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The Nature of the Compulsive Effect of State Law in Federal Tax Proceedings

Covey T. Oliver*

THIRTEEN years ago when Mr. Justice Frankfurter in a federal tax case and for federal tax purposes dismissed the state law of vested and contingent remainders as full of casuistries,1 voices2 of woe and of glee were raised. The assumption common to both reactions was that federal tax law would in the future go its own way in characterizing legal relationships without regard to contradictory characterizations in a state's law of property.

On a simple case-count basis it is plain now that so flat a projection was inaccurate. The intervening years have seen federal courts in federal tax cases steadily and from day-to-day giving effect to state law as conclusive on federal tax liability in such numbers and in such patterns as to make it possible to classify whole areas where federal tax liability is essentially determined by state general law or by state decisions characterizing particular transactions.3 Congress has come increasingly to refer federal taxability to state law.4 Community property, the fiend of an earlier morality play about the sin of contradicting geographic uniformity,5 was briefly banished in the estate and gift tax fields,6 then restored to its old privileged position and the federal tax characterization of marital property for

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1 Helvering v. Hallock, 309 U.S. 107, 117 (1940), adding to the indictment. "There are great diversities among the several states as to the conveyancing significance of like grants; sometimes in the same state there are conflicting lines of decision, one series ignoring the other. Attempts by the Board of Tax Appeals and the Circuit Courts of Appeal to administer § 302(c) by reference to these distinctions abundantly illustrate the inevitable confusion." [Followed by a judicial footnote citing attempts of the Board of Tax Appeals to deal with the peculiarities of New York law in the field of vested and contingent remainders.]

2 Excerpts from some of these are recorded in Oliver, Property Rationalism and Tax Pragmatism, 20 Tex. L. Rev. 675, 675-77 and n. (1942).

3 This is attempted in Oliver, Federal Tax Significance of State Law: A Study of the Areas of Influence, Major Tax Problems of 1953, 483-518, Proceedings of the Tax Institute of the University of Southern California (Matthew Bender 1953).

4 Legislative rectification of judicial legislation in the Technical Changes Act of 1949 is an example; a more significant one is the exception in 1951 of "disclaimers" from other types of inaction regarding general powers of appointment, Int. Rev. Code § 811(f)(2). See Oliver, op. cit. supra note 3 at 499.

5 See Oliver, Community Property and the Taxation of Family Income, 20 Tex. L. Rev. 532, 561, n. 129 (1942), noting that a provision taxing all community income to one spouse (thus vindicating uniformity) would only have added $47,000,000 in revenue, according to 1942 estimates, whereas taxing families as a unit would have added $300,000,000.

all three federal taxes modeled upon it. The Bureau is seen coming alive to the possibilities in state law for making out a federal tax claim, even where the state rule the federal agency resorts to lies within the feudal bramblebushes or lurks in a state statute overlooked or disregarded when the taxpayer's draftsman nodded. In the law school world the authors of property casebooks have shown an increasing awareness of federal taxation for reasons that could hardly be called "academic" in the derogatory sense, and courses in Estate Planning, where property and federal taxation associate most intimately, have risen to compete for time in an already over-crowded curriculum. Finally, almost as if to mock a page of history, a Circuit Court opinion has revived substantive due process of law, that one-time invincible champion of property, as an admitted ground of decision in a federal tax case.

Hindsight and time to reflect on the facts of life about a federal structure and about tax laws make it easy for us now to accept the survival and proliferation of inter-relationships such as those just sketched. We know that most legal relationships about wealth items are declared by state law and we know that federal law is not a system complete in and of itself.

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7 The whole legislative history of the marital deduction, split gift and split income tax provisions of the Revenue Act of 1948 support this statement, especially those ponderous efforts in I.R.T. Rev. Code § 812(e) to describe a simulated community for tax purposes without actually saying so.

8 Such as those surrounding the Doctrine of Worthier Title, even as a rule of "construction." See Oliver, op. cit. supra note 3, at 499, 506 and n. 97. The Commissioner's occasional demonstrations that the state law blade has two edges has been little stressed in earlier writing on the state law problem. There have been developments in the more recent past which might justify taxpayer concern regarding the use of state law against him; see Comment, "Limitations to Settlor's Heirs," 37 Cal. L. Rev. 283 (1949).

9 Such as a provision that all trusts are revocable unless explicitly made irrevocable. See Cal. Civ. Code § 2280 and cf. Oliver, op. cit. supra note 3, at 505.


11 It is obvious that at some point tax law and ownership law ought to be brought together. This seems to be one of the major objectives of courses on Estate Planning.

12 Commissioner v. Clark, 202 F.2d 94 (7th Cir. 1953), holding portions of the Clifford Regulations void as unreasonable and arbitrary in their application to the situation before the Court. The precedents cited, Schlesinger v. Wisconsin, 270 U.S. 230 (1926); Heiner v. Donnan, 285 U.S. 312 (1932); and Hooper v. Tax Commission, 284 U.S. 206 (1931), have not been much in evidence in opinions for over a decade. Helvering v. Bullard, 303 U.S. 297 (1938); Helvering v. Brunn, 309 U.S. 461 (1940), have been generally assumed to mark the decline of substantive due process as an expressed factor in federal tax cases.

13 The classics are the older cases cited in the Clark case, supra note 12, based on the general idea that it is a violation of substantive due process to tax A's income to B. Cf. Oliver, Community Property and the Taxation of Family Income, 20 Tex. L. Rev. 532, 547-551 (1942).

14 The "interstitial nature" of federal law has recently been cited to demonstrate on a "mundane plane of working legislative practice ... the strength of the conception of the central government as one of delegated, limited authority," Hart and Wechsler, The Federal Courts and the Federal System 435-36 (1953). At this writing the impact of Crosskey, Politics and the Constitution in the History of the United States (1953) (which attacks the whole
Additionally, tax law is mainly statutory law; and statutes, federal or state, cannot or do not define all or even most of the terms and concepts in which they speak. Further, the problems of federal-specific and state-general law are not confined to the taxation field; there is current activity elsewhere.15 Finally, as others have pointed out,16 characterization of law in a federal structure is a complicated intellectual and technical operation.

But if complicated federal-state law inter-relationships are not a characteristic solely of the federal taxation-state property area they are apt on a policy and on a frequency basis to have their greatest significance for the majority of Americans there.

Among the policy factors that are especially related to the topic of federal-state relationships touching and concerning federal taxation and state property law are those involving the following values:

- Interests in (a) substantial geographic uniformity and (b) in fiscal justice in federal tax administration.

The former expresses the need for a nationwide tax system. The latter calls for substantially equivalent tax treatment for persons in substantially equivalent economic power positions. The philosophic and policy clashes between these federal tax ideals on the one hand and legal notions of ownership, drawn from state law, have been the principal themes of most of the prior writing on the general topic of this paper.17 They continue...
of basic importance, not only to tax-gatherers, but to the whole of a democratic community living under a dual governmental structure in a time of fiscal stress.

