, 216 U.S. 400, 418 (1910); Gast Realty Co. v. Schnieder Granite Co., 240 U.S. 55 (1916).
192. 256 U S. 377, 392 (1921).
193. 301 U.S. 548 (1937).
194. Act of August 14, 1935, ch. 531, 49 Stat. 620.
195. The Court did say that, "The classification and exemptions directed by the statute now in controversy have support in consideration of policy and practical convenience that cannot be condemned as arbitrary.
The classification and exemption would therefore be upheld of they had been adopted by a state and the provisions of the Fourteenth Amendment were invoked to annul them. This is held in two cases passed upon today in which precisely the same provisions were the subject of attack, the provisions being contained in the Unemployment Compensation Law of the State of Alabama. Carmichael v. Southern Coal & Coke Co. and Carmichael v. Gulf States Paper Corp., 301 U.S. 495 (1937)." *Supra* note 193.
196. 314 U.S. 463 (1935).

nue Act of 1935.[197] Section 105 was a capital stock tax and Section 106 was an excess profits tax. The statute provided that the taxpayer could value his shares of stock, without the adherence to a formula determined by the Government. However, the effect of this legislation was to lower the value placed upon the capital stock and increase the excess profits tax.[198] The taxpayer argued that:

> Sections 105 and 106 of the Revenue Act of 1935 . . . [were] . . . arbitrary and capricious in violation of the Fifth Amendment. The excess profits tax, considered together with its related capital stock tax . . . [placed] . . . a premium on the good luck or ability of the taxpayer to predict the amount of net income it . . . [would] . . . earn in the future. The taxpayer with less ability as a guesser, or in some instances, with less business acumen or opportunity, is heavily penalized and must bear a heavier burden than its more fortunate or able rival.[199]

The Supreme Court rejected this argument holding that the contention was without merit since the Fifth Amendment contains no equal protection clause.[200]

The most recent Supreme Court case which has made reference to equal protection and the Fifth Amendment concerning federal taxation was in 1941 in the case of *Detroit Bank v. United States*,[201] which involved the validity of an estate tax lien over a subsequent mortgage lien. The decedent and his wife owned realty as tenants by the entirety and, upon the death of the decedent, this real estate was not included in his gross estate. It was later concluded that the property should have been included because the decedent had furnished all the consideration for the purchase price of the property.[202] Prior to the assessment and payment of the estate tax, the real estate was mortgaged to the taxpayer who acquired the mortgages in good faith and for value, and with no knowledge of the estate tax lien upon the realty.

The Government claimed that its lien had priority over the taxpayer's mortgages. One of the arguments raised by the taxpayer was that Section 315(a) of the Revenue Act of 1926[203] violated the due

197. 49 Stat. 1733 (1935).
198. This was so because the higher the value placed upon the capital stock the smaller the amount of net income that would exceed the capital stock value.
199. 314 U.S. 463, 465 (1941).
200. 314 U.S 463, 468 (1941).
201. 317 U.S. 330 (1943).
202. Section 302(e) of the Revenue Act of 1926, 44 Stat. 70.
203. Section 315(a) of the Revenue Act of 1926 provides in part:
Unless the tax is sooner paid in full, it shall be a lien for ten years upon the

process clause of the Fifth Amendment by authorizing an unrecorded tax lien against the property mortgaged to it, and withholding such a lien against innocent purchases of property. The Supreme Court summarily rejected this argument by stating that "unlike the Fourteenth Amendment, the Fifth contains no equal protection clause and it provides no guaranty against discriminatory legislation by Congress."[204]

A limited number of lower court decisions have discussed the question of equal protection and the due process clause of the Fifth Amendment with respect to certain forms of federal taxation.[205] In *C. J. Tower & Sons v. United States*,[206] it was contended that Section 806 of the Tariff Act of 1930,[207] which provided for an additional tax of $5.00 per proof gallon in the alcoholic potential of imported grape juice but did not impose such a tax on other imported fruit juices was arbitrary and capricious and was in violation of the due process clause of the Fifth Amendment. To this argument, the United States Customs Court held that nowhere is there any dispute that the duties under Section 806(a) applied uniformly to all like grape imports all over the United States.

