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JUDICIAL TECHNIQUES IN COMBATING TAX  
AVOIDANCE

*Ralph S. Rice\**

THERE is no problem today more fundamental in federal tax law than the rationale (or lack of it) that underlies the conduct of the courts in striking down tax avoidance devices and refusing to recognize business arrangements which meet statutory requirements for tax saving but exude an odor piscatorial.

The cases in the area are, of course, legion. Some arrangement of transactions so as to achieve maximum tax advantages has always been approved; these are the cases involving so-called tax "avoidance" rather than "evasion." This may be illustrated by the case in which a taxpayer obtains a maximum tax deduction by making desirable but not imperative repairs to business property in a high income year. Likewise, to prevent bunching of income, he may bill or collect accounts for services in a low income year. Or in order to obtain advantage of the capital gains provisions of the statute, he may hold a capital asset past the six month period before sale. Tax saving is the obvious purpose and effect of the method selected to consummate the transaction in all of these cases, but traditionally this has been thought to furnish no occasion for imposing a tax otherwise inappropriate.

Not all cases, however, are this clear. There is, for example, the *Twin Oaks* case, in which three stockholders owned all the stock in Supply Company. In 1941, just prior to the adoption of the federal excess profits tax, they set up a partnership in which the wife of one was included. The company assigned all of its property, except some real estate, to the partnership in exchange for a note and assumption of its corporate liabilities. The effect of the transaction was to divert to the partnership substantial income which would otherwise be taxed at high rates as income of Supply Company. The Tax Court held that the transaction was a sham and that the partnership income should be taxed to the corporation. The Ninth Circuit reversed because such a decision "denied the taxpayers the legal right to conduct their business affairs through a medium of their own choice."<sup>1</sup> This may be con-

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<sup>1</sup> *Twin Oaks Co. v. Commissioner*, (9th Cir. 1950) 183 F. (2d) 385 at 387. This case is, of course, only illustrative of the many continually appearing in which ingenuity of taxpayers is pitted against resourcefulness of the Bureau. For example, taxpayers are avidly exploring the tax saving possibilities in sale or other transfer and lease back arrange-

trusted with the troubles of Guy Earl, who sought to avoid taxes on his own earnings by reliance on an agreement which he claimed assigned his earnings to Mrs. Earl before he received them. In his case the Supreme Court concluded that these fruits could not be "attributed to a different tree from that on which they grew."<sup>2</sup>

The disparity in these results presents a familiar dilemma of the courts in interpretation of the federal income tax laws. Presumably, in these cases as in many others, the courts were equally challenged by the unadorned terms of the statute which required exemption, and an unmistakable attempt to save taxes through reliance on formal distinctions. Essentially, the problem faced by the court involves neither semantics nor dialectics, however frequently these appear in the decisions.

It is, of course, trite to say that the income tax statutes of necessity fail to provide specifically and unmistakably for all contingencies in which transactions may properly be taxable. Prescience of statutory draftsmen and members of Congress is limited, and it may not be assumed that Congress could foresee all transactions possible and agree upon a line of demarcation between the taxability of each. Even were Congress so supernally endowed, language expressing the distinction would lead to a statute so complex that by comparison the present Code would be rudimentary. The need for simplicity thus forces Congress to accept a calculated risk of tax avoidance.

ments, and a pattern is currently emerging in the cases. *May Dept. Stores Co.*, 16 T.C. 547 (1951); *Shaffer Terminals, Inc.*, 16 T.C. 44 (1951); *Standard Envelope Mfg. Co.*, 15 T.C. 41 (1950); *Helen C. Brown*, 12 T.C. 1095 (1949); *Catherine G. Armston*, 12 T.C. 539 (1949); *Ingle Coal Co.*, 10 T.C. 1199 (1948); *Buffalo Meter Co.*, 10 T.C. 83 (1948). It is not the purpose of these comments, however, to trace intensively the treatment of tax avoidance in a limited area but rather to consider underlying judicial philosophies. The problem previously has been examined from the point of view of the taxpayer as contrasted with the point of view of the court. See Ballantine, "Psychological Bases for Tax Liability," 27 *HARV. BUS. REV.* 200 (1949); Angell, "Tax Evasion and Tax Avoidance," 38 *COL. L. REV.* 80 (1938); Paul, "Restatement of Tax Avoidance" in *STUDIES IN FEDERAL TAXATION* (1937).

For other somewhat startling successful tax avoidance practices encompassed in boudoir transactions, see *Dorzback v. Collision*, (3d Cir. 1952) 195 F. (2d) 69, and *Newberry's Estate v. Commissioner*, (3d Cir. 1953) 201 F. (2d) 874 at 878. In the latter case it was said: "We have no doubt that the parties, advised by counsel deliberately chose the alternative which appeared to entail the less burdensome tax consequences. But tax saving motivation does not justify the taxing authorities or the courts in nullifying, or disregarding, the taxpayer's otherwise proper and bona fide choice among courses of action." No suggestion is made respecting the standard by which a transaction is measured to determine whether it is "bona fide."

<sup>2</sup>*Lucas v. Earl*, 281 U.S. 111 at 115, 50 S.Ct. 241 (1930). For a more recent frustration of an attempt to attribute fruits to a tree other than that on which they grew, see *Byers v. Commissioner*, (8th Cir. 1952) 199 F. (2d) 273.

It likewise is inevitable that taxpayers will sometimes avoid taxes by tendering purely formal compliance with statutory requirements as a justification for nontaxability. The basis for their success is reasonably apparent: there are obvious reasons why a statute should be considered to mean no more and no less than it says. To abandon the moorings established through the statutory structure might "create difficulties and uncertainties more objectionable in their results than any seeming inequities which would be eliminated or prevented."<sup>3</sup> Tax consequences may determine not only how but whether many business transactions of a nature vital to national economic well being will be consummated. Such transactions may be impeded or altogether foregone where tax consequences are governed by a statute which is continually extended to mean something other than what it says. While the effects of such uncertainty can be, and indeed have been, overstated,<sup>4</sup> the argument is not without force. Even beyond the economic need for certainty, it is at least doubtful how far judicial legislation should go as a matter of self-imposed restraint of the members of the courts. For if the courts extend the plain provisions of the Code, relying on the vague contours of statutory "policy" requirements which exist only in the hearts and minds of the jurists, we may well be coming uncomfortably close to judicial absolutism.

The alternative is no less distressful. When one taxpayer effects a transaction with only literal conformance to the statute and thereby contrives to avoid tax, the damage is not measured solely in terms of the dollar loss of revenue under his own return. Success in one transaction emboldens attempts in others, and the taxpayer, as with all successful men, will have his imitators. Thus there is always the danger that the good fortune of the taxpayer in a single case will be the fountainhead from which will spring multiple transactions in which tax avoidance is the sole, or primary, or contributing purpose. Were only strict adherence to statutory exclusions required to evade taxability, tax administration might soon be bogged down by tax avoidance devices far beyond those currently plaguing the Commissioner and the courts. Yet this is only the beginning of the embarrassment. The only sound basis

<sup>3</sup> *Eaton v. White*, (1st Cir. 1934) 70 F. (2d) 449 at 452.

<sup>4</sup> See Spear, "Corporate Business Purpose' in Reorganization," 3 *Tax L. Rev.* 225 (1947). For other general observations on the subject see the text material *supra* note 1, and Lourie, "The Business Purpose Doctrine," 25 *Taxes* 800 (1947); Flack, "Where Tax Saving is Behind Business Purpose," 23 *Taxes* 910 (1945).

for tax collection lies in the conviction of the people that the tax burden is in general fairly apportioned. The loopholes opened where exemption is approved upon formalistic compliance with statutory requirements invites disillusion with tax administration as well as emulation of the successful taxpayer. Such disillusion eventually may become manifested in concerted taxpayer resistance with disastrous results to the federal treasury.

Thus, the manner in which the lines are drawn between successful and unsuccessful tax avoidance devices becomes critical in tax administration. Three primary questions are presented:

- (a) Is there a measurable pattern running through the tax avoidance decisions?
- (b) If no pattern now exists, must we conclude that no measurable pattern is possible?
- (c) To the extent that any pattern exists, what is its current scope and form?

### *The Judicial Confession of Defeat*

It is not an overstatement to say that in no area of law has there been more fumbling in the circuit courts and below than here. Typical is one opinion in which a taxpayer unsuccessfully sought to arrange a transaction so that what would normally be ordinary income would be taxed to him as capital gain. The obvious issue was control of tax avoidance. The court first acknowledged the difficulty of establishing rational standards for measuring tax liability:

“In tax litigation perhaps more frequently than in the mill-run of other types of justiciable controversy, cases adduced by advocates or revealed by independent research to be of some authoritative value are generally so variant in factual setting as to render detailed discussion of them often more confusing than helpful.”

Under such difficulties a weaker (or more prudent) court might seek refuge in equivocation. The court here grasped the nettle firmly and perhaps more expressively than was intended:

“With this thought in mind, we merely cite a few illustrative cases selected from many which are deemed supportive of the principles upon which our decision rests. Some of these cases relate to one facet, others to another, of the problem which has been resolved. Considering these authorities together, the net effect of the decisions and expressions in them makes us confident that our

decision upon the issue presently before us constitutes no departure from the norm. . . .”<sup>5</sup>

If this conclusion is to be read literally, “law” here consists of a congerie of isolated cases, a review of which will create a non-rational opinion—a subjective “hunch”—in the reviewing body. This opinion is measured against a decision previously made, and if the opinion formed does not demonstrate that the decision was erroneously reached, it will be issued as the decision of the court.

Another decision imports a trial of wits concept into determining taxability, observing that where an intention to minimize taxes is shown, “the court should examine the forms used by [the taxpayer] for the accomplishment of his purpose with particular care; and if his ingenuity fails at any point, the court should not lend him its aid by resolving doubts in his favor.”<sup>6</sup>

Why have courts so openly abjured a rational approach to tax avoidance problems? The reasons are many. Fact situations in the cases are often extremely complex, especially in the area of reorganizations, where tax saving through purely formal compliance with statutory requirements is frequently attempted. The ingenuity of taxpayers is such that cases seldom establish factual patterns so that general principles of liability can be said to be involved. Moreover, a shift of judicial emphasis may lead to differences in result even where substantially similar facts are involved. The distinctions between what the court will permit as tax saving and what it will forbid are more than usually likely to be made on conclusions that cannot readily be articulated, that is: “This taxpayer just went too far.” This also means, of course, that the decision is likely to be emotional to an exceptional extent. Generalization is likewise impeded by the circumstance that the search of taxpayers for loopholes extends throughout the entire tax structure, so that the subject matter could scarcely be more broad. Finally, the difficulties in

<sup>5</sup> *Sloane v. Commissioner*, (6th Cir. 1951) 188 F. (2d) 254 at 260. See also *Okonite Co. v. Commissioner*, (3d Cir. 1946) 155 F. (2d) 248 at 252: “Since no two cases of this sort are ever identical, distinctions may be drawn that are more facile than they are fundamental. We are made all the more certain in our conclusion by the general congruence of the cases mentioned with the result in this case. Okonite points to the use of different words in the plans which were the subject of review in the other cases. . . . We find no such controlling significance in the different words used. The conclusion does not turn on form.” Compare *Staubenville Bridge Co.*, 11 T.C. 789 at 798 (1948): “An attempt to reconcile all the cases on this point with very complicated factual distinctions would be a voluminous and unfeasible task. We shall limit ourselves to a review of the litigated situations sufficiently to illustrate the distinctions which the courts have generally drawn,” and *R. D. Merrill Co.*, 4 T.C. 955 at 969 (1945): “We do not deem it necessary to analyze in detail the many factors which affect our decision.”

<sup>6</sup> *Morsman v. Commissioner*, (8th Cir. 1937) 90 F. (2d) 18.

analyzing the decisions are not eased by the manner in which they are written. Whether by design or accident, the decisions frequently do not trace through the thread of the respective arguments of the parties. All too often the appellate courts borrow the Tax Court technique: a mass of facts is set forth in the early stages of the opinion, followed by a short statement of the holding, referable in general to the facts but without a reasoned argument. The opinion, normally filling the gap between facts and result, is simply omitted.<sup>7</sup>

Notwithstanding the difficulties in analysis, it should not be too easily concluded that no measurable principles of law are here applicable. The cases may be assembled into the following categories:

*Decision by Invective and Unmeaningful Words.* The tendency toward the use of epithets—whether as the sole or supplementary basis for preventing tax avoidance in a particular case—has been well marked in the United States Supreme Court. The leading case in this area is *Gregory v. Helvering*, in which it was said with respect to a claimed corporate reorganization: "The whole undertaking . . . was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. . . . To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose."<sup>8</sup>

Some years later the Court observed: "A given result at the end of a straight path is not made a different result because reached by following a devious path. The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the fund to the creditors, all along intended to come into their hands, so transparently artificial that further discussion would be a needless waste of time."<sup>9</sup>

In the following year one transaction was described as follows: ". . . a lawyer's ingenuity devised a technically elegant arrangement whereby an intricate outward appearance was given to the simple sale. . . ."<sup>10</sup>

<sup>7</sup> See, for example, *Sloane v. Commissioner*, (6th Cir. 1951) 188 F. (2d) 254; *Lewis v. Commissioner*, (1st Cir. 1949) 176 F. (2d) 646; *Okonite Co. v. Commissioner*, (3d Cir. 1946) 155 F. (2d) 248.

<sup>8</sup> *Gregory v. Helvering*, 293 U.S. 465 at 470, 55 S.Ct. 266 (1935). Compare *Adam A. Adams*, 4 T.C. 1186 (1945). Also see *Forman v. Commissioner*, (9th Cir. 1952) 199 F. (2d) 881, referring to the duty of the courts to "pierce the false."