An interest in reasonable professional reliance upon established dispositive and distributive devices and means of professional communication regarding wealth, free of uncertainties and confusions arising from unnecessarily distorting pressures from the tax field.\(^\text{18}\)

It is worth keeping in mind that in the field of property especially, the legal machinery for carrying out desires is not infinitely variable. The vehicle of contract has a torque converter, power steering and four-wheel drive; it can go anywhere the public is allowed to go. The vehicle of ownership, however, does not even have a synchro-mesh transmission; its gears strip easily and disastrously. Some models run only on feudal rails. Tax on the tracks can have unexpectedly severe consequences. Certainly sentiments along the above lines have their many protagonists. Much has been written, especially in the bar journals, and much more said in peroration, especially at bar conventions, in defense of this value. Defections from the phalanx are not to be expected in the immediate future. As to the means of communication, one need only question whether the misuse\(^\text{19}\) in federal tax cases of standard property terminology which should be a part of every lawyer’s vocabulary has any overriding fiscal utility.\(^\text{20}\)

\(^{18}\) Bearing in mind, of course, that whatever should or might have been, according to Professor Crosskey, the private law of this country is for the most part state law and as state law is looked to for the usual, the ordinary, the non-tax, expression of legal relationships.

\(^{19}\) One might adjust to “contingent reversionary interest” but in a case which will not be cited there is reference to a “contingent reversionary remainder”! Federal tax usage of “possibility of reverter” to describe what is accurately a reversion in fee, as in Estate of Spiegel v. Commissioner, 335 U.S. 701 (1949), is hardly to be condoned merely because the possibility of the reversioner’s regaining possession and enjoyment is fairly remote. Nor does it seem that the following plea in confession and avoidance appeals to any real tax, or any other, utility: “The terms ‘reverter’ and ‘the possibility of reverter’ have been used frequently and freely in opinions and discussions of this general subject. They are used here to refer to the return or possible return to the settlor or to his estate, under conditions comparable to those here suggested [Spiegel Case], of property previously placed in trust by the settlor. They are not used in any strict or technical sense peculiar to the law of property.” [sic] Burton, J., dissenting in Spiegel, 335 U.S. 701, 709, n. (1949).

\(^{20}\) Perhaps in connection with the “expressly retained reversion” dealt with in In re Rev. Corp. § 811(c) (2) there is an overriding fiscal utility, assuming that there is some defensible tax policy which would differentiate between a grantor’s providing expressly for the possibility that possession might come back to him and having that result come “naturally” from the fact that the remainder over granted by him was contingent on the remainderman’s surviving the grantor. In the law of property, of course, reversionary interests are not expressly retained; they arise from the simple fact that a man has given away less than he had and from the supplemental dogma that as long as a remainder in fee is contingent, the reversion is in the grantor.
Essentially, the two values are contradictory but no more so than many others in our dual-state lives. As elsewhere in our federal structure, (or as in the design of motor cars) compromises to reach an average level of generally satisfactory performance must be sought. The necessity of these adjustments gives rise to a third policy or interest, which, though it may be thought of as a mere reconciliation of the other two, deserves specific attention. It is the interest in the nature of the adjustments between two sets of laws, state property law and federal tax law. On the face of it, the problem seems simple: (1) legal interests in property, contract, and so on, are created by state law, not federal law; (2) Federal taxes are imposed by Federal law; (3) in imposing taxes with respect to legal interests, the Federal tax law does not have to use the same categories for tax purposes that the state law does for property and contract purposes. It is the basic assumption of this paper that the problem in fact is far from so simple. It is therefore believed that we must examine systematically the "How" and the "How Far" state law affects the incidence of federal taxation; that we must review the concepts, the characterizations, the rationalizations, and (where there is any evidence) the real reasons federal courts act as they sometimes do about state law in federal tax cases. This has received relatively little attention in the thirteen years since the Hallock case, partly one guesses because of the incorrect projection of a trend that did not materialize.

It is the objective of this paper to deal with this third or operational interest. To the writer it seems that this task must be begun soon, lest the ideal of engineered compromises between the two poles of interest in our federal system be forced to yield to a reality of uncontrolled, unpredictable mutation. The main effort here will be toward description and analysis. The present operation is hampered, unfortunately, by the technological inadequacies in equipment. At this writing the author is limited to the levels of law-in-books, though undoubtedly what goes on below at the administrative depths, where most tax controversies live and die, is very significant.

and is vested. See 1 FRASER, CASES AND READINGS ON PROPERTY V (1932). This being the common law situation, if tax reasons dictate a differentiation, the "expressly retained reversion" would have to be described as such; and it was. The tax question remains: would it not have been better to get out of the context of two kinds of reversions entirely and deal with the question on the factual basis, whether the grantee had to survive the grantor in order personally to possess or enjoy the property? Cf. INT. REV. CODE § 811(c) (3).

21 Such as, for instance, some of those which seem to be involved in current controversy over federal-state and executive-legislative authority to make international agreements having internal effects.

22 In the sense that it does not appear to have been the central preoccupation of any study of the state law-federal taxation relationship during this period. Reference has been made to the seemingly cyclical nature of writing on the broader theme, supra note 17; Oliver, Federal Tax Significance of State Law: A Study of the Areas of Influence, MAJOR TAX PROBLEMS OF 1953 483, 484, Proceedings of the Tax Institute of the University of Southern California (Matthew Bender 1953).
has had to be content with what one finds thrown up from there occasion-
ally in the Regulations, the Cumulative Bulletin and other indirect or
scanty sources.  

I. BACKGROUND

We know from the cases that in some situations there is sometimes some
effect given to state law in federal courts when federal tax liability is at
issue. It would seem desirable to have fairly definite ideas as to what in
the federal-state relationship this is based upon; to be able to predict under
what circumstances state law may be denied an effect it would otherwise
have been given; and to be able to explain the procedural manner (plea in
bar, presumption, evidence, etc.) through which state law comes into the
federal tax cause of action. “State law” itself requires attention, especially
with respect to possible differences in federal tax effect between the general
common law of the several states, legal doctrines established by statute or
by lines of decision in particular states, and ad hoc declarations by state
tribunals of the existence or not of specific legal relationships upon which
federal tax liability might depend.

Though there have been judicial utterances24 hostile to any role for
state law in federal taxation, some of them recent,26 federal toleration in
broad outline is well-established,20 at least in cases where the interests of
national uniformity and substantial fiscal justice have not impressed the
federal court involved so greatly as to result in a decision which neutralizes
the pull of state law the other way.