---

gross estate of the decedent, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divest of such lien. If the Commissioner is satisfied that the tax liability of an estate has been fully discharged or provided for, he may, under regulations prescribed by him with the approval of the Secretary, issue his certificate, releasing any or all property of such estate from the lien herein imposed.

204. 317 U.S. 330, 337 (1942).

205. Guiseppi v. Walling, 144 F.2d 608 (1944) involved a provision of the administrators wage order for workers in the embroideries industry which prohibited home work with these limited exceptions:

> No work in the Embroideries Industry, as defined herein, shall be done in or about a home, apartment, tenement, or room in a residential establishment after November 15, 1943, except by such persons as have obtained special home work certificates issued pursuant to applicable regulations of the Wage and Hour Division, authorizing industrial home work by a worker who (1) (a) Is unable to adjust to factory work because of age or physical or mental disability; or (b) Is unable to leave home because his presence is required to care for an invalid in the home; and (2) (a) Was engaged in industrial home work in the Industry, as defined, prior to November 2, 1942 (except that if this requirement shall result in unusual hardship to the individual homeworker it shall not be applied); or (b) Is at the time engaged in such industrial home work under the supervision of a State Vocational Rehabilitation Agency or of a Sheltered Work Shop, as defined in § 525.1, Part 525, Chapter V, Title 29, Code of Federal Regulations.

It was argued among other things that these exceptions were unreasonable and discriminatory. To this the Court of Appeals for the Second Circuit replied:

> The Fifth Amendment contains no 'equal protection' clause [citing Helvering v. Lerner Stores, *supra* note 196.] Moreover, it is by no means clear that the exemption would be an invalid classification even under the Fourteenth Amendment.

See also Minature Vehicle Leasing Corp. v. United States 266 F. Supp. 697 (1967).

206. 135 F. Supp. 874 (1955).

207. Section 806(a) of the Tariff Act of 1930, 46 Stat. 590, 639 (1930) provides:

> grape juice . . . by whatever name known . . . containing or capable of producing more than 1 per centum of alcohol, 70 cents per gallon; and in addition thereto $5 per proof gallon on the alcohol contained therein or that can be produced therefrom.

"Moreover, a claim of unreasonable classification or inequality in the incidence or application of a tax raises no question under the Fifth Amendment, which contains no equal protection clause."[208]

Eleven years after the last Supreme Court decision involving federal taxation and equal protection as part of the due process clause under the Fifth Amendment, the case of *Bolling v. Sharpe*[209] was decided. Although the facts in *Bolling v. Sharpe* do not pertain to taxation,[210] the Supreme Court made some very important observations with respect to equal protection under the due process clause of the Fifth Amendment. The Court said of the relationship between equal protection and due process under the Fifth Amendment:

> The Fifth Amendment . . . does not contain an equal protection clause as does the Fourteenth Amendment which applies only to the states. But the concepts of equal protection and due process, both stemming from our American ideal of fairness, are not mutually exclusive. The "equal protection of the laws" is a more explicit safeguard of prohibited unfairness than "due process of law," and, therefore, we do not imply that the two are always interchangeable phrases. But, as this Court has recognized, discrimination may be so unjustifiable as to be violative of due process.[211]

Nine years after the decision in *Bolling v. Sharpe*, in the case of *Smart v. United States*,[212] Judge Dawson of the United States District Court for the Southern District of New York recognized that the reasonableness of tax classification must be examined to determine if due process was being violated. The Court stated:

> In the case of the fifth amendment, although there is no equal protection clause, an arbitrary and unreasonable classification would constitute a violation of due process.[213] It is therefore necessary to consider the reasonableness of the classification. . . .[214]

In *International Business Machines Corporation v. United States*,[215] a case decided by the Court of Claims,[216] the taxpayer relied upon the