<sup>9</sup> *Minnesota Tea Co. v. Helvering*, 302 U.S. 609 at 613, 58 S.Ct. 393 (1938). See also *Conrad N. Hilton and Sari G. Hilton*, 13 T.C. 623 (1949); *Granburg Equipment Co., Inc.*, 11 T.C. 704 (1948); *Walter S. Heller*, 2 T.C. 371 (1943).

<sup>10</sup> *Griffiths v. Commissioner*, 308 U.S. 355 at 357, 60 S.Ct. 277 (1939). See also *Maletis v. United States*, (9th Cir. 1952) 200 F. (2d) 97; *Seabrook v. Commissioner*, (5th Cir. 1952) 196 F. (2d) 322; *Alexander v. Commissioner*, (5th Cir. 1952) 194 F. (2d) 921. Compare *Davis B. Thornton*, 5 T.C. 116 at 126 (1945) (dissent) and *1432 Broadway Corp.*, 4 T.C. 1158 (1945).

Other comments by the court have been equally pointed and unilluminating. It has been emphasized that a transaction will be disregarded if it is a sham or unreal.<sup>11</sup> Under the same terminology it has been said the proper test in the family partnership cases is whether the partnership was "real" under the revenue laws,<sup>12</sup> and "reality" in general has not infrequently been thought determinative.<sup>13</sup> Also familiar is the comment that "A 'reorganization' which is merely a vehicle, however elaborate or elegant, for conveying earnings from accumulations to the stockholders is not a reorganization under §112"<sup>14</sup> and the observation that "To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress."<sup>15</sup>

<sup>11</sup> *National Carbide Corp. v. Commissioner*, 336 U.S. 422, 69 S.Ct. 726 (1949); *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 63 S.Ct. 1132 (1943); *Helvering v. Minnesota Tea Co.*, 296 U.S. 378, 56 S.Ct. 269 (1935); *Burnet v. Commonwealth Improvement Co.*, 287 U.S. 415 at 419, 53 S.Ct. 198 (1932); *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940). The observation has been reiterated by the lower courts. *Alexander v. Commissioner*, (5th Cir. 1952) 194 F. (2d) 921; *Twin Oaks Co. v. Commissioner*, (9th Cir. 1950) 183 F. (2d) 385; *Paymer v. Commissioner*, (2d Cir. 1945) 150 F. (2d) 334; *Commissioner v. Laughton*, (9th Cir. 1940) 113 F. (2d) 103; *Bruce v. Helvering*, (D.C. Cir. 1935) 76 F. (2d) 442. See also *Central Cuba Sugar Co.*, 16 T.C. 882 (1951); *Shaffer Terminals, Inc.*, 16 T.C. 356 (1951); *Estate of L. B. Whitfield*, 14 T.C. 776 (1950); *Toledo Blade Co.*, 11 T.C. 1079 (1948); *Transport, Trading & Terminal Corp.*, 9 T.C. 247 (1947); *T. W. Rosborough*, 8 T.C. 136 (1947); *S. Kenneth Alexander*, 6 T.C. 804 (1946); *Carlton B. Overton*, 6 T.C. 304 (1946); *W. M. Mauldin*, 5 T.C. 743 at 749 (1945); *Davis B. Thornton*, 5 T.C. 116 (1945); 1432 *Broadway Corp.*, 4 T.C. 1158 (1945); *Stanley D. Beard*, 4 T.C. 756 (1945); *Crown Cork International Corp.*, 4 T.C. 19 (1944); *P.O.B. Montgomery*, 1 T.C. 1000 (1943).

<sup>12</sup> *Commissioner v. Culbertson*, 337 U.S. 733 (1949). See also, in non-partnership cases, *Stiver v. Commissioner*, (8th Cir. 1937) 90 F. (2d) 505; *St. Louis Union Trust Co. v. United States*, (8th Cir. 1936) 82 F. (2d) 61. Tax Court decisions are similar. *W. M. Mauldin*, 5 T.C. 743 (1945); *William F. Fischer*, 5 T.C. 507 (1945).

<sup>13</sup> *Harrison v. Schaffner*, 312 U.S. 579 (1941) ("camouflage of reality"); *Helvering v. Lazarus & Co.*, 308 U.S. 252, 60 S.Ct. 209 (1939) ("substance and realities"); *Nordling v. Commissioner*, (9th Cir. 1948) 166 F. (2d) 703 ("realities, not artificialities"); *Commissioner v. Greenspun*, (5th Cir. 1946) 156 F. (2d) 917 ("transactions to be effective . . . must have reality"). See also *Royal Mfg. Co. v. Commissioner*, (3d Cir. 1943) 139 F. (2d) 958; *Helvering v. Tyler*, (8th Cir. 1940) 111 F. (2d) 422. For similar Tax Court decisions, see *Granburg Equipment, Inc.*, 11 T.C. 704 (1948); *Acampo Winery & Distilleries, Inc.*, 7 T.C. 629 (1946); *Koppers Coal Co.*, 6 T.C. 1209 (1946); *Carlton B. Overton*, 6 T.C. 304 (1946); *W. N. Fry*, 5 T.C. 1058 (1945); *Frederick R. Home*, 5 T.C. 250 (1945); *Seminole Flavor Co.*, 4 T.C. 1215 (1945).

<sup>14</sup> *Bazley v. Commissioner*, 331 U.S. 737 at 743, 67 S.Ct. 1489 (1947). Of a similar general nature is the description of a tax saving device as an "attempt to simulate by book entries the basis for a tax credit." *Royal Mfg. Co. v. Commissioner*, (3d Cir. 1943) 139 F. (2d) 958. The *Bazley* case likewise refers to a "paper recapitalization," with which may be compared the reference in *Mauldin v. Commissioner*, (4th Cir. 1946) 155 F. (2d) 666 to "mere paper reallocation of income." See also *Foster v. United States*, 303 U.S. 118 at 121, 58 S.Ct. 424 (1938): "The use of bookkeeping terms and accounting forms and devices cannot be permitted to devitalize valid tax laws." And see *Barrett v. Commissioner*, (1st Cir. 1950) 185 F. (2d) 150, referring to "outer form."

<sup>15</sup> *Commissioner v. Court Holding Co.*, 324 U.S. 331 at 334, 65 S.Ct. 707 (1945). Compare *Court Holding Co.*, 2 T.C. 531 at 538 (1943).



To the extent that comments such as the foregoing are merely the expression of a result they are obviously unobjectionable. However, so far as they may be and have been considered to embody a rational process by which the court reached its decision, they may well be misleading. This much is clear: a person seeking to project a rule for future conduct of the courts will find few bases for prediction in past invectives.<sup>16</sup>

Other comments of the courts—in terms which imply a shade less moral obloquy or personal condemnation—are no more enlightening. For example, analysis is hardly promoted by the observation, however true, that taxation is a practical matter.<sup>17</sup>

Neither are we aided by the observation that substance must be regarded rather than form.<sup>18</sup> The Supreme Court has recently dubbed

<sup>16</sup> Note the comments of the court in *Kocin v. United States*, (2d Cir. 1951) 187 F. (2d) 707 at 708: "In keeping with the decisions, it could be called a 'sham,' a 'disguise,' a 'masquerade,' a 'fiction,' a 'subterfuge,' a 'make-believe,' a 'mere pretense,' a 'mask,' a 'screen,' a 'veil,' an 'artifice,' a 'ruse,' or other names, supplied by the dictionary, which indicate that it does not succeed as an insulator of the corporation from tax liability."

<sup>17</sup> *Harrison v. Schaffner*, 312 U.S. 579, 61 S.Ct. 759 (1941); *Kohn v. Commissioner*, (2d Cir. 1952) 197 F. (2d) 480; *Barrett v. Commissioner*, (1st Cir. 1950) 185 F. (2d) 150; *Tennessee, Alabama & Georgia Ry. Co. v. Commissioner*, (6th Cir. 1951) 187 F. (2d) 826; *Page v. Haverty*, (5th Cir. 1942) 129 F. (2d) 512; *Snowden v. McCabe*, (6th Cir. 1940) 111 F. (2d) 743; *Commissioner v. Ashland Oil & Refining Co.*, (6th Cir. 1938) 99 F. (2d) 588; *Paul G. Greene*, 7 T.C. 142 (1946); *Koppers Coal Co.*, 6 T.C. 1209 (1946).

<sup>18</sup> *Weiss v. Stearn*, 265 U.S. 242, 44 S.Ct. 490 (1924); *United States v. Phellis*, 257 U.S. 156, 42 S.Ct. 63 (1921); *Hatch's Estate v. Commissioner*, (9th Cir. 1952) 198 F. (2d) 26; *Royal Mfg. Co. v. Commissioner*, (3d Cir. 1943) 139 F. (2d) 958; *Berwind v. Commissioner*, (3d Cir. 1943) 137 F. (2d) 451; *Mead v. Commissioner*, (5th Cir. 1942) 131 F. (2d) 323; *Earp v. Jones*, (10th Cir. 1942) 131 F. (2d) 292; *Commissioner v. Falcon Co.*, (5th Cir. 1942) 127 F. (2d) 277; *Morgan Mfg. Co. v. Commissioner*, (4th Cir. 1941) 124 F. (2d) 602; *Louis W. Gunby, Inc. v. Helvering*, (D.C. Cir. 1941) 122 F. (2d) 203; *Inland Development Co. v. Commissioner*, (10th Cir. 1941) 120 F. (2d) 986; *Tinkoff v. Commissioner*, (7th Cir. 1941) 120 F. (2d) 564; *Buhl v. Kavanagh*, (6th Cir. 1941) 118 F. (2d) 315; *Helvering v. Tyler*, (8th Cir. 1940) 111 F. (2d) 422; *Snowden v. McCabe*, (6th Cir. 1940) 111 F. (2d) 743; *Commissioner v. Southern Bell Telephone & Telegraph Co.*, (6th Cir. 1939) 102 F. (2d) 397; *Commissioner v. Ashland Oil & Refining Co.*, (6th Cir. 1938) 99 F. (2d) 588; *Morsman v. Commissioner*, (8th Cir. 1937) 90 F. (2d) 18; *North Jersey Title Insurance Co. v. Commissioner*, (3d Cir. 1936) 84 F. (2d) 898; *Starr v. Commissioner*, (4th Cir. 1936) 82 F. (2d) 964; *Halliburton v. Commissioner*, (9th Cir. 1935) 78 F. (2d) 265; *Helvering v. Security Savings & Commercial Bank*, (4th Cir. 1934) 72 F. (2d) 874; *Tulsa Tribune Co. v. Commissioner*, (10th Cir. 1932) 58 F. (2d) 937; *Labrot v. Burnet*, (D.C. Cir. 1932) 57 F. (2d) 413; *Clemmons v. Commissioner*, (5th Cir. 1931) 54 F. (2d) 209; *Board v. Commissioner*, (6th Cir. 1931) 51 F. (2d) 73. In recent years an occasional echo from the past is heard. *Tennessee, Alabama & Georgia Ry. Co. v. Commissioner*, (6th Cir. 1951) 187 F. (2d) 826. See also *Twin Oaks Co. v. Commissioner*, (9th Cir. 1950) 183 F. (2d) 385 at 387, referring to changes "in form only, without substance" and *Overton v. Commissioner*, (2d Cir. 1947) 162 F. (2d) 155 at 156, concerning "exalting form above substance." Compare *Slayton v. Commissioner*, (1st Cir. 1935) 76 F. (2d) 497 at 500: "The actual facts and not form is the determining factor. . . ."

Other decisions have emphasized that "the incidence of taxation depends on the substance of a transaction" [*Commissioner v. Court Holding Co.*, 324 U.S. 331 at 334, 65 S.Ct.

this distinction "unrealistic,"<sup>19</sup> and Judge Learned Hand described it at an earlier date as an "anodyne for the pains of reasoning."<sup>20</sup> The courts have emphasized "actualities"<sup>21</sup> or "good faith,"<sup>22</sup> and occasionally have described the tax result of a transaction by saying that it was or was not "bona fide."<sup>23</sup> Equally general is the designation of "con-

707 (1945)] and still others, variously phrased, likewise emphasize "substance." *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U.S. 179, 62 S.Ct. 540 (1942); *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940); *Helvering v. Lazarus & Co.*, 308 U.S. 252, 60 S.Ct. 209 (1939); *Burnet v. Commonwealth Improvement Co.*, 287 U.S. 415, 53 S.Ct. 198 (1932). The Tax Court cases convey similar emphasis. *Conrad N. Hilton*, 13 T.C. 623 (1949); *Tennessee, Alabama and Georgia Ry. Co.*, 13 T.C. 486 (1949); *Granberg Equipment, Inc.*, 11 T.C. 704 (1948); *Standard Realization Co.*, 10 T.C. 708 (1948); *Acampo Winery & Distilleries, Inc.*, 7 T.C. 629 (1946); *Isabella M. Sheldon*, 6 T.C. 510 (1946); *Jacob DeKorse*, 5 T.C. 94 (1945); *1432 Broadway Corporation*, 4 T.C. 1158 (1945). See also *Nordberg Mfg. Co. v. Kuhl*, (D.C. Wis. 1946) 69 F. Supp. 750 and *DuPont v. Deputy*, (D.C. Del. 1938) 23 F. Supp. 33.

<sup>19</sup> *Helvering v. Le Gierse*, 312 U.S. 531, 61 S.Ct. 646 (1941).

<sup>20</sup> *Commissioner v. Sansome*, (2d Cir. 1932) 60 F. (2d) 931 at 933.