When we look beyond this de facto situation for a theory to explain the
nature of the compulsive effect sometimes of state law, we may seem to
subject ourselves to a practical realist’s scorn for seeking rules where rather
complete judicial discretion is only partly masked. A possibly valid defense
might be that we are not only seeking the reasons that institutions give for
their behavior, but also the real motivations for that behavior; that these

23 The need for “full field” investigation seems to the writer to be particularly acute with
respect to the actual federal tax treatment at the administrative level of marital property ad-
justments in community property states, and it is hoped in connection with a study in process
that something of a tax “Kinsey Report” can be developed to give information in an area poorly
lighted by printed decisions. Cf. Oliver, op. cit. supra note 3 at 512, et seq.

24 Brainard v. Commissioner, 91 F.2d 880 (7th Cir. 1937); cf. Commissioner v. Masterson,
127 F.2d 252, 256 (5th Cir. 1942). But compare the latter with Masterson v. Commissioner,
141 F.2d 391 (5th Cir. 1944).

25 Dissent of Fee, D.J., in Commissioner v. Goodan, 195 F.2d 498, 500 (9th Cir. 1952)
ssemble; Channing v. Hassett, 200 F.2d 514 (1st Cir. 1952); Saulsbury v. U.S., 199 F.2d 578
(5th Cir. 1952).

26 Elsewhere the large number of cases permitting state law to affect federal tax liability
have been grouped functionally into a number of areas of influence, Oliver, op. cit. supra note 3,
passim.
"real reasons" are of great potential utility in predicting action; and that, anyway, the institutional facts of life in a hierarchical system are such that the rationalizations top courts give for their behavior may, in lower courts, become the real reasons for decisions. The point last made, however, must not obscure another institutional fact: that while the broad lines of action regarding state law in federal taxation have been set by the Supreme Court, it is in the Tax Court and the District Courts that on a frequency basis most questions involving state law's effect are settled. Since the Supreme Court has virtually disengaged itself from internal revenue litigation, a great deal of drift from Supreme Court doctrines can take place, here as elsewhere in the federal tax field, before there is a re-tightening, if any, of the lines.

As to real reasons and given reasons, there is relative confusion regarding the grounds upon which state law is allowed to come into federal tax cases. As we shall see, a systematic examination of the cases where state law has entered federal tax cases to govern the outcome shows that various reasons are given or suggested. Sometimes the result is explained on the basis of the nearest thing to an "official" theory we have:

State law may control only when the federal taxing act, by express language or necessary implication makes its own operation dependent on state law.2

The joker, of course, is "necessary implication." In a number of tax cases, as we shall later develop, state law is applied as a matter of routine, without there being on the part of the federal court any effort recorded in the opinion to apply the "command of the statute." This may mean that the situation is just too well established or too simple to be dealt with in any such step-by-step manner. It is doubted that all of the cases can be so easily disposed of. Additionally, this formulation of a Master Rule, though it might give an answer to why state law comes in, would explain little about

27 The Supreme Court has not spoken directly on the topic of this study for some time. Its last utterances were in Commissioner v. Church, 335 U.S. 632 (1949) and Commissioner v. Spiegel, 335 U.S. 701 (1949), where the treatment of state law was somewhat ambivalent, to say the least. In Church, one might assert with only slight overemphasis, May v. Heiner was overruled in preference to dealing with the state law question. In Spiegel the refusal to review the Circuit Court's determination on the state law of reversionary interest appears at once to affirm that state law may validly enter a federal tax case involving the existence or not of such an interest and to disengage the Supreme Court from having to concern itself directly with what that law is.

28 Burnet v. Harmel, 287 U.S. 103, 110 (1932). The statement appears to have originated in this case, one of the first to put national uniformity above the local classification of property-types; cf. Mississippi Valley Trust Co. v. Commissioner, 72 F.2d 197 (8th Cir. 1934). The technique of statutory construction to determine the effect of state law may have begun at least as early as the earliest case cited in Harmel, i.e., with Von Vaumbach v. Sargent Land Co., 242 U.S. 503, 519-20 (1917).
the operative effect state law would have in any particular federal tax context.

Moreover, there are text-book and opinion references in the context of this topic to other principles, such as, inter alia, res judicata, collateral estoppel by judgment and the principle of *Erie v. Tompkins.* There are intimations that the inherently interstitial nature of all federal law has to be taken into account in some situations, not in others. In the cases of two decades ago and earlier, substantive due process of law had its place in this area. The extent to which the disappearance of due process as a formal reason marked its entire withdrawal from the scene, and the relationship of historic due process itself to some of the precedents still relied upon regarding state law's place are additional variables requiring speculative investigation.

Finally, it may be that some of the answers are not to be found in the various doctrines which from case to case are used to describe the relationship of state law to the federal tax controversy but rather in the procedural way in which state law is treated by the federal court in the tax case.

It is proposed, therefore, to present the analysis in two sections. In the section following (II) the various theories or notions tending toward compulsive effect will be examined. In the third section more narrowly procedural aspects will be taken up. Emphasis in the latter section will be on (a) the development or lack of development of federal criteria and techniques for disqualifying state law under certain circumstances where it would otherwise come in and on (b) the treatment of state law as fact or as law when it does come into federal tax litigation. In both sections major subdivisions will be between the two well-known types of state law: (i) the state decision declaring relationships in the transaction now before the federal court in a tax case and (ii) state doctrine arising from the state precedents and statutes. The former we shall refer to as "The State Decision"; the latter as "The Law of the State." Since some of the principles examined in sections II and III relate only to state decisions and others only to state law, but some to both, further internal division exists within the sections to reflect these relationships also. In several instances some relatively recent cases have been used in an illustrative manner by way of introduction to a particular sub-topic.

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29 304 U.S. 64 (1938), apparently on the supposition that it may have ultra-diversity radiations in "federal question" areas.

30 Cf. HART AND WECHSLER, *op. cit. supra* note 14, at 456-57, where the explanation is cast in terms of the federal tax law's incorporation by reference of state law in certain situations.

31 See text at note 110 *infra.*
II. AN ANALYSIS OF THEORIES TENDING TOWARD GIVING COMPULSIVE EFFECT TO STATE LAW IN FEDERAL TAX CASES

A. Theories of Compulsive Effect Related to the State Decision

Illustrative Case: Commissioner v. Thomas Flexible Coupling Co.\(^{32}\)

Under a 1939 patent arrangement between the taxpayer corporation and a stockholder and wife of the principal stockholder, the Tax Court had held for tax years 1939-41 that certain payments by the corporation were merely voluntary and not deductible by it as ordinary and necessary expenses. In 1943 the corporation re-transferred the patents to the stockholder and she thereupon granted the taxpayer corporation an exclusive license, providing for royalties to her. In 1945 the corporation, citing the Tax Court’s refusal to permit deductions, informed the stockholder it would make no further payments to her under either agreement. She then obtained a declaratory judgment, affirmed by the highest state court, that both the 1939 and the 1943 agreements were supported by “valid, adequate and legal consideration.”

