

Equity in the Administration of Federal Taxes



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OF THE legal relations upon which the corporate and individual clients must seek advice, none is more vexing than those created by the tax laws of local, state and national governments. Lawyers can no longer remain aloof from the tax problem as one that is trivial, nor can they abandon the problem as an accounting problem, nor can the corporation or family adviser turn it over as an independent and disconnected problem for the specialist. Taxation is not a separate problem but is interwoven with every problem or relationship that involves acquisition or disposition of property.

The public, which includes your clients, thinks of taxation largely in terms of rates, economists in terms of incidence and secondary effects, the Treasury in terms of revenue. The bar, better than any other group, is qualified to think of taxation in terms of fair procedure for the ascertainment of liability between the Government, on one hand, and the taxpayer on the other.

Business men have a deep hostility to all problems of taxation. Its burden is so immediately felt and the benefit is so general and remote that the connection between the taxes paid and the benefits received is often totally forgotten. General Motors recently issued a statement to its stockholders in opposition to added taxes in which it declared that "The Government does not create wealth—it dissipates wealth." Someone had forgotten that while General Motors was making automobiles in which there was a profit, the Government was building the highways on which they would be used but on which there was no profit. The revenue producing part of this joint advance has been taken by private industry and the expense part of it by government. No small part of the burden of taxation imposed by our states and even by the Federal Government is the cost of their contribution to the advancement of the motor industry.

As we move in the direction of greater air transportation, airports, lighting services, and other unprofitable parts of that advancement are contributed

by government, while the revenues are collected by private industry. Instances could be multiplied without number in which the Government has been compelled to expend large sums in furnishing facilities upon which business has progressed, and the horse and buggy taxes left off when the horse and buggy quit business.

In the struggle over forms of tax, and rates and brackets, our clients have usually overlooked the importance of administrative provisions and only realize their significance when they become entangled with them. Perhaps they are justified in assuming that their legal advisers, individually and collectively, will attend to the matter of providing fair administration.

The Conflict of Law and Equity

ANY effort to introduce greater equity in tax administration meets at the threshold the age-long strife between certainty against reasonableness, law against equity. Certainty demands fixed rules, literally and uncompromisingly, applied. When we buy certainty we pay as a price arbitrary and unreasonable results. Government of tax liability by rule is predictable but often indefensible. It is strictly a matter of authority. It says "Thou shalt" and "Thou shalt not" and that ends it. Opposed to certainty, is reasonableness, which strives for a rational result even at the expense of bending, or, to be more judicial, "interpreting" the rules. Its flexibility and reasonableness are also bought at a price. Confident prophecy is no longer possible. Its results depend less upon the rule and more upon the attitude of the persons who interpret the rule. Its reasoned result in one case may produce confusion in many others.

Lawyers know how English judges invented equity powers long ago as a means of moderating the harsh and formal technicalities in which the common law had crystallized. Equity powers were designed to give the Court a conscience and then, since a conscience running rampant is a very confusing and unpredictable thing, equity itself began to crystallize into formalities and fine distinctions.

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Nevertheless the question is asserting itself as to whether conscience might not play a larger part in tax administration.

Our courts were early confronted with the conflict and chose on the side of certainty. Efforts to handle taxing power with an eye to equity were chilled by the Supreme Court in an early case in which the device used by a taxpayer was conceded to be a probable fraud upon the revenue. But the Court made the answer "That if the device is carried out by the means of legal forms it is subject to no legal censure."¹ This declaration early in the history of internal revenue taxation of the United States tended to make taxes a matter of form rather than of substance and has given comfort to every tax trickster since.

The Supreme Court has held definitely to a belief in form as opposed to reasonableness in taxation as appears from the language of Mr. Justice Holmes in *Bullen v. Wisconsin*,² where he said, "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."

The tendency of such declaration has been to justify a formal and technical relationship between the citizen and the sovereignty that would not be tolerated between two citizens, and to permit a rule of formalism to avoid tax obligations that would not be permitted to avoid the obligations of a private contract.