<sup>21</sup> *Commissioner v. Culbertson*, 337 U.S. 733, 69 S.Ct. 1210 (1949); *Maletis v. United States*, (9th Cir. 1952) 200 F. (2d) 97; *Mauldin v. Commissioner*, (4th Cir. 1946) 155 F. (2d) 666; *Buhl v. Kavanagh*, (6th Cir. 1941) 118 F. (2d) 315. Compare *Morgan Mfg. Co. v. Commissioner*, (4th Cir. 1941) 124 F. (2d) 602 at 605 ("actually intended"); *Slayton v. Commissioner*, (1st Cir. 1935) 76 F. (2d) 497 ("actual facts"); *S. Silberman & Sons v. Commissioner*, (7th Cir. 1935) 76 F. (2d) 360 ("actually paid"); and *Niles v. Milbourne*, (4th Cir. 1939) 100 F. (2d) 723 ("actual sale and purchase"). See also *May Dept. Stores Co.*, 16 T.C. 547 (1951); *Shaffer Terminals, Inc.*, 16 T.C. 356 (1951); *Cooper Foundation*, 7 T.C. 389 (1946); *1432 Broadway Corp.*, 4 T.C. 1158 (1945).

<sup>22</sup> *Commissioner v. Culbertson*, 337 U.S. 733, 69 S.Ct. 1210 (1949); *Brown v. Commissioner*, (3d Cir. 1950) 180 F. (2d) 926; *Thompson v. Riggs*, (8th Cir. 1949) 175 F. (2d) 81; *Commissioner v. Montgomery*, (5th Cir. 1944) 144 F. (2d) 313. The treachery of such terms as "good faith" is illustrated by the *Brown* case. There a taxpayer transferred property to his children in trust, with an understanding that the trustee would lease the property back to the taxpayer. This had the obvious purpose and effect of redirecting to the children a portion of what would normally be the earnings of the taxpayer. Notwithstanding that the trustee had the legal power to enforce payment of rents by the taxpayer, it might appear to some that the term "good faith" was something less than accurate in describing the transaction, but the court found it present and sustained the device. This obviously does not demonstrate that the position of the court was wrong; but it indicates that we are very far from objective measurement of tax consequences by such terms as "good faith." For Tax Court decisions, see *May Dept. Stores Co.*, 16 T.C. 547 (1951); *Camiel Thorrez*, 5 T.C. 60 (1945) (dissent); *Crown Cork International Corp.*, 4 T.C. 19 (1944). Other decisions of courts of appeals include: *Marcus v. Commissioner*, (5th Cir. 1953) 201 F. (2d) 850; *Toor v. Westover*, (9th Cir. 1952) 200 F. (2d) 713; *Roughan v. Commissioner*, (4th Cir. 1952) 198 F. (2d) 253; *Kasper v. Baron*, (8th Cir. 1951) 191 F. (2d) 737.

<sup>23</sup> E.g., *Goodman v. Commissioner*, (2d Cir. 1953) 200 F. (2d) 681; *Seabrook v. Commissioner*, (5th Cir. 1952) 196 F. (2d) 322; *Alexander v. Commissioner*, (5th Cir. 1952) 194 F. (2d) 921; *Bratton v. Commissioner*, (10th Cir. 1951) 193 F. (2d) 416; *Kasper v. Baron*, (8th Cir. 1951) 191 F. (2d) 737; *Barrett v. Commissioner*, (1st Cir. 1950) 185 F. (2d) 150; *Nelson v. Commissioner*, (8th Cir. 1950) 184 F. (2d) 649; *Gouldman v. Commissioner*, (4th Cir. 1948) 165 F. (2d) 686; *Thorrez v. Commissioner*, (6th Cir. 1946) 155 F. (2d) 791; *Niles v. Milbourne*, (4th Cir. 1939) 100 F. (2d) 723; *McInerney v. Commissioner*, (6th Cir. 1936) 82 F. (2d) 665. If the transaction is described as "bona fide" the tax is saved; if described as not "bona fide" it is unavailing to save

duit"<sup>24</sup> which courts frequently use to describe instrumentalities which they ignore in order to frustrate tax avoidance.

*Decision on "Policy" Bases.* A somewhat different and even less desirable ground of distinction between successful and unsuccessful tax saving devices is contained in a frequently quoted opinion written by Justice Holmes: "We do not speak of evasion, because, when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits. When an act is condemned as an evasion what is meant is that it is on the wrong side of the line indicated by the policy if not by the mere letter of the law."<sup>25</sup>

This comment, when analyzed, has disturbing overtones. At a casual glance it appears that a taxpayer who complies with all the requirements of a statute may successfully avoid the imposition of a tax, however artificial the transaction might have been. A closer look, however, indicates that his pains may have been taken in vain if he has stepped outside the "policy" of the statute, which may be different from the "mere letter" of the law. Presumably it follows that the courts will decide first what the "policy" is, and secondly whether there is a conflict with the "mere letter" of the law inherent in the transaction. But "policy" in a tax statute is not easy to find; presumably those within the scope of the statute must pay a tax and others are excused. Moreover, since no bases are suggested for determining what the policy is, and when a conflict exists, the observation seems unlikely to advance analysis. It reveals a point of view held with respect to tax avoidance

the tax. Presumably "bona fide" and "good faith" are interchangeable terms. The Latin appears more popular in the Tax Court. See *Differential Steel Car Co.*, 16 T.C. 413 (1951); *Standard Envelope Mfg. Co.*, 15 T.C. 41 (1950); *Conrad N. Hilton*, 13 T.C. 623 (1949); *Granberg Equipment, Inc.*, 11 T.C. 704 (1948); *Joseph W. Imler*, 11 T.C. 836 (1948); *T. W. Rosborough*, 8 T.C. 136 (1947); *Louis Adler Realty Co.*, 6 T.C. 778 (1946); *Carlton B. Overton*, 6 T.C. 304 (1946); *W. M. Mauldin*, 5 T.C. 743 (1945); *Stanley D. Beard*, 4 T.C. 756 (1945); *W. P. Hobby*, 2 T.C. 980 (1943); *Clara M. Tully Trust*, 1 T.C. 611 (1943). See also *Newberry's Estate v. Commissioner*, (3d Cir. 1953) 201 F. (2d) 874, quoted in note 1 supra.

<sup>24</sup> *United States v. Cumberland Public Service Co.*, 338 U.S. 451, 70 S.Ct. 280 (1950); *Commissioner v. Court Holding Co.*, 324 U.S. 331, 65 S.Ct. 707 (1945); *Griffiths v. Commissioner*, 308 U.S. 355, 60 S.Ct. 277 (1939); *Kaufmann v. Commissioner*, (3d Cir. 1949) 175 F. (2d) 28; *Ingle Coal Corp. v. Commissioner*, (7th Cir. 1949) 174 F. (2d) 569; *Budd International Corp. v. Commissioner*, (3d Cir. 1944) 143 F. (2d) 784; *Lyon, Inc. v. Commissioner*, (6th Cir. 1942) 127 F. (2d) 210; *Packard v. Commissioner*, (2d Cir. 1940) 113 F. (2d) 488; *United Light & Power Co. v. Commissioner*, (7th Cir. 1939) 105 F. (2d) 866; *Jones v. Page*, (5th Cir. 1939) 102 F. (2d) 144; *Electrical Securities Corp. v. Commissioner*, (2d Cir. 1937) 92 F. (2d) 593; *Bank of America Nat. Trust & Savings Assn.*, 15 T.C. 544 (1950); *Conrad N. Hilton*, 13 T.C. 623 (1949); *Dallas Downtown Development Co.*, 12 T.C. 114 (1949).

<sup>25</sup> *Bullen v. Wisconsin*, 240 U.S. 625 at 630-631, 36 S.Ct. 473 (1916).

some thirty-five years ago, but decisions under this doctrine seem peculiarly to represent what Justice Roberts has described as "a ticket good for this day and train only."

*Decision by Common Sense.* Still another general approach has been (perhaps facetiously) suggested: the view that the solution to the problem here will be found in the exercise of common sense.<sup>26</sup> However much this consummation is to be desired, revenue agents and taxpayers notoriously disagree on what tax consequences should arise from a transaction, each claiming the support of that general assortment of information, logic, experience and intuition described as common sense. There is, alas, no guarantee that the bench has a monopoly on the commodity; some have even doubted that the bench has an aliquot proportion. This in turn raises the philosophical question: Can you determine whether a judicial decision is right?<sup>27</sup> Until such time as it is demonstrated that the judges adopt the "right" side as between contending litigants we must continue the search for a more explicit rationale to resolve the question of tax avoidance. The "common sense" concept consequently hardly commends itself as a source of accurate prediction respecting the success of tax avoidance devices in any case doubtful enough to give rise to litigation.

*The Result is Controlled by What Was Done.* Other approaches to the problem have a more convincing but equally deceptive appearance of rationality. Included among these is the comment which was made at an early date by the United States Supreme Court that "questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants"<sup>28</sup> or by

<sup>26</sup> *Batman v. Commissioner*, (5th Cir. 1951) 189 F. (2d) 107 at 110-111: "If courts and judges were a little wiser, or not quite so wise; if we could see, as we should see, face to face, or, though not as through a glass darkly, not quite so clearly as we sometimes erroneously think we see; if we fully understood semantics and the uses and abuses of words; we should be as little troubled, should have as little difficulty, in piercing through the name 'partnership' to the facts in family partnership cases as the court had in *Guy v. Donald*, supra. If knowing, or using, a little less of technical legal reasoning, we knew and used a little more of common sense; if, as the child, in the story of the Emperor's Garment, saw through the pretense to the fact, that the Emperor in reality had no garment on; if, in short, we could see this case, as it really is, we could easily see that what is presented as a partnership here is really not one at all. It is merely an arrangement for shoring up and expanding the family fortunes at the expense of the tax collector."

<sup>27</sup> The difficulties in such a decision are discussed with penetration in Magrish, "Can We Prove That a Judicial Decision is 'Right,'" 20 *UNIV. CIN. L. REV.* 165 (1951).

<sup>28</sup> *Weiss v. Stearn*, 265 U.S. 242, 44 S.Ct. 490 (1924). See also, *Minnesota Tea Co. v. Helvering*, 320 U.S. 609, 58 S.Ct. 393 (1938); *United States v. Phellis*, 257 U.S. 156, 42 S.Ct. 63 (1921). Numerous lower courts have reached the same result. See *Louis W. Gunby, Inc. v. Helvering*, (D.C. Cir. 1941) 122 F. (2d) 203; *Snowden v. McCabe*, (6th Cir. 1940) 111 F. (2d) 743; *Commissioner v. Southern Bell Telephone & Telegraph Co.*, (6th Cir. 1939) 102 F. (2d) 397; *Bruce v. Helvering*, (D.C. Cir. 1935) 76 F. (2d) 442; *Estate of John B. Lewis*, 10 T.C. 1080 (1948).

what "was done rather than by the mere form of words."<sup>29</sup> Yet in none of the decisions was there actual question as to what was done; the conduct of the parties, such as signing of documents and other circumstances of the critical transactions, was never in issue. The words might be thought to mean that a taxpayer will not be heard to protest that he is doing one thing, if he is actually doing another, but such a proposition hardly requires affirmation by the United States Supreme Court. Perhaps something further is implied. If so, the conclusion would seem to be that if a taxpayer says he is doing one thing, and goes through all of the formal motions which would give him a legitimate basis under the statute for such a claim, he will in some cases nevertheless not be heard to make his claim. The immediate inquiry, of course, is "In what cases, and why?" That question is not answered, and it is evident that analysis is not advanced by the assertion that the court is examining what was done when—at least literally—there is no dispute on that issue. It seems probable that in fact the comments here are neither more nor less meaningful than the general expression that substance will be regarded over form.

We have thus far been examining what may be considered a semantic smoke screen in discussions about the problem. A good many decisions—written in haste or despair—do not provide further analysis. Others do, and have content of sufficient respectability to merit discussion. Whatever may be of value in the search for firm guides to prediction of results in tax avoidance cases is found in this latter group. For purposes of preliminary examination these cases have been separated into two classes: those which support judicial frustration of tax avoidance and those which do not.

### *Judicial Self-limitation in Tax Avoidance Cases*

Several principles have been advanced which support the general view that courts should readily recognize tax consequences required by compliance with formal terms of the statute. One of these is the well known observation in the *Gregory* case that "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."<sup>30</sup> This sentiment was not then new,<sup>31</sup> and has since been

<sup>29</sup> *Helvering v. Tex-Penn Oil Co.*, 300 U.S. 481, 57 S.Ct. 569 (1937). Compare *O. William Lowry*, 3 T.C. 730 (1944).

<sup>30</sup> *Gregory v. Helvering*, 293 U.S. 465 at 469, 55 S.Ct. 266 (1935).