This state court declaration of the legal relationship between the taxpayer and the inventor was brought to the attention of the Circuit Court when the tax causes of action for 1939-41 came up for review. The Circuit Court did not give it effect, not because it had come after the Tax Court ruling, but because ordinary and necessary expenses were “not a question of state law under \(Erie v. Tompkins\), 304 U.S. 64....”\(^{33}\)

Then came other tax years (1942-44), and the Commissioner said the taxpayer was estopped to make again the contentions for deduction that had previously been rejected, but both the Tax Court and the Circuit Court\(^{34}\) held against him. Main reason: the intervening state decision prevented the first federal tax decision from controlling the second tax case arising out of the patent transaction.

The Tax Court spoke in a context of denying “res judicata” effect to the first federal decision, the Circuit Court in terms of no “collateral estoppel.” The basis of each negation was that an intervening doctrinal change (the state decision) had occurred. In language closely coupled to its mention of “res judicata” the Tax Court\(^{35}\) went on to say that the state court decision “on who owes what and to whom” was binding upon it, added that of course what was deductible was a federal question, and proceeded to

\(^{32}\) 198 F.2d 350 (3d Cir. 1952). Estate of Vose, 20 T. C. No. 81 (1953) and 14 T. C. 113 (1950) might have served as well.


\(^{34}\) 14 T. C. 802 (1950), five judges dissenting, 821 and \textit{supra} note 33.

\(^{35}\) \textit{Id.} at 816.
find that all the payments for the last tax year and an equal amount of larger payments for preceding years were "ordinary and necessary expenses" of the corporation.

A Tax Court dissent claimed that the state proceedings were not sufficiently adversary to have the effect given them, citing authorities. However, the Tax Court majority said on this point:

If . . . we had to be guided by the dissenting opinion [in the State Supreme Court] . . . we would, doubtless, sustain respondent's contention that these Pennsylvania judgments were in nonadversary proceedings. . . . However, it is to the majority opinion of the Supreme Court of Pennsylvania that we must look for the character of the proceedings and not to the dissenting opinion . . . regardless of what we might think as to its merits.

In the Circuit Court the Commissioner made a desperate effort to contain the state decision by arguing that since it had come down during the course of appeal from the Tax Court in the earlier (1939-41) tax proceeding, it should not have the effect of preventing that earlier tax proceeding from controlling the tax cause of action for the later years. Explaining that its action in excluding the state decision previously had been required by the limited scope of review the Circuit Courts then had under the Dobson Rule, the Circuit Court this time decided that the taxpayer had not previously had its day in court on the intervening state decision and hence that it would be "unjust and improper to apply the doctrine of collateral estoppel . . . ."

This case, it is hoped, has served to focus attention upon a typical situation coming within the scope of this subdivision and to suggest the range of the problems, policy and operational, which arise.

We shall now proceed, according to the plan previously described, to consider the various possible doctrinal bases for giving effect in Federal tax litigation to state court decisions declaring the legal relationships of the taxpayer. These are:

1. Res Judicata

Although the Supreme Court long ago made the classic differentiation between res judicata and collateral estoppel and although the Tax Court gives evidence on occasion of appreciating the separateness of the

36 Id. at 823.
37 Id. at 816 (emphasis supplied).
40 Id. at 356.
41 Cromwell v. County of Sac, 94 U.S. 351 (1876).
two doctrines, the Tax Court seems to prefer the former term for routine purposes of communication. Res judicata, of course, would hardly ever really occur in a federal tax setting, because of the theory that each tax year involves a separate cause of action; and identity of cause of action is a hallmark of the doctrine. But aside from the general disutility of imprecision, this usage would seem to do no particular harm, unless the Tax Court’s use of the term outside its correct meaning should have the effect of inducing the Court to shift its most respectful attention from a tax cause of action to a necessarily different cause of action in the state courts.

Where the state decision intervenes between two federal tax causes of action involving the same parties, might the state decision not have more compulsive effect if it is considered in the context of res judicata rather than in that of collateral estoppel? It hardly seems possible that it could, because either term would be used in this situation to refer to the prior federal decision, not to the intervening state decision. In fact, it is to be supposed that the res judicata concept in this situation would be less favorable to the state decision than would the technically correct doctrine of collateral estoppel, because the latter when applied to a prior federal tax case, as we shall see, limits conclusiveness for that case to situations where there has been neither doctrinal change or change in the relationship of the parties to the tax-relevant transaction. Res judicata if applied as such would not be so accommodating.

One would derive greater comfort from the above exercise if the tendency of the Tax Court to speak of res judicata and of the binding effect of the state characterization in almost the same judicial breath were not as pronounced as it is. The closeness of the utterances tends to encourage the thought that the state decision is res judicata in federal tax litigation.

2. Collateral estoppel by judgment

As between two federal tax causes of action involving the same parties and essentially the same basic tax-relevant transaction, the Supreme Court has given quite definite guidance. Collateral estoppel is recognized. Here again, even though the res judicata requirement of identity of causes of action does not exist, an intervening state decision cannot itself be the basis of a bar. Rather, as we saw, the intervening state decision correctly viewed would at most preclude conclusiveness being given to the prior federal decision.