David Harum admitted that the words he had spoken in a horse trade were not "gospel truth," but he said that they were good enough "jury truth." Under the stimulation of the rule of formalism a similar attitude has grown up toward the government and statements that would not pass as sportsmanlike or fair between gentlemen were regarded often as good enough "tax truth."

When, however, this rule of formalism is reversed, it is deplored by the taxpayers. If the taxpayer is permitted to skate to the very edge of tax evasion without compunction as to the true substance of his transactions, it is equally correct for the tax collector to catch him the moment he has crossed the line even if accidentally and even if he has crossed the line in form but not in substance.

There is growing criticism of the rule of formalism as applied to tax administration. Examples of severe and unreasonable prejudice, sometimes to the Government and sometimes to the taxpayer, produce a reaction against it and it is realized that notwithstanding the statement of the Supreme Court there is not an exact and easily discernible line on the one side of which lies immunity and on the other side of which lies liability to tax. Tax liability cannot be defined by metes and bounds with mathematical precision. There is a twilight zone between the taxable and nontaxable transactions and a marginal field within which reasonable and honest men may differ

both as to the facts and as to the application of the law.

The dissatisfaction with this situation is evidenced in the complaints of tax attorneys in law review articles and in official circles.

The Subcommittee of the Ways and Means Committee of the House of Representatives in its 1933 report on "Tax Avoidance" recognized the need of some "Equitable Provision" and stated that it would submit a recommendation "on this important problem at a later date if certain practical difficulties can be overcome." To date they have not been overcome.

There is also growing recognition on the part of the courts of undue formalism of the tax law. In *Gregory v. Helvering*³ the Supreme Court refused to permit a taxpayer to take shelter from a tax burden by using reorganization provisions of the statute to disguise a sale and said "The whole undertaking * * * was in fact an elaborate and devious form of convenience masquerading as a corporate reorganization and nothing else." In the recent case of *Bull v. Commissioner*,⁴ the Supreme Court compelled the Government to do equity by allowing a claim barred by the statute and arising out of a transaction which was not barred by the statute, in order that an unjust enrichment of the Government at the expense of the taxpayer would not occur. However, no court has yet avowed equitable jurisdiction in tax cases. The occasions when courts exercise the powers to do equity are rare and not likely to be very much extended. Meanwhile, the old adage that "hard cases make bad law" is frequently exemplified in tax decisions.

Treasury Department Studies Problem

THE Treasury Department, recognizing the inequities of the present system, both to the taxpayer and to the Government, is engaged in a study of the administrative features of the income and other tax laws as the basis upon which constructive administrative reform can be based. It is not my purpose to anticipate those studies, but it is important that all who have to do with tax procedure reform understand at the outset what the problem is.

Our problem is the ancient one, how to have our cake and eat it too—how to have an impartial and inflexible rule which will still take account of each individual's circumstances and yield to reason. Lewis Carroll long ago called attention to the fact that "the more you have of this the less you have of that." The more we have certainty the less we have reason. The more we have of reason the less able are we to make confident prophecy as to what tax liabilities will be. The problem is one of a proper selection of values and of proper balance or combination of the two, always remembering that as one end of the seesaw goes up the other goes down.

Some of the complexity, conflict and confusion in the tax law, is due to the number of cooks who make the broth. Congress gives us a statute, and the

¹ *U. S. v. Isham*, 17 Wallace, 496, p. 506.

² 240 U. S. 625, p. 630.

³ 293 U. S. 465; 55 S. Ct. 266.

⁴ 55 Sup. Ct. Rep. 695.

Treasury supplements it with regulations, and amends the regulations with frequent Treasury Decisions. The Bureau and the General Counsel make rulings and interpretations, published and unpublished, and mimeographs attempt to convey to officials the policy and attitude of the administration. Then begins judicial interpretation. The Board of Tax Appeals, the Court of Claims and every United States District Court in the land have original jurisdiction of cases in which they lay down the law. The Circuit Courts of Appeal hand down binding interpretations. The Attorney General writes opinions on tax matters which are controlling on the administrative authorities and the Solicitor General, through determining in what cases to apply for, or consent to, review, and in what cases to acquiesce in lower court decisions, governs the Bureau. Then the Supreme Court has the final word in the limited class of cases that reach hearing there. No less than thirteen sources, with diverse aims, backgrounds and equipment, are contributing to the stream of tax law that vexes lawyer and taxpayer alike.