<sup>31</sup> See *Bullen v. Wisconsin*, 240 U.S. 625, 36 S.Ct. 473 (1916).

frequently restated.<sup>32</sup> To a greater extent than other generalities this comment expresses a conviction that the existence of a tax advantage does not automatically and in all events taint a transaction to the point where it will be disregarded for tax purposes. At the same time, the weasel words so indigenous to the subject are not wanting. Here they are found in the expression "by means which the law permits." Since the enterprise at hand is finding what the law does not permit, and the cases are silent on that subject, we do not progress far under this doctrine. It is ironic but not unexpected that the decisions generally conclude that the means were not permitted by law.<sup>33</sup>

A second viewpoint is encompassed in a series of decisions holding that the issue "always is whether the transaction under scrutiny is in fact what it appears to be in form." The doctrine was first suggested in the *Chisholm* case of the Second Circuit in 1935<sup>34</sup> and has won

<sup>32</sup> E.g., in *Commissioner v. Tower*, 327 U.S. 280 (1946); *Batman v. Commissioner*, (5th Cir. 1951) 189 F. (2d) 107; *Earp v. Jones*, (10th Cir. 1942) 131 F. (2d) 292; *Starr v. Commissioner*, (4th Cir. 1936) 82 F. (2d) 964; *Estate of John B. Lewis*, 10 T.C. 1080 (1948); *Acampo Winery & Distilleries, Inc.*, 7 T.C. 629 (1946), and *Camiel Thorrez*, 5 T.C. 60 (1945) (dissent). It is sometimes said [*Seminole Flavor Co.*, 4 T.C. 1215 at 1235 (1945)] that: "there was no obligation on the stockholders to arrange their own . . . affairs so as to result in a maximum tax burden." See also *Stanley D. Beard*, 4 T.C. 756 (1945); *Kaufmann Department Stores Securities Corp.*, 2 T.C. 656 (1943); *Koppers Co.*, 2 T.C. 152 (1943). For additional comment, note *Clara M. Tully Trust*, 1 T.C. 611 at 621 (1943): "The respondent's argument in this proceeding seems largely based upon the fact that petitioners could have turned in their 10,000 shares of second preference stock to the Corning Glass Works for cash and thus have been taxed 100 percent on the gains, rather than to have sold the stock to an outside party and be taxed on the percentages of capital gains as provided by law, and that, because they did not do it that way, they should nevertheless be taxed as if they had done it that way." Sometimes this doctrine is stated in language more eloquent than helpful. See, for example, *Deal v. Morrow*, (5th Cir. 1952) 197 F. (2d) 821 at 826, where it was said: "It is one thing to say that when a taxpayer has a choice of methods for accomplishing a business result, all of them real, genuine and *bona fide*, and one of them will minimize his taxes more than another, he can employ that one. It is quite another thing to say that a purely synthetic expedient, having no real function as to the taxpayer and the sale, and serving no genuine purpose as to him except to reduce his taxes, may not be condemned as ineffective for that purpose." See also *Riddlesbarger v. Commissioner*, (7th Cir. 1952) 200 F. (2d) 165, and *Newberry's Estate v. Commissioner*, (3d Cir. 1953) 201 F. (2d) 874, quoted in note 1 *supra*.

<sup>33</sup> See cases cited *supra* at note 32. Compare, however, *Commissioner v. Eldridge*, (9th Cir. 1935) 79 F. (2d) 629.

<sup>34</sup> *Chisholm v. Commissioner*, (2d Cir. 1935) 79 F. (2d) 14 at 15. The court said, "The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance. True, it is always the intent that controls; and we need not for this occasion press the difference between intent and purpose. We may assume that purpose may be the touchstone, but the purpose which counts is one which defeats or contradicts the apparent transaction, not the purpose to escape taxation which the apparent, but not the whole, transaction would realize. In *Gregory v. Helvering*, . . . the incorporators adopted the usual form for creating business corporations; but their intent, or purpose, was merely to draught the papers, in fact not to create corporations as the court understood that word. That was the purpose which defeated their exemption, not the accompanying pur-

support in the Sixth,<sup>35</sup> Third,<sup>36</sup> and Eighth<sup>37</sup> Circuits. At first the phrase conveys that orotund ring associated with political speeches and evangelistic campaigns. Actually it involves much more than that. In analyzing this doctrine it must first be noted that, at least in theory, an intention to avoid taxes does not in itself require the courts to reject a tax saving device.<sup>38</sup> Under the *Chisholm* doctrine, it is stated that an intention which "defeats or contradicts the apparent transaction" may be determinative of tax liability.

This kind of a distinction seems dubious. If intention to save a tax is immaterial, should not an intention to change the appearance of a transaction be likewise immaterial? The explanation may be that as a matter of policy the courts are not prepared to say that every transaction motivated by a tax saving purpose should be disregarded for all tax purposes. Neither does the court want to open the door to tax avoidance by saying that intention of every sort is immaterial. The compromise is to say that some intention—though not intention to save taxes—is material. What is this intention? To get back to the epithets, it may be stated that the taxpayer intended a thing which was a "sham" or "unreal" or without "substance" or was not "bona fide."

pose to escape taxation; that purpose was legally neutral. Had they really meant to conduct a business by means of the two reorganized companies, they would have escaped whatever other aim they might have had, whether to avoid taxes, or to regenerate the world." For a similar line of reasoning, see *Commissioner v. Tower*, 327 U.S. 280 at 288-289, 66 S.Ct. 533 (1946): "Respondent contends that the Tax Court's holding that he is taxable for the profits from the partnership is contrary to a principle long recognized by this Court that 'The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.' *Gregory v. Helvering*, 293 U.S. 465, 469. We do not reject that principle. It would clearly apply, for example, in a situation where a member of a partnership, in order to keep from paying future taxes on partnership profits and in order to get into a lower income tax bracket, sells his interest to a stranger, relinquishing all control of the business. But the situation is different where the taxpayer draws a paper purporting to sell his partnership interest even to a stranger, though actually he continues to control the business to the extent he had before the 'sale' and channels the income to his wife. Then a showing that the arrangement was made for the express purpose of reducing taxes simply lends further support to the inference that the husband still controls the income from his partnership interest, that no partnership really exists and that the earnings are really his and are therefore taxable to him and not to his wife. The arrangement we are here considering was of the type where proof of a motive to reduce income taxes simply lent further strength to the inference drawn by the Tax Court that the wife was not really a partner." See also note 30 *supra*, and text.

<sup>35</sup> *United States v. Cummins Distilleries Corp.*, (6th Cir. 1948) 166 F. (2d) 17.

<sup>36</sup> *Meurer Steel Barrel Co., Inc. v. Commissioner*, (3d Cir. 1944) 144 F. (2d) 282; *Commissioner v. Gilmore's Estate*, (3d Cir. 1942) 130 F. (2d) 791.

<sup>37</sup> *Morsman v. Commissioner*, (8th Cir. 1937) 90 F. (2d) 18. The view has likewise been taken in the Tax Court. See *W. P. Hobby*, 2 T.C. 980 (1943); *Court Holding Co.*, 2 T.C. 531 (1943).

<sup>38</sup> For a discussion of the theory that a motive to save taxes is immaterial in this context, see notes 41 to 56 *infra*, and text.

The difficulties with words such as these has been noted. It is not helpful to explain this doctrine—as did the court—by remarking that a marriage may be a joke, or a contract may have reservations, and that therefore courts may deny the validity of both if “the transaction as a whole is different from its appearance.” A line between taxability and non-taxability can hardly be drawn by a general observation that things are not always what they seem, or what they are intended to seem. Stated baldly, this doctrine seems to be that when a taxpayer intends one thing but pretends to intend another, effect will be given to the intention that he really had, and not the one he pretended to have. At least two things are wrong about such a doctrine: it seems somewhat less than frank, since it is claimed that a tax saving intention is immaterial. But as a practical matter, surely no one would believe that such a conclusion would be reached in any case unless an intention to avoid taxes were present. The whole purpose of having any doctrine at all is to prevent tax avoidance. Second, the rule that a tax saving motive does not affect the tax consequences of a transaction seems to arise because a decision as to intention is too subjective; that under such a doctrine tax avoidance would be frustrated or approved in the unlimited discretion of the court. This deficiency is not cured in the rule suggested; no limit to judicial discretion appears in a doctrine under which the tax consequences of a transaction are dependent on whether a taxpayer intended one thing but pretended to intend another.

This deficiency is illustrated in the reference of the court in the Second Circuit to the *Gregory* case, which had just then been decided by the Supreme Court. It was said that there the incorporators adopted the usual form for creating business corporations, but their intention was merely to draft the papers. Literally, this just was not so. In legal effect the incorporators constituted new corporations, and this effect was intended. This intention was, of course, subsidiary to the further intention of saving taxes by the transaction. It is logic-chopping with a vengeance to say that the factor which impelled the Supreme Court to deny recognition to the corporate device was unrelated to the fact that the transaction was designed to save taxes, and turned on the fact that the parties to the transaction pretended to intend something which they did not in fact intend. Further, that the logic is tenuous is demonstrated by the interpretation put on the *Chisholm* case by the court in the Third Circuit, which cited the case in concluding that a partnership there involved was “. . . merely an ingenious method adopted for the sale of the corporate assets. The shrewd pre-conceived plan does not effectively disguise this primary intent.” Such



language would seem to indicate that the court there considered that formation of the partnership should be nugatory for tax purposes because done pursuant to an intention to save taxes, a view explicitly rejected in the *Chisholm* case.

Actually, the *Chisholm* case may have a meaning expressed in the conclusion that the purpose which is paramount is the purpose—expressed in the *Gregory* terms—to do business by means of the transaction. In *Chisholm*, the court suggested that the absence of intention to really do business with the corporations created was fatal to the tax saving device in the *Gregory* case. On the other hand, the partnership in *Chisholm* was considered to have a purpose—management of property—and that purpose insulated the tax saving device from frustration. It seems probable—although not completely clear—that the case turned on this circumstance. In any event, the time has now arrived to consider further the effect of intention in tax avoidance cases.

*The General Significance of Intention.* Not infrequently the state of mind of the taxpayer determines tax liability under specific requirements of the statute. Examples which most readily come to mind include the contemplation of death provision respecting federal estate taxes [I.R.C., §811(c)] and the cases respecting unreasonable accumulation of surplus [I.R.C., §102]. Other more recent statutes include section 129, which imposes tax where tax avoidance is a “principal purpose” of certain transfers, and section 45, which authorizes the Commissioner to reallocate gross income and deductions in certain cases where it is necessary to prevent “evasion” of taxes or clearly to reflect income.

In addition, the question of motive has been consistently troublesome in all attempts to work out a rationale to control tax avoidance outside of the specific statutory cases. We are not here concerned with cases turning, for example, on such issues as whether a transaction was a loan or contribution to capital,<sup>39</sup> or whether a merger or sale was contemplated.<sup>40</sup> What we are interested in here is the case where it is acknowledged or asserted that tax saving was a motivating factor in what was done.

It is frequently stated in those cases that a tax saving motive behind a transaction is immaterial for tax purposes. This is unquestionably the most confusing doctrine of all, for it is almost never asserted unless

<sup>39</sup> The decision in *Wilshire & Western Sandwiches v. Commissioner*, (9th Cir. 1949) 175 F. (2d) 718 for example, turned on such an issue.

<sup>40</sup> As in e.g., *Banner Machine Co. v. Routzahn*, (6th Cir. 1939) 107 F. (2d) 147. For a list of cases in which intention was thought to be critical, see *Helvering v. National Grocery Co.*, 304 U.S. 282 at 289, 58 S.Ct. 932 (1938).

accompanied by a caveat.<sup>41</sup> Thus, decisions asserting this rule have stated it to be applicable in reorganization cases only if reorganization was in fact effected<sup>42</sup> or adopted.<sup>43</sup> In other cases the rule is to be applied only if there is conformance to the terms<sup>44</sup> or the purpose<sup>45</sup> of the statute, or if the transaction is not a sham and has substance,<sup>46</sup> or is in fact what it appears to be in form,<sup>47</sup> or is genuine<sup>48</sup> or has the "essential elements" necessary to establish its validity as an actual sale and purchase<sup>49</sup> or is in reality what it appears to be<sup>50</sup> or is not illegal or fraudulent.<sup>51</sup> Moreover, the actual result in some cases demonstrates that tax savings under a transaction have in fact been denied because the transaction was obviously motivated by tax avoidance.<sup>52</sup>

Any "rule" so apologetically stated and qualified fore and aft is not likely to convince. This is especially true in view of the cases sustaining tax saving under certain transactions in which the courts have emphasized that no tax avoidance intention was demonstrated. Frequently the cases have reiterated that a transaction was entered into in "good

<sup>41</sup> For exceptions to the rule, see *Commissioner v. H. W. Porter Co.*, (3d Cir. 1951) 187 F. (2d) 939; *Mead Corp. v. Commissioner*, (3d Cir. 1940) 116 F. (2d) 187.

<sup>42</sup> *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266 (1935).

<sup>43</sup> *Survaunt v. Commissioner*, (8th Cir. 1947) 162 F. (2d) 753.

<sup>44</sup> *Electrical Securities Corp. v. Commissioner*, (2d Cir. 1937) 92 F. (2d) 593.

<sup>45</sup> *Fairfield S. S. Corp. v. Commissioner*, (2d Cir. 1946) 157 F. (2d) 321; *Commissioner v. Riggs*, (3d Cir. 1935) 78 F. (2d) 1004; *Estate of Hill*, 10 T.C. 1090 (1948); *Estate of John B. Lewis*, 10 T.C. 1080 (1948).

<sup>46</sup> *Twin Oaks Co. v. Commissioner*, (9th Cir. 1950) 183 F. (2d) 385. See also *Standard Envelope Mfg. Co.*, 15 T.C. 41 (1950).

<sup>47</sup> See notes 34 to 36 *supra*, and text.

<sup>48</sup> *United States v. Cumberland Public Service Co.*, 338 U.S. 451, 70 S.Ct. 280 (1950); *Gouldman v. Commissioner*, (4th Cir. 1948) 165 F. (2d) 686. Compare *May Dept. Stores Co.*, 16 T.C. 547 (1951); *Jacob DeKorse*, 5 T.C. 94 (1945).

<sup>49</sup> *Niles v. Milbourne*, (4th Cir. 1939) 100 F. (2d) 723.

<sup>50</sup> *Morsman v. Commissioner*, (8th Cir. 1937) 90 F. (2d) 18. See also *T. W. Rosborough*, 8 T.C. 136 (1947); *W. M. Mauldin*, 5 T.C. 743 (1945); *Fairfield Steamship Corp.*, 5 T.C. 566 (1945).

<sup>51</sup> *Eaton v. White*, (1st Cir. 1934) 70 F. (2d) 449. Compare *Howell Turpentine Co.*, 6 T.C. 364 (1946).