42 As in the Flexible Coupling case, 329 U.S. 810, 813 (1946).
It is interesting to note, however, that there is one possibility of the state decision bearing on the tax-relevant transaction itself working a collateral estoppel: i.e., if the Commissioner should come into the state proceeding. He has declared against joinder to the possible prejudice of collecting the tax.\footnote{Mim. 6134, April 14, 1947.} He has, on the other hand, sought to prevent the use against him in a federal controversy of a state decision to which he was not a party by pleading in federal tax litigation that he had no opportunity to contest the tax-relevant issue in the state proceeding. He has found sympathy in the literature,\footnote{Especially in Cardozo, \textit{Federal Taxes and the Radiating Potencies of Tax Court Decisions}, 51 \textit{Yale L.J.} 783 (1942).} but not much in the Tax Court.\footnote{As to this the decisions giving compulsive effect in one way or another to an intervening state court declaration of legal relationships are \textit{res ipso loquitur}; and cf. the observation of the Tax Court in Estate of Butler, 18 T.C. 914, 922 (1952) in rejecting the Commissioner's contention that he could assert a state limitation on the amount of bequests to charity: “The effect of the respondent's argument is to make the Commissioner of Internal Revenue a proper party plaintiff to sue for violations under Section 17 of the Decedent Estate Law of New York. Of course, this is impossible. The statute fails to include the Commissioner among those enumerated as beneficiaries of its provisions.”} Collateral estoppel is particularly important to our study of the effect of state decisions on federal taxation for reasons that the \textit{Flexible Coupling} case\footnote{See text at note 32 supra.} suggests. Broadly speaking, thanks to the \textit{Sunnen} case,\footnote{333 U.S. 591 (1948).} collateral estoppel by the prior tax judgment has a fairly limited scope since it is restricted to situations where the tax-relevant transaction remains “identical in all respects.”\footnote{In the \textit{Sunnen} case, \textit{id.} at 602, the Supreme Court appears to be going even farther. Identical contracts are sufficiently different to prevent collateral estoppel from applying; the \textit{Tait} case, 289 U.S. 620 (1933), was differentiated, because there “the two proceedings involved the same instruments and the same surrounding facts.”} Further, there is the teaching that an “intervening doctrinal change” includes an intervening state decision.\footnote{The indirect deference to the intervening state decision antedates deference to intervening doctrinal changes in federal tax law, as the \textit{Blair} case, 300 U.S. 5 (1937), was decided before \textit{Sunnen}. The latter case, however, formalized the doctrinal change rule, and the lower federal courts have since continued to pay their respects to the state decision on the authority of the \textit{Sunnen} case, as well as the \textit{Blair} case. As will be shown later herein, the \textit{Sunnen} decision was hailed and is still respected in many quarters for liberating federal tax practice from the iron hand of the prior tax decision on a single transaction having recurring tax consequences. Whether intervening doctrinal changes from state decisions should continue to have similar respect does not appear to be the subject of frequent discussion.} There is a confusing and perhaps significant ambivalence about this rule as applied to the state decision. The doctrine of true res judicata, if it applied in favor of the prior federal decision, would be impervious to change in legal doctrine, for it is of the
essence of the doctrine that the judgment becomes "the law of the case," regardless of what stare decisis might command for the precedent of the case. Outside the federal tax field the concept of collateral estoppel seems to include a similar imperviousness for the law of the first case, only changes going to the continuation of the transaction having the effect of making the first decision inapplicable. But the federal tax cases establish that the intervening state decision keeps the first federal tax decision from being binding. Does this mean that the federal tax rule as to the effect of the prior law's continued applicability to the transaction is a different rule about collateral estoppel, or does the state decision just come in to show that the transactions are not the same? If state law were confined to the latter situation, then federal tax collateral estoppel would be like general collateral estoppel, the state decision would merely differentiate the transactional bases of the federal decision, not supplant it, and "The Law" of federal tax liability would remain entirely a federal matter. The separate statements about (i) changed circumstances and (ii) intervening doctrinal change in the *Sunnen* and other cases, however, preclude any such supposition. Thus the state decision declaring the tax-relevant relationship comes in, not only to eliminate the prior federal decision but to take its place in compulsive effect. This occurs not only for the "pure law" involved, but also at least for the ultimate facts upon which that decision is based. In the *Flexible Coupling* case the process was carried so far that the Supreme Court of Pennsylvania, one judge dissenting, effectively determined federal tax liability, including even questions as to the real or sham nature of the modified arrangement.

Ambivalence as to whether the state decision is "law" may be suggested sometimes by the way the Tax Court report of the tax case refers to the state decision. At times the state decision is "found" by the Court in the

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52 I am indebted to Professor Albert A. Ehrenzweig for the suggestion that historically questions of law were compulsive in a second proceeding only if both proceedings involved the same cause of action, i.e., "real" res judicata. A later fusion of res judicata and estoppel by judgment extended conclusiveness on questions of pure law to different causes of action involving the same parties. Professor Scott, 56 Harv. L. Rev. 1, 7-10 (1942), evidently reflects the fused view when he speaks of a second cause of action involving the same parties and basic transaction as being bound by the first case on questions of law, as well as on questions of fact, though in a more limited way. At the time Scott wrote, the federal tax cases seemed to indicate that as between a particular taxpayer and the government a tax ruling based on a particular economic transaction would be forever conclusive. Since then the *Sunnen* case was decided. Hence a tax version of collateral estoppel, sans conclusiveness as to the law of the earlier federal tax case, in the event of intervening doctrinal change, is referred to in the text at this point.

53 Giving the state court conclusiveness on the real or sham nature of the arrangement may well turn out to be the fiscal stress that breaks the present pattern; cf. Rice, *Judicial Techniques in Combating Tax Avoidance*, 51 Mich. L. Rev. 1021 (1953).
Findings of Fact. At other times the state decision appears in the Opinion without the formality of a prior Finding.

3. Stare Decisis

Just as institutional attitudes about res judicata and collateral estoppel tend to make the state court a part of the federal-tax-liability-deciding mechanism, so do they militate against the single or specific state decision having compulsive effect as a tax precedent in other tax cases involving other taxpayers in similar circumstances. In the first place, the compulsive effect of the past adjudications depends on either (a) the accumulation of many individual pieces of authority or (b) a single very high authority. The lower state court decision on a particular relationship does not, with reference to federal tax cases, meet either requirement; the highest State court decision may be found not applicable to the present facts.

The theory of precedent, of course, may have a different role to play when we come to it in connection with “The Law of the State,” as distinguished from “The State Decision.” Within the federal structure, moreover, as a part of federal stare decisis it furnishes the compulsion to give compulsive effect to state decisions. This is a pressure of a different order, however, being subject to the techniques of differentiation, disregard, and repudiation, just as are other precedents throughout the system.

It is to be noted that if “res judicata” for one federal tax decision in another federal tax case were nothing more than stare decisis in so far as questions of law were concerned, the intervening state decision might not enjoy de facto as much conclusive effect as it appears to have. That is to say, from the stare decisis approach the emphasis all the way along would have been on federal tax law doctrinal change, vel non, rather than upon a doctrinal change controlling the legal relationship involved in taxation, i.e., upon the sort of “doctrinal change” specifically involved in the Sunnen case.

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54 In Estate of Preston, 14 T.C. 1391, 1396 (1950) the Tax Court stated in its opinion that it was bound by state law and added: "... Therefore in the Findings of Fact, facts have been found with respect to the decisions in the litigation [state] which has involved the trust in question." Cf. the observation in Gillette v. Commissioner, 182 F.2d 1010 (9th Cir. 1950) that the Tax Court should conform to 28 U.S.C. Rule 32a (1946), finding the facts specially and stating separately its conclusions of law.

55 This may occur more frequently where the Tax Court is of the opinion that the inferior state court has erred in declaring the state law, cf. Estate of Carey, 9 T.C. 1047 (1947), or where the Tax Court must venture into an application of the state general jurisprudence, there having been no prior specific state adjudication on the relationship relevant to the tax cause of action, Estate of Clove, 17 T.C. 1467 (1952); Estate of Paul, 16 T.C. 743 (1951).

56 State decisions are not federal tax precedents, and state courts do not review inferior federal courts in federal tax cases. The compulsive effect of stare decisis is fundamentally hierarchical. In this situation the hierarchy does not exist, unless, of course, Professor Crosskey, supra note 14, is right and is followed.
(intervening federal tax decisions) rather than the sort involved in the earlier *Blair* case\textsuperscript{67} (intervening state property decision).