All of these, except Congress, disclaim power to do anything but enforce the law as it is written. No one is given, and none will assume, power to do equity.

Congress sometimes attempts to do equity by legislation. After a general rule has been found to bear with unexpected or unequal weight upon some group, an exception is created. Then, if the exception is availed of for evasion, an exception to the exception is created. One rigid and unworkable formula supplants another, to the confusion of taxpayers and to the profit of lawyers. The legislative history of the income tax leaves little doubt that equity cannot be anticipated by legislation, and that mischief comes of the effort to take care of special cases and particular classes by statute.

Then there is the effort to do equity by legislation after the event. Every session of Congress passes a number of bills to grant private relief. Considering these individually, many seem to be trying to undo obvious injustice, others have concealed schemes not so laudable in purpose. All represent a wrong approach to the problem. If the statutory rights of the Government are ever waived, the benefit of the waiver should not be confined to those whose influence or persistence wears down legislative inertia.

Chancery Powers Not Sought by Treasury

SOME persons unfamiliar with the problems of administration think that the whole matter of equity doing is for the Bureau, that the Commissioner should assert no "unfair" claim, and his counsel should defend no position the equity of which is not clear. I cannot imagine the Treasury wanting chancery powers, or the right to waive tax claims for doubt of equity. And it would require a commissioner with a mind as neutral as the Recording Angel to administer it. The fact is that no one can be always on the same side of a controversy and preserve his neutrality. I am not sure that we should even strive for neutrality. The taxpayer is better

informed of the facts, represented by highly interested and zealous counsel, and is the government to have no advocate? If the right of the Government is waived by mistaken judgment, it is forever without remedy, but the taxpayer may always have a remedy by appeal if the administrative decision be wrong. Ideal administration would permit no evasion and no overreaching by government. While human nature remains human we will have some of both, and it forms the materials of our litigation.

If there is to be power to disregard the law and to do individual justice in the matter of taxation that power can only be vested, with hope of success, in a tribunal judicial in character. It must be surrounded by the judicial tradition in order to protect its personnel from political pressure. It must hear in public, decide upon a record, and make its reasons known if it is to keep public confidence. And its jurisdiction must be equally available to the government and to the taxpayer. There are more cases of inequitable escape from tax than of inequitable collection of tax. On the whole the Government would probably gain from application of equitable principles to taxation.

A tax equity tribunal, if it were to be useful, would not be one to decide cases according to the law. We have enough of that now. The complaint is not that the law is not followed, it is that the law is followed too blindly. Equity would have to do what the present courts cannot do—it would decide when the law should be disregarded. Also it could not advantageously be a fact-finding body. We have enough of them. The reviewing of cases from one group to another is one of the vices of our system. There is never an end of it and the course of a tax case through the multitude of reviewing hands is often a delirious one. But it is demanded by taxpayers, rather than by government. The taxpayer always wants one more chance. He has nothing to lose and may win if he can get another hearing somewhere. The present machinery is over adequate for deciding law and fact.

There is no one with authority to say that the law as applied to a particular state of facts should be disregarded in the interest of a fair result. Perhaps there should not be. How would a decision that, while the law did not authorize a particular assessment, justice required it, be received by taxpayers? After all, I doubt if taxpayers would, as a class, want an equity court unless it were a one-way court.

It is also important that we get clearly in mind what powers must be given and what steps must be taken if we are to establish an equitable basis for taxation as distinct from a basis by arbitrary rule.

Tax Administration Now Legalistic

OUR income tax administration has become legalistic rather than realistic or economic. It is very desirable that the principles for determination of tax liability be very simple and elementary if we are to ask citizens to assess themselves their tax liability.

If simplicity and freedom from technicality is to be accomplished, it must be, however, at the expense

of divorcing our tax system entirely from our legal and judicial system. So long as tax problems must be strained through the judicial sieve they will be shaped by the legal mind. The possibility of court review makes it to the advantage of the taxpayer to employ counsel to assert even the most extreme of legalistic positions, and the Government combats the position with the same kind of tools.