<sup>52</sup> See *Hay v. Commissioner*, (4th Cir. 1944) 145 F. (2d) 1001; *Helvering v. Elkhorn Coal Co.*, (4th Cir. 1938) 95 F. (2d) 732; *Starr v. Commissioner*, (4th Cir. 1936) 82 F. (2d) 964. Compare *Harrison v. Schaffner*, 312 U.S. 579, 61 S.Ct. 759 (1941), in which a tax saving device was frustrated on the ground that tax avoidance was the "obvious purpose and effect" of the transaction. See also *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 58 S.Ct. 393 (1938). For similar results in the Tax Court, see *Central Cuba Sugar Co.*, 16 T.C. 882 (1951); *Rufus Riddlesbarger*, 16 T.C. 820 (1951); *Granberg Equipment, Inc.*, 11 T.C. 704 (1948); *Alprosa Watch Corp.*, 11 T.C. 240 (1948); *Carlton B. Overton*, 6 T.C. 304 (1946); *Jacob DeKorse*, 5 T.C. 94 (1945); *Crown Cork International Corp.*, 4 T.C. 19 (1944); *William C. Hay*, 2 T.C. 460 (1943). See also *May v. McGowan*, (2d Cir. 1952) 194 F. (2d) 396: ". . . the district court found there was no purpose to evade taxes."

faith.<sup>53</sup> While the term lacks specific content it is at least possible that it means that no tax saving purpose was present.<sup>54</sup> In other cases, the decision has been specifically justified on the basis that no tax avoidance plan was established.<sup>55</sup> It has likewise been asserted that tax incidence depends rather on economic reality than purity of motive.<sup>56</sup> In all of these cases courts have found it necessary to justify decisions for taxpayers by reciting that in the case decided the taxpayer had no tax saving purpose. One is impelled to inquire what relevance this has if the intention of the taxpayer is really immaterial.

The doctrine that a tax saving intention is not material is accordingly hedged about with limitations and qualifications of the most general nature. Indeed, the pious protestation that an intention to avoid taxes has no effect on tax liability simply cannot be the law under any circumstances. The existence of a calculated plan to avoid taxes is the basic explanation for all of the cases concerning the effect of transactions which are commercially unfamiliar and comply with formal requirements for minimizing taxes under the statutes.

*The "Was the Transaction Binding" Test.* Another doctrine recently restated is that as long as any tax saving transaction entered into by the taxpayer is actually binding on him, it is valid and effective to minimize tax liability. There is a deceptive simplicity about the rule. In a recent

<sup>53</sup> *Brown v. Commissioner*, (3d Cir. 1950) 180 F. (2d) 926; *Commissioner v. Philadelphia Transportation Co.*, (3d Cir. 1949) 174 F. (2d) 255. See also cases cited in notes 22 and 23 *supra*.

<sup>54</sup> This seems especially true in the family partnership cases. See *Commissioner v. Culbertson*, 337 U.S. 733, 69 S.Ct. 1210 (1949); *Thompson v. Riggs*, (8th Cir. 1949) 175 F. (2d) 81. Note also *Valspar Corp. v. Commissioner*, (2d Cir. 1949) 172 F. (2d) 171, in which reference is made to "bad faith or tax evasion."

<sup>55</sup> *Commissioner v. Edmonds' Estate*, (3d Cir. 1948) 165 F. (2d) 715; *United National Corp. v. Commissioner*, (9th Cir. 1944) 143 F. (2d) 580; *Commissioner v. Webster's Estate*, (5th Cir. 1942) 131 F. (2d) 426 at 429: "The transaction here involved was not a pure subterfuge designed at tax avoidance like that condemned in *Gregory v. Helvering*. . . . Here the method undertaken was a plain statutory procedure available to the corporations by reason of their legitimate business status, not by virtue of any situation in which they had deliberately placed themselves, and the record clearly shows that several business considerations prompted the selection of the merger as the means by which to accomplish their intended result. That tax avoidance was one of the considerations is of no importance." See also *Morgan Mfg. Co. v. Commissioner*, (4th Cir. 1941) 124 F. (2d) 602 and *Louis W. Gunby, Inc. v. Commissioner*, (D.C. Cir. 1941) 122 F. (2d) 203 at 206: "If Gunby's purpose in giving the particular form he did to this transaction had been to avoid income taxes,—in other words, if his purpose had been to defraud the revenue, or if he had claimed in his own behalf a loss on the securities turned over to the corporation,—we might be justified in viewing the situation in a different light, but nothing of that kind is suggested, and we think, in the circumstances, the fact that he did not comply with the Maryland law should not control the decision we have to make. That law is an act regulating corporations. It is not a revenue act." *Inland Development Co. v. Commissioner*, (10th Cir. 1941) 120 F. (2d) 986; *Bruce v. Helvering*, (D.C. Cir. 1935) 76 F. (2d) 442; *Cedar Valley Distillery*, 16 T.C. 870 (1951); *S. Kenneth Alexander*, 6 T.C. 804 (1946); *Seminole Flavor Co.*, 4 T.C. 1215 (1945); *P.O.B. Montgomery*, 1 T.C. 1000 (1943).

<sup>56</sup> *Hash v. Commissioner*, (4th Cir. 1945) 152 F. (2d) 722.

case involving a so-called step transaction, a tax saving device was sustained on the ground that "the separate steps were all binding when taken."<sup>57</sup> In an earlier case, a man gave funds to his wife, then gave a note and borrowed them back, it appearing that he did so in order to deduct the interest which he later paid on the note. The court held that the taxpayer properly could claim a deduction:

"... Although Mr. Johnson may have had such confidence in his wife's forbearance that he knew the note would not be collected during his life, nevertheless she was left legally free to . . . collect it. The distinction, though often hard to detect in fact, is perfectly clear in principle between creating rights which you trust will not be exercised and creating no legal rights at all; a transaction of the first kind changes existing legal relations between the parties, the other does not."<sup>58</sup>

In another early case, the issue was whether effect should be given to a partnership obviously formed for tax reduction purposes. The question was answered in the affirmative on the ground, among others, that while the two brothers involved might collectively end the partnership when they wished, they were not bound to do so; and as long as the partners were in fact bound, effect must be given to the partnership.<sup>59</sup>

This is another instance where a doctrine has a superficial ring of truth and the virtue of absolute simplicity. Yet the cases in which the courts have frustrated tax avoidance schemes are legion. In the majority of these—indeed, almost all—the transaction assigned as the basis for reducing tax liability was in fact binding on the parties. The courts nevertheless declined to give effect to the devices.<sup>60</sup> Under these circumstances it seems clear that this view cannot represent the law, notwithstanding occasional decisions supporting it below the Supreme Court level. Actually, if this doctrine were generally approved, taxpayers would unquestionably find the challenge to their ingenuity too inviting to resist.

<sup>57</sup> *Tennessee, Alabama & Georgia Ry. Co. v. Commissioner*, (6th Cir. 1951) 187 F. (2d) 826 and see *T. W. Rosborough*, 8 T.C. 136 (1947); *William F. Fischer*, 5 T.C. 507 (1945). Compare, however, *Portland Oil Co. v. Commissioner*, (1st Cir. 1940) 109 F. (2d) 479 and *Toledo Blade Co.*, 11 T.C. 1079 (1948).

<sup>58</sup> *Johnson v. Commissioner*, (2d Cir. 1936) 86 F. (2d) 710.

<sup>59</sup> *Chisholm v. Commissioner*, (2d Cir. 1935) 79 F. (2d) 14. See also *Jones v. Helvering*, (D.C. Cir. 1934) 71 F. (2d) 214.

<sup>60</sup> Note, for example, a few recent cases decided by the United States Supreme Court: *National Carbide Corp. v. Commissioner*, 336 U.S. 422, 69 S.Ct. 726 (1949); *Commissioner v. Phipps*, 336 U.S. 410, 69 S.Ct. 616 (1949); *Commissioner v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715 (1948); *Bazley v. Commissioner*, 331 U.S. 737, 67 S.Ct. 1489 (1947); *Commissioner v. Tower*, 327 U.S. 280, 66 S.Ct. 532 (1946); *Commissioner v. Court Hold-*

*Judicial Principles Restricting Tax Avoidance*

*The View that the Revenue Must Come First.* The foregoing approaches, used in approval of tax saving doctrines, are confused and self-contradictory. The converse doctrines, which are expressed by the courts in expanding their powers to strike down tax avoidance schemes, are scarcely more helpful. There is, for example, the somewhat astonishing statement—made in a moment of presumably unconscious candor—that a principle restricting tax avoidance by limiting carryover of deficits in reorganizations was “. . . grounded . . . on the necessity to prevent escape of earnings and profits from taxation.”<sup>61</sup>

Other courts have been less blunt but likewise support their decisions by reliance on the conclusion that the revenue must come first. The so-called epithet approach described earlier reflects this view. Other decisions speak specifically of frustrating evasion of tax liability,<sup>62</sup> defeating the payment of taxes,<sup>63</sup> and conduct intended “solely to reduce tax liability.”<sup>64</sup>

No court has said, however, and none is expected to say, that a person who would incur tax liability if he handled a transaction in a certain manner should always be said to have incurred that liability even though he in fact concluded the transaction so as to avoid the tax.<sup>65</sup>

ing Co., 324 U.S. 331, 65 S.Ct. 707 (1945). Compare, however, *United States v. Cumberland Public Service Co.*, 338 U.S. 451 at 453, 70 S.Ct. 280 (1950): “The Court of Claims found that the method by which the stockholders disposed of the properties was avowedly chosen in order to reduce taxes, but that the liquidation and dissolution genuinely ended the corporation’s activities and existence. . . . Accordingly it found as a fact that the sale was made by the shareholders rather than the corporation, and entered judgment for respondent.”

<sup>61</sup> *Commissioner v. Phipps*, 336 U.S. 410, 69 S.Ct. 616 (1949).

<sup>62</sup> *Morgan Mfg. Co. v. Commissioner*, (4th Cir. 1941) 124 F. (2d) 602.

<sup>63</sup> *Bruce v. Helvering*, (D.C. Cir. 1935) 76 F. (2d) 442.

<sup>64</sup> *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940). Compare also *Bazley v. Commissioner*, 331 U.S. 737 at 742-743, 67 S.Ct. 1489 (1947): “One does not have to pursue the motives behind actions, even in the more ascertainable forms of purpose, to find, as did the Tax Court, that the whole arrangement took this form instead of an outright distribution of cash or debentures, because the latter would undoubtedly have been taxable income whereas what was done could, with a show of reason, claim the shelter of the immunity of a recapitalization-reorganization.” And see *Steubenville Bridge Co.*, 11 T.C. 789 (1948), and cases cited.

<sup>65</sup> Rather, the contrary is true. *Commissioner v. Gilmore’s Estate*, (3d Cir. 1942) 130 F. (2d) 791 at 795-796: “Granted that the elimination of the holding company as a subject for taxation was a legitimate business object, it does not follow that the method taken in getting rid of it is a tax-free method. We think this gets down to the proposition that if there are two ways of accomplishing a legitimate business result, one of which clearly creates a taxable transaction, one is equally subject to tax liability if he chooses the other unless there is an adequate business reason for the particular method used. We do not think this is the rule of the statute, the Regulations, nor, as we read them, the decisions. The cases cited by the appellant do not extend the Gregory doctrine this far. In each of them, that which was attempted to be accomplished in a tax-free manner was not within the spirit and

Hence, these comments do not really aid in drawing the line between success and failure of tax avoidance devices.

*The Business Purpose Rule.* A leading principle in this area is expressed in the view that a transaction which formally complies with statutory requirements will be unavailing to reduce taxes unless undertaken with a business purpose.<sup>66</sup> In practice the doctrine has been

purpose of the reorganization provisions." Note also the comments in *Commissioner v. Kolb*, (9th Cir. 1938) 100 F. (2d) 920 at 926: "Where for legitimate business purposes a person has a choice of conducting his business transactions without tax liability, such a liability does not arise simply because it would have arisen if another process had been chosen." See also the cases cited at note 32 supra.