4. **Full Faith and Credit**

The doctrine has been specifically rejected in a leading Supreme Court case\textsuperscript{68} involving the effect of state decisions on federal taxation; and it is therefore not surprising, especially in view of the availability of other approaches, that it has been virtually ignored as a possibility since. Even if it were to be used, its outer limits would certainly be no greater than those of res judicata in its strict sense, of which the constitutional doctrine and its statutory analogue\textsuperscript{59} are variants.

5. **Posing of a Further Problem**

In an earlier cycle of preoccupation with the state law problem, Professor Griswold, writing of the effect of the intervening state decision, observed:\textsuperscript{60}

...[T]he problem of the effect of state law on federal tax questions ... is a very elusive topic, the analysis of which does not seem yet to have been completed ....

One reason for the continued validity of both the complaint and the challenge is illustrated by a paragraph of history regarding the “doctrinal change” rule, which underlies so much within this sub-topic.

Prior to the decision in the *Sunnen* case it was feared by some,\textsuperscript{61} including the American Bar Association’s Committee on Federal Taxation,\textsuperscript{62} that the earlier federal tax case would be too binding, too insensitive to errors of tax law and to delicate variations in the facts ... in a word, too mechanistic, regardless of who won or lost, or how they played the game. Hence the *Sunnen* case was hailed as a “signal service to all tax practitioners, whether they represent the Government or the taxpayer.”\textsuperscript{63} As indicated, however, both cases\textsuperscript{64} and analysis show that the down-grading of the earlier federal tax precedent has been accompanied by the up-grading of the specific state decision. In context, moreover, it has been seen that taxpayer-controlled variations in the basic tax-relevant transaction contribute to blocking the earlier federal tax decision from the play, thus leaving a

\textsuperscript{67} 300 U.S. 5 (1937).
\textsuperscript{68} Freuler v. Helvering, 291 U.S. 35 (1933).
\textsuperscript{59} Applicable in general to the judgments of state and territorial courts, Davis v. Davis, 305 U.S. 32 (1938); 28 U.S.C. § 1738 (1946).
\textsuperscript{63} Sellin, *supra* note 61, at 371.
\textsuperscript{64} This reflects a net impact of a number of cases, but see text at notes 44-59 *supra*. 
clearer field for the state decision to run where the Commissioner cannot or will not scrimmage.

It is submitted that as to “How” and “How Far,” this development marks the possibility of very effective and very large intrusions into federal taxation from ad hoc state decisions, unless in Section III we find adequate counter-measures for the procedural disqualification or minimization of state adjudications in certain situations. The development also poses sharply, but only partially suggests the answer to, the “Why” of state law’s compulsive effect.

**B. Theories of Compulsive Effect Related to “The Law” of the State**

*Illustrative Case: Commissioner v. Goodan*

The issue was the taxability to the settlors of income added to corpus and arising from taxable stock dividends on corporate shares in companies controlled by the settlors. These settlors had transferred their interests in the corporations to a trustee on trust for themselves for life, then to their respective spouses for life, remainder to their issue, and failing issue to their heirs at law. The trust instrument provided for dividend stock to go to corpus, but the Commissioner asserted a deficiency against the settlors for it. In its first opinion in the case the Tax Court notes that the petitioners relied upon *Bixby v. California Trust Company* in the state intermediate appellate court as controlling in their favor on the question whether any trust really existed. The Commissioner relied on the same state case as authority for his position that no trust existed. The *Bixby* case, of course, involved other parties and no tax cause of action. The Tax Court opinion discussed the California law of trusts and of remainders to one’s heirs extensively and eventually agreed with the taxpayers’ theory of the state decision.

Thereafter, prior to appellate action in the tax case, the Supreme Court of California reversed the intermediate court in the *Bixby* case. Thereupon, the Tax Court vacated its former opinion, examined the newly declared jurisprudence of California, and concluded that the California high court reversal of the *Bixby* case was distinguishable from the situation at bar in the *Goodan* case, thus restoring its judgment in favor of the taxpayer.

In a *per curiam* opinion the Ninth Circuit agreed with the Tax Court, but one judge dissented very strongly, taking the position that the local precedents should at most have been used by the Tax Court only to

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65 195 F.2d 498 (9th Cir. 1952).
66 12 T.C. 817 (1949).
68 33 C.2d 495, 207 P.2d 1018 (1949).
69 195 F.2d 498 (9th Cir. 1952).
“bolster” its decision, and then only if either (a) there had been a specific state court construction of the trust instrument involved in the tax case or (b) the particular relationship was something as well-established in local law as a partnership or a marital community would be. Further, the dissenting judge expressed the view that in his opinion the instrument, as a matter of interpretation, created no trust, seemingly because of the general rule that legal and equitable title must be effectively separated for a trust to exist.

For the discussion to follow we note:

a. The tremendous effect a state precedent had in a situation where, under I.R.C. § 22(a), Supplement E, and the judicial gloss in Clifford, Horst, et al., federal rules alone would have favored taxability.

b. That the reasons why, and the procedure under which state law came into the case were not mentioned at all, either by the Tax Court or the majority of the Circuit Court. The effect of state law seems to have been taken for granted.

c. A vigorous federal judicial reaction (in the dissent) against any important role for state law.

d. This reaction, however, was expressed principally in terms indicating that the judge regarded the transaction not to have created a trust, because in violation of a most fundamental and generally accepted requirement for the existence of a trust, separation of legal and equitable title.

We now take up the main possibilities for explaining the effect of a body of state law on federal taxation. These are:

1. *Erie v. Tompkins*?

   It has been suggested by *obiter*, judicial and otherwise, that the doctrine of *Erie v. Tompkins* might carry so far beyond its application in diversity of citizenship cases as to explain the compulsive effect of state general law in federal tax cases. It is difficult to form an estimate as to the validity of this suggested clue to federal judicial action, because the basic Supreme Court decisions upon which state law’s effect are grounded were decided before *Erie*. Thus the federal tax cases in the area cannot be said really to pivot on the *Erie* decision. Although the outer limits of the *Erie* doctrine remain unclear, especially as between substantive and proce-

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70 See the quotation from the Third Circuit’s first opinion in the *Thomas Flexible Coupling* case, at text at note 33 *supra*.
71 *RABKIN AND JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION* § 71.08(3) (1951).
72 304 U.S. 64 (1938).
73 They are discussed in the text at footnotes 91–117 *infra*.
dural matters, it would not seem that this glorification of "the unwritten law of the state as declared by its highest court" would carry over to the completely different value-situation involved in federal taxation. A test would be available, perhaps, if we could find a federal court in a rather recent (post-<italic>Erie</italic>) tax case giving effect to state jurisprudence of relative novelty or of statutory uniqueness regarding a particular tax-relevant legal relationship, where most American taxpayers in the more commonly accepted "majority rule" jurisdictions would be subject to a tax the residents of the particular state did not have to bear. To pose the question thus is to expose a major flaw in <italic>Erie</italic> as a basis for compulsive effect in tax cases: <italic>Erie</italic> tends to create dis-uniformity in "the law" applied in the federal courts. Its toleration is so broad as to permit in operation the federal court application of even radically deviant state law. These effects, if permitted in federal tax cases, contradict the ideal of geographic uniformity in federal taxation. Deviant state law, it is suggested in greater detail elsewhere, has not fared well as to compulsive effect, except in so far as it has in the not-too-recent past appealed to "due process" and whatever other values governed when the older community property cases were decided.