We may assume that those who have reached the economic aristocracy who constitute income taxpayers have moderate knowledge of the law of property and contracts such as would be necessary to determine tax liability. But principles of law that were valid in the field in which they were developed have been imported into the income tax administration where their adaptability may be defended in logic but scarcely so in good administration. When we press such doctrines as the constructive receipt of income beyond the point necessary to prevent intentional evasion, we are in a field where the layman is lost. We get into such legalistic mazes as the one we are in regarding improvements made by a tenant as income to the landlord. Should they be reported as income when added to the landlord's property? Or should they report on an accrual basis? Or do they become income when turned over to the landlord's possession? Or only when the landlord realizes by selling them? I have little patience with forcing the lay taxpayer to answer such abstractions for which even the legal mind has no very satisfactory solution. Tax experts have spun their theories so fine both on the side of the government and of the taxpayer that some of their discussions inevitably bring up the image of the kitten with a ball of twine.

And yet can revenue agents or Treasury officials overlook the very questions upon which the legal minds decide cases that involve the applicability of tax laws? The taxpayer urges "common sense" in tax administration—but the cases are decided on law.

Consequences of Delayed Judicial Decisions

THE long wait for final court action is responsible for much maladministration. A statute is passed, a question raised. Often the Supreme Court will not hear it unless and until there is a conflict of decision in Circuit Courts. Meanwhile, we guess at what the law will be, but we do not trust our guess. The Bureau always has many cases in the morgue waiting for settlement by the courts of some underlying question. And pending decision you may be shocked to know that we sometimes take both positions. That is, we take opposite sides of the same question, whichever will be to the advantage of the revenues. I was shocked at the apparent dishonesty of that policy when it first came to my attention. But I can find no way to avoid it. If we guess wrong, and a lot of cases expire by limitation, our position would be indefensible. Also, both sides of the same question are being taken by taxpayers who are under no duty to be consistent with each other. The problem of how to properly administer the law, while you are waiting for the courts to

make up their minds what the law is, can be best illustrated by the cases governed by the famous *Butterworth* decision.

A man bequeathed properties to a trustee to pay the net income to his widow during her natural life in lieu of her statutory rights and dower in the husband's estate. Manifestly, some one should pay a tax on this income, and the Commissioner proceeded to collect from the beneficiary. The Circuit Court of Appeals held in several cases that the income was not taxable to her as a beneficiary. There was no conflict in the Circuit Court decisions and, under the mandate laid down by the courts, the Commissioner proceeded to refund tax to those beneficiaries who had protected their rights, and also according to the decision of the courts assessed the tax on this income to the trustees in such cases as the assessment was not barred by limitations. A similar case finally reached the Supreme Court, which decided that the Circuit Courts were in error and that the income, under these circumstances, should have been taxed to the beneficiary and not to the trustee. So, under the mandate of this latest declaration of the Court, the Commissioner has brought suit to recover many of the erroneous refunds which he had made to widows and is obliged to make refunds to many trustees. In many cases, however, the refunds and their recovery are both barred by the Statute of Limitations, and the Government or the taxpayer must abide by an unlawful result because the decision of the Court could not be known in time to govern their acts. Many cases resulting in long periods of confusion and uncertainty in large litigation, and many unfair results could be cited in which the delay in learning what law the Court would apply has been responsible.

The Statute of Limitations Barrier

CHANCERY powers, to be of use, must include power to disregard the Statute of Limitations. It is responsible for many unjust results. Its inequities are visited upon the Government and upon the taxpayer.

In 1926 a utility company abandoned a trolley line and thereby suffered a large loss. The Public Service Commission, having jurisdiction, for reasons of its own, did not allow the charge-off on the books of the company until 1929. It then made the write-off and took the deduction from its income in that year. The Bureau was of the opinion that the loss occurred in 1926 and would not allow it in 1929. The statute had closed 1926. The taxpayer therefore was not allowed the loss in either year. It was caught between the conflicting policies of the regulatory commission and the Commissioner of Internal Revenue, and by the time the effect of the two policies became apparent remedy was barred.