<sup>66</sup> The principle is asserted in one form or another in many cases. See, for example, *National Carbide Corp. v. Commissioner*, 336 U.S. 422, 69 S.Ct. 726 (1949); *Commissioner v. Estate of Bedford*, 325 U.S. 283, 65 S.Ct. 1157 (1945); *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 63 S.Ct. 1132 (1943); *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940); *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 58 S.Ct. 393 (1938); *Helvering v. Minnesota Tea Co.*, 296 U.S. 378, 56 S.Ct. 269 (1935); *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266 (1935); *58th St. Plaza Theatre v. Commissioner*, (2d Cir. 1952) 195 F. (2d) 724; *Jones v. Baker*, (10th Cir. 1951) 189 F. (2d) 842; *Kocin v. United States*, (2d Cir. 1951) 187 F. (2d) 707; *John L. Denning Co. v. Commissioner*, (10th Cir. 1950) 180 F. (2d) 288; *Lewis v. Commissioner*, (1st Cir. 1949) 176 F. (2d) 646; *Commissioner v. Transport Trading & Terminal Corp.*, (2d Cir. 1949) 176 F. (2d) 570; *Kohl v. Commissioner*, (8th Cir. 1948) 170 F. (2d) 531; *Gouldman v. Commissioner*, (4th Cir. 1948) 165 F. (2d) 686; *Survaunt v. Commissioner*, (8th Cir. 1947) 162 F. (2d) 753; *Heady v. Commissioner*, (7th Cir. 1947) 162 F. (2d) 699; *Commissioner v. Greenspun*, (5th Cir. 1946) 156 F. (2d) 917; *Thorrez v. Commissioner*, (6th Cir. 1946) 155 F. (2d) 791; *Hash v. Commissioner*, (4th Cir. 1945) 152 F. (2d) 722; *Stern v. Harrison*, (7th Cir. 1945) 152 F. (2d) 321; *Paymer v. Commissioner*, (2d Cir. 1945) 150 F. (2d) 334; *Tower v. Commissioner*, (6th Cir. 1945) 148 F. (2d) 388; *Palace Theatre v. United States*, (7th Cir. 1945) 148 F. (2d) 30; *Commissioner v. Smith*, (2d Cir. 1943) 136 F. (2d) 556; *Commissioner v. Webster's Estate*, (5th Cir. 1942) 131 F. (2d) 426; *Commissioner v. Gilmore's Estate*, (3d Cir. 1942) 130 F. (2d) 791; *Lyon, Inc. v. Commissioner*, (6th Cir. 1942) 127 F. (2d) 210; *Morgan Mfg. Co. v. Commissioner*, (4th Cir. 1941) 124 F. (2d) 602; *United States v. Brager Bldg. & Loan Corp.*, (4th Cir. 1941) 124 F. (2d) 349; *Louis W. Gunby, Inc. v. Commissioner*, (D.C. Cir. 1941) 122 F. (2d) 203; *Tinkoff v. Commissioner*, (7th Cir. 1941) 120 F. (2d) 564; *Anheuser-Busch, Inc. v. Helvering*, (8th Cir. 1940) 115 F. (2d) 662; *Pickard v. Commissioner*, (2d Cir. 1940) 113 F. (2d) 488; *Von's Investment Co., Ltd. v. Commissioner*, (9th Cir. 1940) 111 F. (2d) 440; *Commissioner v. Kolb*, (9th Cir. 1938) 100 F. (2d) 920; *Electrical Securities Corp. v. Commissioner*, (2d Cir. 1937) 92 F. (2d) 593; *Commissioner v. Freund*, (3d Cir. 1938) 98 F. (2d) 201; *Lea v. Commissioner*, (2d Cir. 1938) 96 F. (2d) 55; *Helvering v. Elkhorn Coal Co.*, (4th Cir. 1938) 95 F. (2d) 732; *North Jersey Title Insurance Co. v. Commissioner*, (3d Cir. 1936) 84 F. (2d) 898; *Ballwood Co. v. Commissioner*, (3d Cir. 1936) 84 F. (2d) 733; *Helvering v. Winston Bros. Co.*, (8th Cir. 1935) 76 F. (2d) 381; *O'Meara v. Commissioner*, (10th Cir. 1929) 34 F. (2d) 390; *Central Cuba Sugar Co.*, 16 T.C. 882 (1951); *Cedar Valley Distillery*, 16 T.C. 870 (1951); *Rufus Riddlesbarger*, 16 T.C. 820 (1951); *Estate of Lewis B. Meyer*, 15 T.C. 850 (1950); *Standard Envelope Mfg. Co.*, 15 T.C. 41 (1950); *Granberg Equipment, Inc.*, 11 T.C. 704 (1948); *Fred B.*

invoked in a considerable variety of tax avoidance devices: recapitalizations,<sup>67</sup> reorganizations,<sup>68</sup> personally controlled corporations,<sup>69</sup> family partnerships,<sup>70</sup> redirection of corporate earnings through partnerships,<sup>71</sup> corporate distributions,<sup>72</sup> gifts to members of the family,<sup>73</sup> and liquidations.<sup>74</sup>

Snite, 10 T.C. 523 (1948); Crown Cork International Corp., 4 T.C. 19 (1944); William C. Hay, 2 T.C. 460 (1943). The doctrine is not thought to apply in all cases. See, for example, *Commissioner v. H. W. Porter Co.*, (3d Cir. 1951) 187 F. (2d) 939; *Hirsch v. Commissioner*, (9th Cir. 1941) 124 F. (2d) 24. See also *Differential Steel Car Co.*, 16 T.C. 413 (1951).

<sup>67</sup> *Bazley v. Commissioner*, 331 U.S. 737, 67 S.Ct. 1489 (1947); *Heady v. Commissioner*, (7th Cir. 1947) 162 F. (2d) 699; *Estate of Lewis B. Meyer*, 15 T.C. 850 (1950); *Clyde Bacon, Inc.*, 4 T.C. 1107 (1945); *Louis Wellhouse, Jr.*, 3 T.C. 363 (1944).

<sup>68</sup> *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 58 S.Ct. 393 (1938); *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266 (1935); *Survaunt v. Commissioner*, (8th Cir. 1947) 162 F. (2d) 753; *Stern v. Harrison*, (7th Cir. 1945) 152 F. (2d) 321; *Commissioner v. Gilmore's Estate*, (3d Cir. 1942) 130 F. (2d) 791; *Lyon, Inc. v. Commissioner*, (6th Cir. 1942) 127 F. (2d) 210; *Louis W. Gunby, Inc. v. Commissioner*, (D.C. Cir. 1941) 122 F. (2d) 203; *Anheuser-Busch, Inc. v. Helvering*, (8th Cir. 1940) 115 F. (2d) 662; *Pickard v. Commissioner*, (2d Cir. 1940) 113 F. (2d) 488; *Commissioner v. Freund*, (3d Cir. 1938) 98 F. (2d) 201; *Lea v. Commissioner*, (2d Cir. 1938) 96 F. (2d) 55; *Helvering v. Elkhorn Coal Co.*, (4th Cir. 1938) 95 F. (2d) 732; *Ballwood Co. v. Commissioner*, (3d Cir. 1936) 84 F. (2d) 733; *Standard Realization Co.*, 10 T.C. 708 (1948). Incidentally, it may be noted in these cases that no distinction obtains between shareholder and corporation purpose. See *Lewis v. Commissioner*, (1st Cir. 1949) 176 F. (2d) 646, and cases cited.

<sup>69</sup> *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940); *Commissioner v. Greenspun*, (5th Cir. 1946) 156 F. (2d) 917; *Tower v. Commissioner*, (6th Cir. 1945) 148 F. (2d) 388; *Palace Theatre v. United States*, (7th Cir. 1945) 148 F. (2d) 30; *North Jersey Title Insurance Co. v. Commissioner*, (3d Cir. 1936) 84 F. (2d) 898; *Estate of L. B. Whitfield*, 14 T.C. 776 (1950); *Louis Adler Realty Co.*, 6 T.C. 778 (1946); *Thomas K. Glenn*, 3 T.C. 328 (1944); *William C. Hay*, 2 T.C. 460 (1943).

<sup>70</sup> *United States v. Cumberland Public Service Co.*, 338 U.S. 451, 70 S.Ct. 280 (1950); *Goodman v. Commissioner*, (2d Cir. 1953) 200 F. (2d) 681; *Toor v. Westover*, (9th Cir. 1952) 200 F. (2d) 713; *Roughan v. Commissioner*, (4th Cir. 1952) 198 F. (2d) 253; *Settos v. United States*, (7th Cir. 1951) 192 F. (2d) 521; *Kasper v. Baron*, (8th Cir. 1951) 191 F. (2d) 737; *Jones v. Baker*, (10th Cir. 1951) 189 F. (2d) 842; *Kocin v. United States*, (2d Cir. 1951) 187 F. (2d) 707; *Collamer v. Commissioner*, (4th Cir. 1950) 185 F. (2d) 146; *Tinkoff v. Commissioner*, (7th Cir. 1941) 120 F. (2d) 564; *John P. Denison*, 11 T.C. 686 (1948); *Paul G. Greene*, 7 T.C. 142 (1946); *Davis B. Thornton*, 5 T.C. 116 (1945); *Camiel Thorrez*, 5 T.C. 60 (1945).

<sup>71</sup> *John L. Denning Co. v. Commissioner*, (10th Cir. 1950) 180 F. (2d) 288; *Cedar Valley Distillery*, 16 T.C. 870 (1951). See also *Central Cuba Sugar Co.*, 16 T.C. 882 (1951); *58th Street Plaza Theatre*, 16 T.C. 469 (1951); *Ingle Coal Corp.*, 10 T.C. 1199 (1948).

<sup>72</sup> *Bazley v. Commissioner*, 331 U.S. 737, 67 S.Ct. 1489 (1947); *58th St. Plaza Theatre v. Commissioner*, (2d Cir. 1952) 195 F. (2d) 724; *United States v. Lynch*, (9th Cir. 1951) 192 F. (2d) 718; *Commissioner v. Transport Trading & Terminal Corp.*, (2d Cir. 1949) 176 F. (2d) 570; *Joseph W. Imler*, 11 T.C. 836 (1948); *Edward L. Kraus, Jr.*, 6 T.C. 105 (1946). Compare *Transport Trading & Terminal Corp.*, 9 T.C. 247 (1947).

<sup>73</sup> *Gouldman v. Commissioner*, (4th Cir. 1948) 165 F. (2d) 686; *Commissioner v. Greenspun*, (5th Cir. 1946) 156 F. (2d) 917; *Hash v. Commissioner*, (4th Cir. 1945) 152 F. (2d) 722.

<sup>74</sup> *Commissioner v. Webster's Estate*, (5th Cir. 1942) 131 F. (2d) 426; *Helvering v. Winston Bros. Co.*, (8th Cir. 1935) 76 F. (2d) 381.

In theory, the doctrine is rationalized as an aid to statutory construction: the language of the statute is interpreted in the light of the meaning intended to be put upon it by Congress, which in turn intended the statute to be applicable only to transactions which were entered into with a business purpose.<sup>75</sup> Of course, under such an interpretation, the affinity of this rule to decision by invective<sup>76</sup> is manifest. For example, a device is said to be a "sham"; it is a sham because it was not designed to serve a business purpose; and it is stricken down notwithstanding compliance with the formal terms of the statute because it was not the intention of Congress to permit tax reduction through shams. The doctrine is likewise akin to the principle that tax avoidance is detected by ascertaining whether there was an intention which "defeats or contradicts the apparent transaction."<sup>77</sup> That doctrine might be combined in practice with the business purpose rule by concluding that if a taxpayer pretends to one purpose (business) but actually has another (tax saving) the transaction will be ignored for tax purposes. The sentiment expressed in this doctrine is appealing: if a transaction is arranged for business purposes, tax consequences should be recognized; when it is established for tax saving purposes, it should be ignored.

However, a critical problem in application of the rule arises when both a business and tax saving purpose is manifest. In every case where a taxpayer contemplates a substantial transaction he will assuredly consider the tax, as well as business consequences. Consequently, this issue recurs with great frequency. Leaving to one side the cases holding that any tax saving device will be effective if the parties are actually bound,<sup>78</sup> the cases dealing with this aspect of the business purpose rule are very few indeed, and the Supreme Court has ignored it completely. Some of the cases that have dealt with the problem appear to have considered—as is proper—that the device will be frustrated if tax saving is the primary and business objectives are the secondary purposes of the transaction.<sup>79</sup> Others have implied that if a business purpose

<sup>75</sup> For discussion of the general theory that courts are simply ascertaining legislative intention, see *infra* notes 99 to 100 and text.

<sup>76</sup> See notes 8 to 16 *supra* and text.

<sup>77</sup> See notes 34 to 37 *supra* and text.

<sup>78</sup> See notes 57 to 60 *supra* and text.

<sup>79</sup> *Meurer Steel Barrel Co., Inc. v. Commissioner*, (3d Cir. 1944) 144 F. (2d) 282 at 284: "The arrangement was perhaps too elaborate. From start to finish, as the Tax Court found, there is substantial indication of a unified operation which had as its goal the sale of petitioner's assets free from the taxes which would ordinarily arise. The Tax Court, on the facts before it, had ample reason for deciding that from the time Jones secured his option designed to acquire the assets and good will of the taxpayer, directly or indirectly, the transaction proceeded with that end in view. As it advanced, the other objective, namely,



is anywhere apparent, the tax saving scheme will be effective.<sup>80</sup> This problem accentuates the basic deficiency in the doctrine: only the most unimaginative of tax counsel will find it difficult to project innumerable business reasons supporting any device to save taxes.

Another problem of theory may be noted. The courts have repeated to the point of boredom that an intention to save taxes is immaterial in measuring the tax consequences of any transaction. However (to restate the business purpose rule) it is equally well established that an intention to consummate a transaction for purposes other than business does govern tax liability. Actually there are only two purposes which are pertinent in these cases: if the courts find that no business purpose exists, the clear corollary is that the sole purpose of the taxpayer was to save taxes. Then the intention of the taxpayer to save taxes clearly becomes material, for it is abundantly clear that a tax saving purpose alone is not a business purpose.<sup>81</sup> On the other hand, where a transaction is consummated partly with a view to saving taxes, and partly for business reasons, there is no necessary conflict between the business purpose rule and the view that a tax saving purpose is immaterial; as has been noted, some courts have reconciled the views by holding that where both purposes are present the existence of a tax saving intention does not contaminate.<sup>82</sup>

Leaving the question of theory to one side, grave problems of consistency in applying the doctrine appear. It is clearly a doctrine of last resort, invoked only where no more concrete and measurable principle is available to lend respectability to the decision of the court. Like other rules, it is invoked when it suits the pleasure of the court to decide

that of avoiding taxes on the profit arising out of the contemplated disposal of the assets, became the more clearly defined, the more it was formally concealed behind the mechanics of the disposal of the corporation to the partnership and the continuance of the latter in business for two weeks, with the assets then turned over to Rheem Co." See also *Commissioner v. Smith*, (2d Cir. 1943) 136 F. (2d) 556.

<sup>80</sup> See *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940), referring to a transaction "solely to reduce tax liability"; see also *Commissioner v. Webster's Estate*, (5th Cir. 1942) 131 F. (2d) 426.