The interstitial nature of federal law, generally recognized by the Supreme Court as being based on the technical inability in specific statutory treatment of a federal question to define the content of all the legal terms and concepts involved, has been recognized with respect to even so comprehensive a body of legislative and administrative codification as that represented by the I.R.C. and the Regulations. While Justice Brandeis' statement in <italic>Erie v. Tompkins</italic> that there was no federal common law has not stood uncontradicted by later opinions coming from the Supreme Court, there is still, even in the tax field (as distinguished from some others, such

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76 In other areas of federal interest the same doubts about the admission of deviant state law under the aegis of <italic>Erie</italic> also arise; <i>seemle</i> Clearfield Trust Co. v. U.S., 318 U.S. 363 (1943), where Douglas, J. wrote (at 367):

In our choice of the applicable federal rule we have occasionally selected state law . . . . But reasons which may make state law at times the appropriate federal rule are singularly inappropriate here. [Where the rights of the United States against the guarantor of a forged endorsement on a Government check were involved.] <i>Cf. Comment, 53 Col. L. Rev. 991 (1953)</i>.

77 The phrase is that of Hart and Wechsler, <i>op. cit. supra</i> note 3. See also Cahn, <i>op. cit. supra</i> note 17, b. at 815.


80 304 U.S. 64, 78 (1938), with which compare Hinderlider v. La Plata Co., 304 U.S. 92, 110 (1938).
as the "federal law merchant") very little that could be called a federal common-law-of-property-for-tax-purposes-only. Yet it is precisely in the field of property law, broadly defined to include the basic temporal-quantitative concept of estates, the various "Rules of Property," and the essentials of trusts and future interests, that dis-uniform or deviant state jurisprudence is at a minimum.

It is not surprising, then, that the tax cases so frequently find tax-relevant legal relationships to exist without giving us any clear indication of how the judges got the law. Sometimes a species of judicial notice can be identified. Under Professor Morris' rule of thumb, moreover, we can be relatively sure that in cases of greater judicial uncertainty "The Law" comes in as law: i.e., on the basis of book research and argument, rather than on proof. The implication as to compulsive effect of state general law, then, is that the pressure is institutional-intellectual, for the issue is accepted as one for the legal scientist-scholar to decide, not the menial trier of fact to find.

This analysis suggests, also, the fate of startlingly or unusually deviant state law. In the first place, it is not as susceptible to judicial notice; so it must be proved to the court, rather like foreign law. Secondly, it offends by contradicting "The Law." Thirdly, it invokes the fear of dis-uniformity in the tax structure. How a federal court in a tax case deals with the deviant state law is instructive: what it usually does is to cite the "uniformity" line of cases or find something in the taxing statute to free it from the effect of the state decision.

It should not be assumed, however, that the variant law is always easily to be identified. As decisions and statutes proliferate in this country, it is to be expected that the capacity of a federal court in a tax case, especially a court specializing in tax matters, to discriminate between the orthodox and the deviant, between the "majority rule" and the "better rule," and so on, might sometimes be overtaxed, with the result that the institutional guidelines, either for or against compulsive effect, fail.

3. Summary and analogy

The incompleteness of the federal law-system, even in fields so well-furrowed as those of Internal Revenue, and the existence of a general American common law system which makes pretensions to relative com-


83 The two lines of Supreme Court cases dealing with state law in federal tax cases are discussed in text at notes 91-117 infra.

84 As illustrative of the difficulties involved in a federal court's finding state law without a specific state decision, see Pearce v. Commissioner, 315 U.S. 543 (1942).
pleteness, establish conditions under which the institutional techniques and knowledge of the lawmen who sit as judges in federal tax cases compel them, to a marked degree, to borrow color and content for the skeletal federal tax norms from the general system. It is thus seen that the problem is very similar to that which exists at other points of contact between the central and the state power-structures. It is somewhat surprising, recalling the alarums and the fanfare that have accompanied the judicial, and occasionally the legislative, repairing of the federal tax dikes against particular state law break-throughs, that so much complacency seems to exist as to many other areas of undisputed fiscal significance which remain continually inundated by common law characterizations for tax purposes.

C. Theories Generally Applicable to Both Types of State "Law"

1. The Command of the Taxing Statute

Illustrative Case: Republic Oil Refining Company v. Granger.

The previous examples involved the Tax Court as the federal tax court of first instance. By contrast the Republic Oil case shows how federal law may come into a tax case that begins "nearer to home," as it were, in one

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85 As, for instance, the problem involved in Reconstruction Finance Corp. v. Beaver County, 328 U.S. 204 (1946). It is interesting to compare the attitude of the Supreme Court in this case (involving the question whether certain machinery owned by an R.F.C. subsidiary had become under the local law of fixtures "real property" within a federal statute permitting state taxation of that type of holding by the R.F.C. and its subsidiaries) with that of the federal district court in the Republic Oil Refining Company case, 198 F.2d 161 (3d Cir. 1952).

86 Cf. Oliver, op. cit. supra note 2, at 532.

87 The decade-long sound and fury regarding the estate taxation of powers of appointment, beginning with the Griswold-Leach controversy and not quite ending with the 1951 enactment of what is currently Int. Rev. Code § 811(f) (2) is, perhaps, the best single example. Currently there appears to be mild executive and some scholarly preoccupation with the tax-free shift from life tenant (other than the grantor) to remainderman. It has not, however, reached the levels of legislative or judicial activity; cf. Warren and Surrey, Federal Estate and Gift Taxation 429-432 (1952).

88 The areas are numerous and several of them are large, cf. Oliver, op. cit. supra note 3. In an article on trade regulation, read some years ago and not readily to be found now for exact citation, a stanza was quoted that, without being appropriate here in any moralizing vein, does suggest the possibility that the numerous (but ignored) invasions of federal taxation by state law may in the aggregate mean more loss of revenue than that involved in the specific situations which, over the years, fiscal architects in the Treasury and in the law schools have fretted, argued and acted about. The stanza goes something like this:

The silent pirates of the shore
Steal and plunder more
Than any roving red ranger
Who steals his farthings hot from danger.

It is believed there is a good deal of truth in this for tax purposes, today. Cf. note 6 supra.