From 1918 to 1920 the railroads were operated on accrual basis but had never reported the amounts accruing from government, as they were not ascertained. When payment was received in 1923 it contended that it was not income for that year, but for the prior years of government operation. It was sustained in that contention; those years were closed by limitation so no tax was ever paid.

These two cases illustrate the haphazard operation of the statute. Many cases could be cited where the effect had been unjust to one side or the other. Some lawyers have made enviable fees by playing the statute against the government.

All will agree that it is desirable to have a time come when questions of tax liability are over, when records may be disposed of and inquiry ended. The very nature and the virtue of a statute of limitation is that it is arbitrary, and, while often unjust, has a social value that offsets its occasional injuries. It has proved to be very beneficial in other fields of law. There, however, if a debtor once pleads the statute, it may be assumed that his relations with that creditor are ended. But it is different with the Government. The relation with the taxpayer is continuing. It is not a single, isolated transaction that is outlawed. The tax effect of the transaction may be felt for years long after the statute has run. It is hard to apply a statute of repose to a state of affairs where there is no repose. Banquo may be slain by the statute, but his ghost will sit at many a conference table thereafter. Yet we must either have the statute or not have it.

Difficulties of Annual Basis of Reporting Income

A COURT of chancery would need powers to disregard the policy of cutting up the affairs of the taxpayer into strictly annual sections. Business is not done that way. The operations of any year govern those that follow, and strikes root into those that have passed.

A strict annual basis for the computation of the tax has been followed in this country, although England has found greater equity in paying some regard to average income over a reasonable period. We, however, take a gradual process like the recognition that a debt has become a loss, or that a stock has become worthless and insist that a moment be fixed when it passed from one class to the other. Nothing could be more arbitrary than to date worthlessness except to date the moment that the worthlessness was known. Of course there are cases where the signs are sudden and unmistakable. Losses of this kind usually creep up on one, and the difference in optimism of taxpayers may account in good faith for a considerable difference in the dates when they feel impelled to recognize a loss. Of course, he is also inclined to take the loss when it will do him the most good. But there is a tendency to substitute the judgment of the reviewing officer, with the aid of much hindsight, for that of the taxpayer who had only foresight to rely upon.

Then the annual basis has led to an undue emphasis upon the annual rate of depreciation allowance. The really important thing is that the taxpayer shall not, in the aggregate, exceed one hundred per cent of investment with his depreciation charges. Too high an annual rate may look like an advantage, and is a temporary one. But in the long run it has cost taxpayers a pretty penny to have charged off their plant at too fast a rate, and now, when the tax rates

are higher, to have little depreciation left as a cushion.

Should a tax tribunal with equity powers be authorized to depart from the strict annual basis in determining a fair tax?

Other Devices of an Equitable Nature

ANOTHER device of an equitable nature is the representative suit, and it is worthy of consideration whether it could be applied to tax matters. In many situations one person may sue on behalf of himself and of others similarly situated. Frequently large groups of taxpayers who are all stockholders affected by one reorganization or who have other identical interests in the subject matter are all interested in a decision but are not technically bound by it and have not had opportunity to be heard in the case in which it was rendered. As a practical matter one decision frequently settles an entire group of cases, although it is not always accepted by all who are affected. Could we adopt the representative principle in settling tax liabilities?

Another device of statutory parentage, but with a suggestion of equitable ancestry, is the declaratory judgment. It was devised to enable litigants to ascertain their rights from the courts without awaiting occurrence of damages or other conditions necessary to a law action. There is a constant demand upon the Commissioner, or his Counsel, for rulings declaratory of the law, which will have the effect of advising taxpayers what their liabilities will be if they undertake certain reorganizations or other transactions. We recognize that it is but fair that the taxpayer learn the law governing his liability before he has committed himself irrevocably.

In practice, however, such rulings have proved to be a fruitful source of misunderstanding and litigation. In the first place, no court undertakes to render declaratory judgments to advise citizens what their rights or liabilities will be if they undertake certain ventures in the future. They will declare what the liabilities are that have already resulted from the acts of the parties, but I know of no jurisdiction in which the courts have undertaken to render declaratory judgments on hypothetical questions. Yet this is exactly what the Commissioner is asked to do. The taxpayer accepts the ruling, or rejects it, as suits his interest. He follows through the plan he has submitted, or he alters it as he may be advised. And, more troublesome than all else, he frequently neglects to state all of the facts which are important to a ruling. The Commissioner later learns of unrevealed facts and reverses the ruling. The taxpayer complains that he has been "double crossed," and the Commissioner complains that he has been misled.