<sup>81</sup> *National Carbide Corp. v. Commissioner*, 336 U.S. 422, 69 S.Ct. 726 (1949); *Commissioner v. Smith*, (2d Cir. 1943) 136 F. (2d) 556 at 559: "But in the case at bar we need go no farther than to say that there was no substantial business reason for the creation or continued existence of *Innisfail* since its only, or at least, its main object was to furnish the owner of all its stock with a means of diminishing his taxes." *Electrical Securities Corp. v. Commissioner*, (2d Cir. 1937) 92 F. (2d) 593 at 595: "The avoidance or suspension of taxes is not a business." The Tax Court is in accord: *Rufus Riddlesbarger*, 16 T.C. 820 (1951); *William C. Hay*, 2 T.C. 460 (1943). Compare *Adam A. Adams*, 5 T.C. 351 (1945) (dissent); *W. P. Hobby*, 2 T.C. 980 (1943); *P.O.B. Montgomery*, 1 T.C. 1000 (1943). But compare *Bratton v. Commissioner*, (10th Cir. 1951) 193 F. (2d) 416.

<sup>82</sup> See notes 79 to 80 *supra*.

for the Commissioner, and is ignored in cases when recognition would be embarrassing. In this area, no less than others in the law, courts occasionally find it more convenient to ignore than to distinguish precedents. Consider, for example, the *Cumberland* case,<sup>83</sup> in which the taxpayers obviously set up a transaction in such a fashion as to avoid a tax under the doctrine later adopted in the *Court Holding Company* case.<sup>84</sup> The trial court found that the method by which certain properties were disposed of was avowedly chosen in order to reduce taxes; and the transaction was consummated by a series of steps, some of which had no function other than to insulate against tax liability. The Commissioner's argument that tax should be imposed in these circumstances was rejected by the trial court, and the Supreme Court accorded finality to that decision. Yet on the basis of earlier cases it seems abundantly clear that the manner in which the transaction was consummated involved "no business or corporate purpose,"<sup>85</sup> that "escaping taxation is not a business activity,"<sup>86</sup> that "the whole arrangement took this form instead of an outright distribution of cash . . . because the latter would undoubtedly have been taxable income [to the corporation],"<sup>87</sup> that there should be "disregard of a transfer of assets without a business purpose but solely to reduce tax liability,"<sup>88</sup> and that "a given result at the end of a straight path is not a different result because reached by following a devious path."<sup>89</sup>

A brief glance at other Supreme Court decisions during the past five years emphasizes the point. In the *Culbertson* case, for example, the decision was expressed only partially in terms of business purpose and was based primarily on the even more amorphous concept that the partnership arrangement must be "real," and "in good faith."<sup>90</sup> This, of course, is a retreat toward absolute anarchy in the decisions. The doctrine was ignored in the *Phipps* case,<sup>91</sup> in which business purpose was not shown to be lacking but the Court imposed a tax in an exceptionally obscure opinion. In the *Bazley* case, however, the doctrine was used in a most vigorous form: there the case apparently turned on the joint judicial conclusion that business purpose was absent and a tax saving purpose

<sup>83</sup> *United States v. Cumberland Public Service Co.*, 338 U.S. 451, 70 S.Ct. 280 (1950).

<sup>84</sup> *Commissioner v. Court Holding Co.*, 324 U.S. 331, 65 S.Ct. 707 (1945).

<sup>85</sup> *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266 (1935).

<sup>86</sup> *National Carbide Corp. v. Commissioner*, 336 U.S. 422, 69 S.Ct. 726 (1949).

<sup>87</sup> *Bazley v. Commissioner*, 331 U.S. 737, 67 S.Ct. 1489 (1947).

<sup>88</sup> *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940).

<sup>89</sup> *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 58 S.Ct. 393 (1938).

<sup>90</sup> *Commissioner v. Culbertson*, 337 U.S. 733, 69 S.Ct. 1210 (1949). The result in the case was changed by amendment to the Internal Revenue Code in 1951. See I.R.C., §§191 and 3797(a)(2).

<sup>91</sup> *Commissioner v. Phipps*, 336 U.S. 410, 69 S.Ct. 616 (1949).

was present.<sup>92</sup> The cases thus demonstrate that—even if a cohesive doctrine of business purpose could be developed as a matter of theory—the scope of the practical application of business purpose rule has been and now is thoroughly unpredictable. In summary, the business purpose doctrine appears too evanescent to be helpful. Differences in result frequently arise to the extent that various courts emphasize or ignore either the business or tax avoidance purposes respectively advanced by the taxpayer and the Commissioner. The effect of the doctrine where both business and tax saving motives are present has not been definitively stated. Finally and most important, the application of the doctrine is whimsical; it is invoked when thought desirable and ignored when it is inconvenient.

*The Step Transaction Rule.* Another rule frequently mentioned is the so-called “step transaction” doctrine. The problem here at first appears to be of narrow compass: when several steps are taken in a transaction is the effect of the entire transaction to be considered, or should the transaction be broken down into its separate parts? Speaking in general terms it would seem that if a transaction has a business purpose but is consummated by a number of unnecessary steps in order to minimize taxes which would otherwise arise, this doctrine will be invoked. Thus, in the *Court Holding* case a corporation sought to sell its assets, and the stockholders by successive steps liquidated the corporation, distributed the assets, and sold to the persons who originally negotiated for purchase from the corporation. The purpose and effect of the series was to avoid imposition of income tax on the corporation, and the Court taxed the income from the sale to the corporation as though it had in fact made the sale.<sup>93</sup> The earlier cases have been collected and the conclusion reached that the several transactions should be treated as one where, on an objective view of what took place, they could be said to be interdependent. The enterprise under that doctrine is to interpret the objective facts of a series of transactions so as to ascertain whether the legal relations created by one in the series would have been fruitless without a completion of the series.<sup>94</sup> Here, as in the business purpose rule, subsidiary principles have been freely articulated. It has been said, for example, that the transaction must be

<sup>92</sup> *Bazley v. Commissioner*, 331 U.S. 737, 67 S.Ct. 1489 (1947).

<sup>93</sup> *Commissioner v. Court Holding Co.*, 324 U.S. 331, 65 S.Ct. 707 (1945).

<sup>94</sup> See PAUL, *SELECTED STUDIES IN FEDERAL TAXATION* (Second Series) 200-253 (1938). This view has been followed by the courts. See, for example, *ACF-Brill Motors Co. v. Commissioner*, (3d Cir. 1951) 189 F. (2d) 704; *American Wire Fabrics Corp.*, 16 T.C. 607 (1951); *Ruth M. Cullen*, 14 T.C. 368 (1950); *Helen C. Brown*, 12 T.C. 1095 (1949); *Westfir Lumber Co.*, 7 T.C. 1014 (1946); *Illinois Water Service Co.*, 2 T.C. 1200 (1943). Compare *Hatch's Estate v. Commissioner*, (9th Cir. 1952) 198 F. (2d) 26.

viewed as a whole<sup>95</sup> and that no segregation of steps is appropriate where all are taken pursuant to a unitary plan<sup>96</sup> or are integrated parts of a single scheme.<sup>97</sup> Likewise, a single transaction cannot be broken up into various elements to avoid a tax.<sup>98</sup>

It requires little penetration to conclude that under this doctrine, as with others, prediction is difficult to the point of impossibility. The success of the tax saving enterprise is measured by the intention of the taxpayer—whether he intended one transaction or separate transactions—and the intention must be ascertained from objective evidence. Since the objective evidence (facts) in each case will be different, and no patterns appear to be emerging under the doctrine, its significance appears dubious.

*The Search for Legislative Intention.* Sometimes when courts are faced with a new and wondrous mechanism by which the ever hopeful taxpayer seeks to insure tax savings, they prudently retire behind the statement that the statute was not intended to authorize the result sought by the taxpayer. In the entire cabinet of bromides for use on such occasions, there is none to cause the analytical taxpayer more

<sup>95</sup> *Commissioner v. Court Holding Co.*, 324 U.S. 331 at 334, 65 S.Ct. 707 (1945): "The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title." See also, *Helvering v. Le Gierse*, 312 U.S. 531, 61 S.Ct. 646 (1941); *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 58 S.Ct. 393 (1938); *Budd International Corp. v. Commissioner*, (3d Cir. 1944) 143 F. (2d) 784; *Heberlein Patent Corp. v. United States*, (2d Cir. 1939) 105 F. (2d) 965; *Hazeltine Corp. v. Commissioner*, (3d Cir. 1937) 89 F. (2d) 513; *Thurber v. Commissioner*, (1st Cir. 1936) 84 F. (2d) 815; *Halliburton v. Commissioner*, (9th Cir. 1935) 78 F. (2d) 265. In *Tennessee, Alabama & Georgia Ry. Co. v. Commissioner*, (6th Cir. 1951) 187 F. (2d) 826, the same statement was made in a decision which distinguished an earlier case on most dubious grounds. See also, *May Dept. Stores Co.*, 16 T.C. 547 (1951); *Tennessee, Alabama & Georgia Ry. Co.*, 13 T.C. 486 (1949); *Independent Oil Co., Inc.*, 6 T.C. 194 (1946); *Frederick R. Horne*, 5 T.C. 250 (1945); *Jacob DeKorse*, 5 T.C. 94 (1945); *Clyde Bacon, Inc.*, 4 T.C. 1107 (1945).

<sup>96</sup> *United States v. Gendron Wheel Co.*, (6th Cir. 1938) 100 F. (2d) 57; *Commissioner v. Ashland Oil & Refining Co.*, (6th Cir. 1938) 99 F. (2d) 588; *National Bank of Commerce in Memphis v. United States*, (D.C. Tenn. 1949) 87 F. Supp. 302; *Grace Bros., Inc.*, 10 T.C. 158 (1948); *Clyde Bacon, Inc.*, 4 T.C. 1107 (1945).

<sup>97</sup> *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U.S. 179, 62 S.Ct. 540 (1942); *American Wire Fabric Corp.*, 16 T.C. 607 (1951); *Shaffer Terminals, Inc.*, 16 T.C. 356 (1951); *Catherine G. Armston*, 12 T.C. 539 (1949); *Richard K. Mellon*, 12 T.C. 90 (1949); *Ingle Coal Corp.*, 10 T.C. 1199 (1948); *Koppers Coal Co.*, 6 T.C. 1209 (1946); *Isabella M. Sheldon*, 6 T.C. 510 (1946); *Globe-News Publishing Co.*, 3 T.C. 1199 (1944); *Illinois Water Service Co.*, 2 T.C. 1200 (1943). To the same effect, see *Lewis v. Commissioner*, (1st Cir. 1949) 176 F. (2d) 646; *United Light & Power Co. v. Commissioner*, (7th Cir. 1939) 105 F. (2d) 866.

<sup>98</sup> *Buhl v. Kavanagh*, (6th Cir. 1941) 118 F. (2d) 315; *Starr v. Commissioner*, (4th Cir. 1936) 82 F. (2d) 964; *Koppers Coal Co.*, 6 T.C. 1209 (1946). Compare *Conrad N. Hilton*, 13 T.C. 623 (1949); *Walter S. Heller*, 2 T.C. 371 (1943).

anguish. These references go beyond recourse to traditional legislative materials; in many cases the congressional debates and committee reports are silent on the subject. Rather, what is here involved is the view expressed in the *Gregory* case and others<sup>99</sup> that Congress did not intend a purely formal compliance with statutory requirements to be effective in avoiding a tax. We are not vouchsafed an explanation of how the Court arrived at the conclusion that Congress intended the statute to be read in a manner other than it was written, and no extrinsic evidence on that subject is available. Accordingly, it may not be unkind to entertain the thought that when the Supreme Court says Congress did not intend to permit tax avoidance, it really means only that the Court refuses to permit it. This brings us once again to that most baffling of all questions: upon what basis does the Supreme Court distinguish the cases in which a wholly literal compliance with statutory terms will be effective to save taxes, from those in which such tax saving is frustrated?<sup>100</sup>

<sup>99</sup> This concept has been variously stated, with the inevitable cloudiness of expression. Some courts have said that the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended. *Gregory v. Helvering*, 293 U.S. 465 at 469, 55 S.Ct. 266 (1935); *Commissioner v. Riggs*, (3d Cir. 1935) 78 F. (2d) 1004; *Commissioner v. Dyer*, (2d Cir. 1935) 74 F. (2d) 685; *Labrot v. Burnet*, (D.C. Cir. 1932) 57 F. (2d) 413. Others have said that the statute "is not to be read literally," *LeTulle v. Scofield*, 308 U.S. 415, 60 S.Ct. 313 (1940), or the effort is to "seek out the true intentment of the law," *Lewis v. Commissioner*, (1st Cir. 1949) 176 F. (2d) 646, or the statute "does not permit" the desired result, *Limericks, Inc. v. Commissioner*, (5th Cir. 1948) 165 F. (2d) 483, and must be read "in the light of its own purpose," *Fairfield S. S. Corp. v. Commissioner*, (2d Cir. 1946) 157 F. (2d) 321, "or the intention of its makers," *Pembroke Realty & Securities Corp. v. Commissioner*, (2d Cir. 1941) 122 F. (2d) 252. Moreover, "we need more than a dictionary" to understand the terms of a statute, *Electrical Securities Corp. v. Commissioner*, (2d Cir. 1937) 92 F. (2d) 593. For other comments, see *Helvering v. Le Gierse*, 312 U.S. 531, 61 S.Ct. 646 (1941); *Foster v. United States*, 303 U.S. 118, 58 S.Ct. 424 (1938); *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462, 53 S.Ct. 259 (1933); *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 38 S.Ct. 540 (1918); *John A. Nelson Co. v. Commissioner*, (7th Cir. 1935) 75 F. (2d) 696; *Estate of Hill*, 10 T.C. 1090 (1948); *Estate of John B. Lewis*, 10 T.C. 1080 (1948); *Carlton B. Overton*, 6 T.C. 304 (1946); *Crown Cork International Corp.*, 4 T.C. 19 (1944). Of course, these cases do not involve the very frequent situation where interpretation of the terms of the statute is actually in issue. The statute was clear in the cited cases, but the court concluded that its effect was altered by a tax avoidance purpose manifested in an artificial transaction.