208. 135 F. Supp. 874, 878 (1955).
209. 347 U.S. 497 (1954).
210. The case involved the validity of segregation in the Public Schools of the District of Columbia.
211. 347 U.S. 497, 499 (1954). *See also*, Shapiro v. Thompson, 394 U.S. 618 (1969).
212. CCH 1962 STAND. FED. TAX. REP. (62-2 U.S. Tax Cas.) #9744 at 89,959 (S.D.N.Y. Sept. 30, 1963).
213. Court citing Steward Machine Co. v. Davis, 301 U.S. 548, 585 (1937).
214. *Supra* note 212.
215. 343 F.2d 914 *cert. denied* 86 Sup. Ct. 647 (1966).
216. See pages 29 thru 32 of the brief for the plaintiff before the U.S. Court of Claims.

references concerning the relationship of due process and equal protection which were annunciated in *Bolling v. Sharpe* and in *Smart v. United States*. During 1951-1958, IBM and Remington Rand were the two main producers of electronic computers which were identical in all significant respects.[217] Before mid-April 1955 each company paid a ten percent excise tax on the sale or lease of their "business machines."[218] On April 13, 1955 Remington Rand requested a ruling from the Commissioner that certain of its devices were not subject to the excise tax. The Commissioner issued a private ruling in favor of Remington's request. After becoming aware of this ruling, IBM sought a similar ruling two and a half months later. The Commissioner did not act upon this request for more than two years. In the interim, Remington received a refund for the period of 1952 to the date of the ruling and it continued not to pay excise taxes after the ruling. On May 1, 1957 the Internal Revenue Service decided to rule that the devices were subject to the excise tax, and Remington was informed that the tax would be prospective. After conferences, and other incidental procedures, the tax was reinstated as to Remington on February 1, 1958. As a result, Remington did not pay excise taxes for a period of six years—January 1952 to January 1958.

On November 26, 1957 the request of IBM to be exempt was dismissed. IBM filed suit for refund in the U.S. Court of Claims. The substantive issue involved was whether the Internal Revenue Service's conduct toward IBM as contrasted with the treatment given to Remington Rand invalidated the excise taxes levied upon the IBM equipment. One of the arguments made by IBM was that equal protection had been denied it by an unreasonable classification. The Court of Claims agreed, but in different language than stated above. The Court held:

> The history . . . [of this case] . . . exposes a manifest and unjustifiable discrimination against the taxpayer. We do not say, we need not say, that the differential treatment was deliberate or malevolent. It is enough that the direct result of the Service's course of conduct, though inadvertent and unplanned, was to favor the other competitor so sharply that fairness called upon the Commissioner, if he could under Section 7805(b), to establish a greater measure of equality. For all tax rulings, it is important that there be like treatment to those who should be dealt with on the same

217. IBM type 604 computer systems and Remington Rand univac 120 and 60 systems were identical.

218. Section 3406(a)(6) of the INTERNAL REVENUE CODE OF 1939 replaced by Section 4191 of the INTERNAL REVENUE CODE OF 1954.

> basis. . . .[219] Parity in levying of manufacturers' excises is essential to free and fair competition.[220] The gap here in the imposition of the business machine tax was so large that the Commissioner could not choose to ignore it if an appropriate remedy was at hand.[221]

Although this case does not answer the argument based upon equal protection under due process of the Fifth Amendment as it was explained above, the decisions in *IBM* and *Smart* illustrate that the Courts are willing to examine whether or not unreasonable classifications have occurred. And if it has occurred, either due process will be considered violated or legislation will be construed to include the non-benefited party.

From a reading of the cases involving equal protection and due process under the Fifth Amendment, one cannot be sure how the Supreme Court or any court will treat the form of discrimination in remedial tax legislation as illustrated in the *Zacks* case. However, one thing is certain—that is, the trend is in favor of the taxpayer. In light of the Supreme Court's finding that at certain times equal protection is within the scope of due process when human rights are involved, there is no reason why property rights should not be protected from unreasonable classifications under the due process clause of the Fifth Amendment.