We have given considerable study to the possibility of setting up a division for the purpose of giving binding rulings, particularly in situations where a large number of taxpayers will be affected by proposed transactions. So far, no satisfactory formula has been devised, and the aid of the bar would be welcome in devising a workable plan.

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Some Questions Pressing for Answer

WE ARE getting too much law, and too many kinds of law, and from too many sources, for tax administration to be simple, or the law clear. Should we reserve to the Supreme Court only constitutional questions in tax matters? Should matters of statutory construction be settled by a tax court, instead of by the twelve Circuit Courts of Appeal, with their frequent conflict of viewpoint? Should questions of fact be finally settled by the finding of the Board of Tax Appeals? Cannot questions of valuation be settled administratively?

Many such questions press for answer. The experience, the technical knowledge and training of the lawyer are necessary to the solution.

The bar owes a responsibility to both its government and its clients to give tax procedure as steady and careful consideration as our professional associations give to other problems of the administration of justice.

Significant Decisions of the Board of Tax Appeals

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of his partnership interest, which deduction was allowed, the further loss sustained in the following taxable period by reason of such notes becoming worthless is not a "net loss" within the meaning of Section 117(a) of the Revenue Act of 1928, since it is "not attributable to the operation of a trade or business regularly carried on."—*Lewis G. Carpenter v. Commissioner*, Dec. 9065 [CCH], Docket No. 71617.

Upon the authority of the decision of the Supreme Court in *Helvering v. Morgan's Inc.*, 293 U. S. 121, the Board modifies its opinion in this case, 30 BTA 231, with respect to issue No. 9 regarding the application of net losses of the Red Jacket Jr. Coal Co. for 1924 and succeeding years. The Board there held that two fractional parts of the calendar year 1924, the period before and after affiliation, each constituted a "taxable year" within the meaning of Section 206(b) of the Revenue Acts of 1924 and 1926. The Board now holds that the two periods, January 1 to July 31, 1924, prior to affiliation, and August 1 to December 31, 1924, during affiliation, together constituted one taxable year, the calendar year 1924, in applying any of the Red Jacket Jr. Coal Company's net losses to its own net income. In all other respects, the opinion reported at 30 BTA 231 stands as that of the Board.—*W. M. Ritter Lumber Company et al. v. Commissioner*, Dec. 9084 [CCH], Docket Nos. 42833-42836, 43604-43606, 48749, 57319-57322.

Nontaxable Income.—Taxpayer owned a patent expiring in 1916, license to use which had been granted to another party by contract providing for royalties. Beginning December 1, 1906, the licensee failed to make payment of royalties, but continued to use the patent. In 1909 taxpayer sued for infringement. In 1930 final judgment was entered for taxpayer, awarding him \$296,511.44 on account of damages and interest. This sum represented the amount of royalties provided by the contract plus interest to date of expiration of the patent of which \$103,589.34 represented the royalties and interest accrued to March 1, 1913. The Commissioner held the total sum received in 1930 to be income. The Board found that the sum of \$103,589.34 was attributable to the period before March 1, 1913, and not taxable to him in 1930.—*Niels A. Christensen v. Commissioner*, Dec. 9075 [CCH]; Docket No. 72424.

"Reorganization" Construed.—Transaction did not amount to a "reorganization" under the provisions of the Revenue Act of 1928 where a bondholders' committee bought in the assets of the defunct corporation at a foreclosure sale, paying therefor \$400,000 in deposited bonds and \$140,000 in cash, and thereafter organized petitioner corporation and immediately transferred the properties to it, petitioner thereupon issuing to the bondholders' committee its demand note for \$3,287,000 and 13,000 shares of no par common stock and the bondholders' protective committee later amended the "Plan of Reorganization or Readjustment" so as to change the capital structure of the petitioner by providing for the issue of first mortgage bonds and preferred and common stock, all of which were turned over to the bondholders' protective committee in exchange for the stock and demand note of the petitioner held by the committee, and the bonds and stock were thereafter distributed to the depositors of the old bonds of the Charcoal Co. in proportion to their respective interests.—*Newberry Lumber & Chemical Company v. Commissioner*, Dec. 9089 [CCH]; Docket No. 68511.