Compare *Floyd v. Scofield*, (5th Cir. 1952) 193 F. (2d) 594; *Masonite Corp. v. Fly*, (5th Cir. 1952) 194 F. (2d) 257 at 260: "The intention of the legislature with respect to tax statutes must . . . be ascertained from the language of the act. . . . The literal meaning of the words employed in tax statutes is most important. . . ." *Allen v. Atlanta Metallic Casket Co.*, (5th Cir. 1952) 197 F. (2d) 460; *Riddlesbarger v. Commissioner*, (7th Cir. 1952) 200 F. (2d) 165.

<sup>100</sup> Another and completely subsidiary principle in the general field of tax avoidance is the view that tax avoidance may be made successful if only enough time is taken to accomplish the objective. This view is, of course, encouraged by the comment in the *Gregory* decision that the corporate entity which was there ignored was put to death immediately after its tax saving function had been discharged. The view has since been supplemented in several cases in which tax saving devices were rejected. In *John Kelley Co.*

*Summary*

The object of this article has been to find whether a measurable pattern runs through the tax avoidance decisions and, to the extent that any pattern exists, to determine its form and scope. The various doctrines used in the tax avoidance cases have been separately examined. We have found that views clash and stratify; they do not merge in cold gradation and well balanced form. It now becomes necessary to examine the joint effect of all of them. Before doing so, a brief review of the problem is appropriate.

The nature of the taxation process requires that statutes be drafted so as to establish only the broad outlines of revenue responsibility. Frequently, this impels taxpayers to engage in commercially astonishing transactions which would result in tax savings under literal interpretation of the statute. In measuring the tax consequences of such conduct, courts must weigh the dangers of successful tax avoidance against the perils of imposing tax responsibility by judicial fiat in cases where no such responsibility is imposed by statute. The issue explored is both where and how the line is to be drawn.

In terms of this objective, the comments of the courts and the doctrines they have enunciated are discouraging. It is all very well to call a transaction a sham, but one undertaking to predict the outcome of litigation might find it comforting to be informed of the difference between "sham" and "non-sham." And while all may agree that form must not be exalted over substance, one may properly be concerned at the failure of the courts to establish the point at which form ends and substance begins. Similarly, it is hardly open to doubt that transactions which are not "realistic," or "bona fide," should be ignored; but that does not inform us how or where the line between the purity and unrighteousness should be traced. Finally, when a court rejects a tax saving device by looking to the intention of Congress in enacting the statute, that case has no value of any kind in predicting the treatment of

v. Commissioner, 326 U.S. 521 at 525, 66 S.Ct. 299 (1946), it was said: "There is not present in either situation the wholly useless temporary compliance with statutory literalness which this Court condemned as futile, as a matter of law, in *Gregory v. Helvering*, 293 U.S. 465." See also *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U.S. 179 at 184-185, 62 S.Ct. 540 (1942): "Transitory phases of an arrangement frequently are disregarded under these sections of the revenue acts where they add nothing of substance to the completed affair." *Helvering v. Bashford*, 302 U.S. 454 at 458, 58 S.Ct. 307 (1938): "Any direct ownership by Atlas of Peerless, Black Diamond, and Union was transitory and without real substance; it was part of a plan which contemplated the immediate transfer of the stock or the assets or both of the three reorganized companies to the new Atlas subsidiary." And see, *Lewis v. Commissioner*, (1st Cir. 1949) 176 F. (2d) 646, and *de Goldschmidt-Rothschild v. Commissioner*, (2d Cir. 1948) 168 F. (2d) 975. Tax Court decisions demonstrate the same approach. See, *Estate of Lewis B. Meyer*, 15 T.C. 850 (1950); *Frederick R. Horne*, 5 T.C. 250 (1945); *Clara M. Tully Trust*, 1 T.C. 611 (1943).

a different tax saving device in the future. Standards of "policy" and "congressional intention" are altogether intuitive.

The series of decisions which recite that a taxpayer may reduce his taxes by any legal means can hardly be applauded when no dividing line between legal and illegal means is suggested; and the line of cases holding that tax saving transactions must be given effect if the parties to them are actually bound ignores the multitude of cases in which just such devices were stricken down for tax purposes. The perfunctory observation that a tax saving motive is immaterial is altogether inaccurate in fact, as the cited cases demonstrate. Equally overstated, at the other extreme, is the principle occasionally expressed that tax avoidance devices will be stricken down simply because they impair the public fisc.

This leaves us with two rules which purport to have substance. One is that transactions are effective in obtaining tax savings only where a business purpose is present. The second is the step transaction doctrine, in which the effectiveness of the tax saving device depends on whether the legal relations created in one step would have been fruitless without the completion of the series, the question of fruitfulness turning on what was intended. Thus, basically, intention is the touchstone in each doctrine.

As a practical matter, these rules leave much to be desired. It has been noted that they have been applied in a whimsical manner. In addition, there is ample authority for saying that when the trial court ascertains "intention" it determines the existence of a "fact." Certainly that is so if we adopt the view once cynically expressed that a question of fact is a hard question of law. Hence, review of such decisions is likely to be sharply limited. It was certainly so limited under the *Dobson* rule.<sup>101</sup> While that rule was later rejected by congressional

<sup>101</sup> *Dobson v. Commissioner*, 320 U.S. 489 at 502, 64 S.Ct. 239 (1943): "Whether an apparently integrated transaction shall be broken up into several separate steps and whether what apparently are several steps shall be synthesized into one whole transaction is frequently a necessary determination in deciding tax consequences. Where no statute or regulation controls, the Tax Court's selection of the course to follow is no more reviewable than any other question of fact." The view was frequently reiterated. See, for example, *Commissioner v. Court Holding Co.*, 324 U.S. 331 at 333-334, 65 S.Ct. 707 (1945): "The Tax Court concluded from these facts that, despite the declaration of a 'liquidating dividend' followed by the transfers of legal title, the corporation had not abandoned the sales negotiations; that these were mere formalities designed 'to make the transaction appear to be other than what it was' in order to avoid tax liability. . . . There was evidence to support the findings of the Tax Court, and its findings must therefore be accepted by the courts." See also, *Commissioner v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715 (1948); *Bazley v. Commissioner*, 331 U.S. 737, 67 S.Ct. 1489 (1947); *de Goldschmidt-Rothschild v. Commissioner*, (2d Cir. 1948) 168 F. (2d) 975; *Limericks, Inc. v. Commissioner*, (5th Cir. 1948) 165 F. (2d) 483; *Mauldin v. Commissioner*, (4th Cir. 1946) 155 F. (2d) 666; *Okonite Co. v. Commissioner*, (3d Cir. 1946) 155 F. (2d) 248; *Helvering v. Ward*, (8th Cir. 1935) 79 F. (2d) 381.

action,<sup>102</sup> it is nevertheless clear that whether a transaction is genuine or a sham is a question of fact, even under the congressional amendment.<sup>103</sup> The shades of distinction, if any, between the epithet approach, the business purpose rule and the step transaction doctrine lends support to the belief that trial court determinations under any of these views would be largely immune to appellate review and hence that general rules will be slow to emerge in this area.

This raises the question of whether we have not been barking up the wrong tree in trying to formulate general principles respecting tax avoidance devices. The difficulty in such formulation is easily illustrated. Presumably most people would agree that a person who holds property over six months with the intention of taking advantage of long term capital gain allowance should be successful in saving taxes. Most would also agree that at least some attempts at tax minimizing through corporate distributions should be frustrated. Yet the sad and simple fact is that there is no logically defensible rationale of tax avoidance which will encompass both conclusions. The major premises under which tax avoidance is frustrated in some cases and allowed in others are simply too ephemeral to be articulated. And if articulation were possible, it would only serve to challenge further the ingenuity of the taxpayer.

To approach the problem sanely we must do two things. We must first remember that justification for preventing tax avoidance is rational and legitimate: the need for protection of the federal revenues by preservation of public confidence in our system of taxation. To measure the length to which a court will go, we must stop reaching for the easy, general rule expressed in terms of business purpose or step transactions and devote our energies to charting what the courts have done in fact.

<sup>102</sup> I.R.C., §1141, as amended by 62 Stat. L. 869 (1948).

<sup>103</sup> It was so held in *United States v. Cumberland Public Service Co.*, 338 U.S. 451 at 454, 70 S.Ct. 280 (1950). The Court also stated with respect to the sham transaction problem (p. 456): "It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs." Of similar import are *Lewis v. Commissioner*, (1st Cir. 1949) 176 F. (2d) 646, and *Kohl v. Commissioner*, (8th Cir. 1948) 170 F. (2d) 531, decided after the amendment of I.R.C., §1141. Under the amendment and Rule 52(a) of the Federal Rules of Civil Procedure even a finding of fact is reviewable if it is "clearly erroneous," but within the doctrine of the foregoing cases it is assumed that appellate courts will be most reluctant to so characterize the conclusions of the trial tribunal. Other recent cases include *Toor v. Westover*, (9th Cir. 1952) 200 F. (2d) 713; *Goodman v. Commissioner*, (2d Cir. 1953) 200 F. (2d) 681; *Roughan v. Commissioner*, (4th Cir. 1952) 198 F. (2d) 253; *Settos v. United States*, (7th Cir. 1951) 192 F. (2d) 521; *Kasper v. Baron*, (8th Cir. 1951) 191 F. (2d) 737; *Barrett v. Commissioner*, (1st Cir. 1950) 185 F. (2d) 150; *Nelson v. Commissioner*, (8th Cir. 1950) 184 F. (2d) 649.



Areas are frequent in which successions of cases have occurred in sufficient volume to establish patterns which furnish a basis for reasonable prediction of the outcome of similar cases which may arise in the future.<sup>104</sup> Without attempting an exhaustive assembly of the cases, it is clear that such principles include such major doctrines as those establishing that reallocation of income within a family group will not shift the incidence of income tax liability,<sup>105</sup> nor will transactions which do not vary the actual command of income<sup>106</sup> or the property taxed.<sup>107</sup> Similarly, in reorganization cases the decisions require a continuity of interest,<sup>108</sup> while profits are said to carry over in cases of merger and liquidation but deficits do not.<sup>109</sup> In still another field, decisions respecting the circumstances under which a corporate entity will be disregarded have created a reasonably stable and dependable body of principles.<sup>110</sup> The cases dealing with sale and leaseback arrangements have already been noted.<sup>111</sup> As tax saving devices recur in the same general form, legal principles will emerge. In this sense, "law" is being made, and prediction becomes increasingly accurate under the judicial processes of inclusion and exclusion. The prospect does not entirely please, but we may console ourselves that our blindnesses and uncertainties are only those which fall to all of us seeking "the solid land of fixed and settled rules."

<sup>104</sup> Space forbids discussion of the process by which such a succession of cases (which singly might be said each to involve only a question of fact) in totality defines a principle of law. The matter is discussed in Rice, "Law, Fact, and Taxes: Review of Tax Court Decisions under Section 1141 of the Internal Revenue Code," 51 *COL. L. REV.* 439 (1951).

<sup>105</sup> See, for example, *Commissioner v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715 (1948); *Commissioner v. Tower*, 327 U.S. 280, 66 S.Ct. 532 (1946); *Harrison v. Schaffner*, 312 U.S. 579, 61 S.Ct. 759 (1941).

<sup>106</sup> *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940); *Wickwire v. United States*, (6th Cir. 1941) 116 F. (2d) 679; *Shaffer Terminals, Inc.*, 16 T.C. 44 (1951); *Paul G. Greene*, 7 T.C. 142 (1946).

<sup>107</sup> *Ingle v. Mc Gowan*, (2d Cir. 1951) 189 F. (2d) 785; *Continental Oil Co. v. Jones*, (10th Cir. 1940) 113 F. (2d) 557. See also such cases as *Helvering v. Clifford*, 309 U.S. 331, 60 S.Ct. 554 (1940) and *Corliss v. Bowers*, 281 U.S. 376, 50 S.Ct. 336 (1930).

<sup>108</sup> The leading cases on this doctrine include *LeTulle v. Scofield*, 308 U.S. 415, 60 S.Ct. 313 (1940); *Helvering v. Minnesota Tea Co.*, 296 U.S. 378 at 385, 56 S.Ct. 269 (1935), and *Pinellas Ice and Cold Storage Co. v. Commissioner*, 287 U.S. 462, 53 S.Ct. 257 (1933).

<sup>109</sup> *Commissioner v. Phipps*, 336 U.S. 410, 69 S.Ct. 616 (1949); *Commissioner v. Sansome*, (2d Cir. 1932) 60 F. (2d) 931.

<sup>110</sup> See, for example, *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 63 S.Ct. 1132 (1943), and cases cited. Compare *Advance Machinery Exchange v. Commissioner*, (2d Cir. 1952) 196 F. (2d) 1006; and see *American Range Lines v. Commissioner*, (2d Cir. 1952) 200 F. (2d) 844.

<sup>111</sup> See, e.g., *May Dept. Stores Co.*, 16 T.C. 547 (1951); *Shaffer Terminals, Inc.*, 16 T.C. 356 (1951); *Standard Envelope Mfg. Co.*, 16 T.C. 41 (1950); *Helen C. Brown*, 12 T.C. 1095 (1949); *Catherine G. Armston*, 12 T.C. 539 (1949); *Ingle Coal Corp.*, 10 T.C. 1199 (1948); *Buffalo Meter Co.*, 10 T.C. 83 (1948).