Of course, the author is well aware that the equal protection clause has many criteria, one of which is whether the classification complained of was reasonable. It is the opinion of this author (others it is expected will disagree) that such legislation as Section 117(q) of the Revenue Act of 1956 as it was construed in *Zacks* is an unreasonable classification. Notwithstanding whether the classification in *Zacks* is reasonable, the primary purpose of this article is to point out that this area is now ripe for such an argument.[222]

IV. A Word For "Equality"

"Let all Americans pay taxes on the basis of equality."[223] This rule has been annunciated on several occasions as the underlying doctrine

219. Court citing Automobile Club of Michigan v. Commissioner, 353 U.S. 180, 186 (1957).
220. Court citing Exchange Parts Co. v. United States, 279 F.2d 251, 253 (1960); H. Rep. No. 708, 72d Cong., 1st Sess., pp. 31, 32 (1932).
221. 343 F.2d 914, 923, *Supra* note 215.
222. It would seem that there is no question over the taxpayer's standing to sue in these situations. *See*, Tennessee Power Co., v. T.V.A., 306 U.S. 118 (1938).
223. Eisenstein, The Wonderous Ways of Equity 148 (1961).

upon which our system of taxation is based.[224] It has been stated many times that it is a fundamental precept that a tax system should do equity in the sense of treating alike taxpayers who are in an economic sense similarly situated.[225] In *Tappan v. Merchant's National Bank*,[226] the Supreme Court stated:

> Absolute equality in taxation can never be attained. *That system is best* which comes nearest to it. . . . The object should be to place the (tax) burden so that it will as nearly as possible (fall) equally upon all.[227]

It is true that the term equality in taxation is similar to those other elusive legal terms, such as truth, justice and due process. Nevertheless, the fact that the term may be difficult to define should not be an excuse for not using it in decision making. Justice, for example, although difficult to define, has not been cast out of legal decisions because of difficulty in defining the term. The phrase "what is just" or "justice and fair play" has often been the basis for a legal decision.

Equity in the field of taxation has been defined generally in this manner: "Those who are similarly situated should be similarly taxed."[228] With a system like ours, the success of a voluntary assessment depends upon the goodwill of the taxpayer.[229] With today's competition being so keen among equally situated manufacturers and marketers, a tax benefit which is granted to one and denied to another for identical transactions for the same year can cause the non-benefited party to go out of business or cause him to lose ground in capital expenditures.[230]

It is suggested that the doctrine of equality in taxation be given a greater force in the making of decisions by the courts. It is suggested that this doctrine be recognized more often by the Congress in the interpretation and drafting of legislation. For example, in the *Zacks*[231] case, the legislative history which influenced the Supreme Court's decision was quite limited. As was mentioned in the earlier part of the

224. 104 Cong. Rec. 16919 (1958); BLOUGH, THE FEDERAL TAXING PROCESS 387 (1952); Paul, *Fiscal Priorities For Our Growing Economy*, 2 How L.J. 181 (1956); Heller, *Appraisal of the Administrative Tax Policy*, 8 NAT. TAX J. 12, 25 (1955); GROVES, SPECIAL TAX PROVISIONS AND ECONOMY, IN FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY, JOINT COMMITTEE ON THE ECONOMIC REPORT, 84TH CONG. 1ST SESS. 286 (1955).

225. Paul, *id.* at 23.

226. 19 Wall. 490 (1873).

227. 19 Wall. 490, 504 (1873).

228. EISENSTEIN, *supra* note 223 at 147.

229. Paul, *supra* note 224 at 23.

230. International Business Machine Corp. v. United States, 343 F.2d 914 *cert. denied* 86 Sup. Ct. 647 (1966).

231. Zacks v. United States, 150 Ct. Cl. 814, 280 F.2d 829, *rev'd*, 375 U.S. 59 (1963).

article, the Supreme Court made reference to a three-line paragraph from the Congressional Record which may or may not have been the sole reason for the enactment of 117(q) of the Revenue Act of 1956. Further, there was nothing in the Act itself which said that those already barred by the Statute of Limitations on refunds should not be entitled to a refund. Also, the use of legislative history is often limited because the legislative record is ambiguous and hence inconclusive.[232] Another reason may be that the history can be interpreted in many ways[233] as was clearly shown in the decisions leading up to the Supreme Court's decision in *Zacks*.[234]