Reorganization—Use of Stepped-up Basis for the Computation of Gain or Loss.—The basis for computing taxable gain to petitioner upon the sale of certain shares of stock of Von's Inc., which were acquired from the Grocers Securities Co., an ephemeral corporation, was the same as that of the transferor, which in turn was the same as the basis of the sales in the hands of Charles Von Der Ahe. Excerpts from the opinion follow:

Charles Von Der Ahe and his wife, owning in the aggregate, 30,441 out of 40,000 shares of stock of Von's Inc., had an opportunity to sell the same in 1929, and the husband entered into a contract with Merrill Lynch & Co., bankers, for the sale of the stock. For reasons best known to themselves, the petitioner was organized to acquire these shares before they were actually transferred to the vendee. The wife first transferred her shares to the petitioner; the husband did not transfer his directly to the petitioner, but first transferred them to the Grocers Securities Co., an ephemeral corporation organized for the purpose of receiving them. This corporation apparently had no reason for existence except to receive the title to the shares prior to their transfer to the petitioner. It was merely a conduit for the passing of title from the husband to the petitioner. That it had no other business purpose is shown by the fact that it was dissolved on August 23, 1929.

If, through the device of the organization of the Grocers Securities Co. and the transfer to it of the 23,015 shares of the stock of Von's Inc., merely for the purpose of acting as a conduit and the holding of legal title to those shares for only a brief period of time, the petitioner is enabled to obtain a stepped-up basis for the computation of gain upon the sale of the shares, the result would be to "exalt artifice above reality and to deprive the statutory provisions in question of all serious purpose," which practice was condemned in *Gregory v. Helvering*, 293 U. S. 465.

We are of the opinion that the respondent correctly held that the basis for the computation of gain on the sale of the 23,015 shares of Von's Inc. obtained by it from the Grocers Securities Co., was the cost of those shares to Charles Von Der Ahe, namely, \$86,723.18, the real transferor in the case.

—*Von's Investment Company, Ltd. v. Commissioner*, Dec. 9070 [CCH]; Docket No. 74643.

Surtax on Corporations Incurred by Unreasonable Accumulation of Surplus.—Corporation was availed of during 1922 and 1923 for the purpose of preventing the imposition of the surtax on its stockholders through the medium of permitting the gains and profits to accumulate instead of being divided or distributed. The fact that the provisions of Sec. 220 of the 1921 Act were applied by the Board (which was affirmed by the Circuit Court of Appeals) as to a previous year does not justify the application of the doctrine of *res judicata* for a later year, since the application of Sec. 220 in any taxable year is wholly dependent on the facts and circumstances of that particular year. The following is from the opinion:

Petitioner contends that its large annual additions to surplus were for the purpose of building up that account or fund to an amount equal to the outstanding mortgage, so as to insure itself a strong financial position. Such mortgage represented a \$700,000 encumbrance in 1920 on the office buildings (in which the corporation had a net equity of approximately \$2,000,000) paid in by Smith for stock in that year. The mortgage was for a long term and called for annual curtailments of \$50,000. The record reveals no necessity for building up a surplus equal to the principal amount of the outstanding long term mortgage. Nor does the record substantiate the alleged purpose underlying the large annual additions to surplus. In our opinion it establishes the very purpose proscribed by the statute. While increasing its surplus beyond its ordinary business needs, by failing to declare dividends, the corporation was increasing greatly its liabilities in notes payable, apparently by borrowing from banks to make loans to Smith, the corporation's sole stockholder. Smith had the use of the corporation's funds in an amount greatly in excess of its surplus from 1920 to 1923, inclusive, and, so far as the record discloses, made no payments of interest thereon except for the very small amount paid in 1923, as shown above. Thus it can not be contended that the corporation's loans to Smith constituted