Another problem involves the weight to be given various items surrounding a statute. For example, in *Zacks* the Supreme Court gave special attention to the fact that in other statutes Congress had included an express provision reopening barred tax years.[235] However, it is equally true that Congress has also made specific references when it did not wish barred years to be open.[236]

What does this discussion lead to? It is suggested that in situations involving legislation such as in *Zacks*, courts should put more reliance upon the doctrine of equality in taxation. The use of the doctrine will be most helpful in arriving at a truly just and equitable (if you pardon the expression) decision. Further, the decision will be closer in line with the underlying doctrine which permeates our entire legal system —that is—all men should be treated equally under the law.

The same is true with respect to Congress; it should pay closer attention to the doctrine in its process of enacting retroactive remedial tax legislation. For example, in the legislation involving the *Nickel Plate* case, there is no question that the non-benefited taxpayers were put at an economic disadvantage. With the great surge to give equality to all in the area of human rights, there is no reason why this principle should not be applied by both the courts and the Congress in the area of property rights. More specifically, it should be applied in the area of retroactive remedial tax legislation.

No criticism is of much value unless some solution or solutions to remedy a situation are also given. There are two suggestions which

232. United States v. Steward, 311 U.S. 60 (1940); Marks v. Higgins, 213 F.2d 884 (2d Cir. 1954).
233. *See, e.g.*, Flora v. United States, 362 U.S. 145 (1960), prior opinion 357 U.S. 63, (1958), *petition for rehearing granted* 360 U.S. 922 (1959).
234. *See supra* Part I.
235. *See supra* notes 78, 79, 80.
236. *See supra* note 4.

the courts should follow in making decisions involving legislation such as Section 117(q) of the Revenue Act of 1956.

(a) The Courts should adopt a presumption that a new right is created by the new legislation for years previously closed. To illustrate, suppose legislation is enacted in 1956 to be effective beginning with the year 1950. The presumption should be that the right to benefit under the legislation came into effect on the date of enactment in 1956 rather than in 1950. Under this presumption,[237] the statute of limitations on refunds would run from the date of enactment and thus all taxpayers would be treated equally. It is true that a problem may arise because the statute of limitations runs two years from the date of payment or three years from the date of filing the return whichever is later. However, this problem could be eliminated by the courts making the date of payment the date of enactment of the remedial legislation. This recommendation is not new to this area. It was used by the Court of Appeals for the Second Circuit in the *Hollander* decision.

(b) The second recommendation which the courts should adopt is a presumption of equality with respect to the form of retroactive remedial tax legislation. When there is a doubtful situation involving a piece of retroactive remedial tax legislation such as 117(q) of the Revenue Act of 1956, the court should presume that all taxpayers are to be treated equally. Surely, this presumption would be in keeping with the underlying theory of our system of taxation and at the same time discrimination in such cases would be eliminated.

With respect to Congress, it would be well for it to amend the Revenue Code to include a section which would state that when no reference is made to years barred by the statute of limitations in a relief measure, such rights are created at the time of the enactment of the relief measure and a one-year limitation to file a claim for refund shall be in effect. In doing so, the Congress would eliminate the possibility of forgetting to take care of such instances where no mention is made of claims for barred years. It is believed that Section 6511 of the present Code could be amended to provide such a right.

These few suggestions are not intended to be a panacea for all situations, but it is hoped that they would correct the inequity in most cases. Certainly situations where the Congress openly discriminates by specifically stating that the barred years will be closed will not be cor-

237. Obviously this would have to be a rebuttable presumption since there may be some cases when it is impossible to open all the years because of evidentiary matters.

rected. Only the conscience of the Congress to keep in line with the doctrine of equality of taxation or possibly the proposed equal protection argument can correct such situations.