89 198 F.2d 161 (3d Cir. 1952). Others could as well have been chosen. See U.S. v. Anders Contracting Co., 111 F. Supp. 700 (D.S. Car. 1953); Graves, Inc. v. Commissioner, 202 F.2d 286 (5th Cir. 1953).
of the district courts. The case involved the question whether transportation through a pipeline underlying taxpayer's easement was "transportation within the premises of a refinery," exempt from the federal tax on transport of oil by pipeline. The Circuit Court, speaking of the opinion below, said:90

"... the district court gave decisive force to the property law of the situs, Texas, reasoning that an easement appurtenant deemed a part of the refinery premises by and for the purposes of local property law should for that reason also be deemed a part of 'the premises of a refinery' as that phrase is used in the federal taxing statute."

A majority of the Circuit Court said the state property law was a "relevant" but not "controlling" factor, but affirmed the district judge on the ground that the scope of review was as if on a question of fact. The dissenting Circuit judge objected to affirmance under circumstances where the trial judge had erred as to a conclusion of tax law (e.g., an easement is "within the premises").

An unadorned little case like this suggests:

a. That as a matter of the ordinary routine of federal district court tax work local law may come in without much ado to determine federal tax liability where a normal characterization in property law is not specifically contradicted in the tax statute.

b. A problem of procedure and proof: is the state law a question of fact or of law in a federal tax case, (i) as to initial presentation at the trial level, (ii) on review?

Where the Congress has expressly provided for a reference to state law91 there is, of course, no particular problem as to the compulsive effect to be given to that law, although there will remain problems as to how and where the state law is to be found92 and as to what, if anything, is to be done about deliberate post-reference shaping of state legislation with that federal invitation in contemplation.93

The Internal Revenue Code, however, usually does not specify precisely where and to what extent the incidence of federal taxation is to be governed by state law. Hence for most situations the question becomes one of

90 198 F.2d 161, 163 (3d Cir. 1952).
91 As in Int. Rev. Code § 812(b).
92 The state law of the disclaimer or renunciation of an otherwise taxable power of appointment, for instance, would appear in most states to present difficult questions as to just what "The Law" is, cf. Note, 63 HARV. L. REV. 1047 (1950).
93 What will the federal courts do under Int. Rev. Code § 811(f)(2), for example, if a state legislature provides that any power of appointment may be renounced or disclaimed by the donee thereof at any time prior to exercise in his favor, by deed or will; provided, further, that a non-exercised power shall be deemed to have been disclaimed or to have been renounced, rather than to have lapsed or been released?
what intent the courts will ascribe to the Congress where there is nothing specific in the taxing statute. There is a line of cases, of which "Burnet v. Harmel" and "Lyeth v. Hoey" are the most frequently cited, that stresses the concept of command from the taxing statute as the main or sole source of compulsive effect for state law in federal tax cases. But there exists also another series of decisions, beginning at least with "Uterhart v. U.S." and through "Blair" to the current decisions, where the command of the taxing statute is not emphasized and, indeed, where the reason for giving compulsive effect to state law is not stated, or if specified, is explained in terms of one or more of the theories previously examined. The two lines of cases intersect in Freuler v. Helvering, which specifically rejected res judicata and full faith and credit for the state decision itself as bases for the weight to be given to state law, but did find in the wording of the Revenue Act a command to follow a California inferior court's order affecting distributable income from an estate.

In Blair, decided three years later, we see the lines diverging again; Freuler is there cited as "compare" for the proposition that.

The supervening decision of the state court cannot justly be ignored in the present proceeding so far as it is found that the local law is determinative of any material point in controversy.

The Court went on to say that the question of the validity of certain assignments was a question of local law, citing the "Uterhart" case, Poe v. Seaborn and Freuler. Since then Freuler and Blair have been the twin supports of many cases upholding the application of local law, where the opinions reveal no specific judicial exercise in determining Congressional intention in the premises. Good examples are Helvering v. Estate of Rhodes in both the Circuit Court and Board of Tax Appeals versions and the Supreme Court "per curiam" reversal of Sharp v. Commissioner. The decision giving compulsive effect to state law relied in part on the "Uterhart" case, 240 U.S. 398 (1916), and on the older bankruptcy case of Spindle v. Shreve, 111 U.S. 542 (1884), which, in turn, relied on Nichols v. Levy, 5 Wall. 433 (U.S. 1866) holding that state law determination of property available for debts would be controlling.

\[94\] 287 U.S. 103 (1932).
\[95\] 305 U.S. 188 (1938).
\[96\] 240 U.S. 598, 603 (1916).
\[97\] 300 U.S. 5 (1937). The decision giving compulsive effect to state law relied in part on the "Uterhart" case, 240 U.S. 398 (1916), and on the older bankruptcy case of Spindle v. Shreve, 111 U.S. 542 (1884), which, in turn, relied on Nichols v. Levy, 5 Wall. 433 (U.S. 1866) holding that state law determination of property available for debts would be controlling.
\[98\] 291 U.S. 35 (1933).
\[100\] 282 U.S. 101 (1930). This is the leading case in the series establishing the earlier due process immunity for community property; see Oliver, op. cit. supra note 5, at 536, 547-551.
\[102\] Rhodes, 41 B.T.A. 62 (1940).
\[103\] 303 U.S. 624 (1934). The Circuit Court, 91 F.2d 802 (3d Cir. 1937), had held that it must follow the Findings of Fact made by the Board of Tax Appeals. These were to the effect that the decedent had not purchased certain assets to add to an intervivos trust he had pre-
The lines entwine again briefly in *Helvering v. Stuart*, where for once the *Burnet v. Harmel-Lyeth v. Hoey* series of cases is cited without it following from the citation that the taxpayer's state-declared legal relationships could not stand against national tax uniformity.

The *Stuart* case is also significant for the manner in which it expressed the second, or "necessary implication" segment of the command-of-the-taxing-statute theory:

... When Congress fixes a tax on the possibility of the revesting of property or the distribution of income, the "necessary implication", we think, is that the possibility is to be determined by the state law.

The authorities cited in support were *Blair, Freuler* and the due process line of cases.

This analysis seems to show that the command of the taxing statute is certainly not a "sovereign talisman." It is a major theme, sometimes; but other *motifs* may at other times sound more dominantly. Thus it must be admitted that its utility as a predictor is perhaps only slightly greater than that of some others. From the functional standpoint, however, it does serve as a preliminary classifier of the areas in which state law may be expected to have more, rather than less, effect. In this way it has been helpful in connection with another study.

2. *Substantive Due Process of Law*

When the earlier cases, such as *Blair* and *Freuler* were decided, substantive due process was very much alive in the tax field. Decisions rendered in that era have become the precedents for today's compulsive effect for state law. Despite the several services read over its grave, might not

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104 317 U.S. 154 (1942).
105 See text at note 28 *supra*.
107 See text at notes 109-117 *infra*.
109 Oliver, *op. cit. supra* note 3. Sometimes the judicial process is seen to be working fairly clearly from the value judgment on opening or closing a tax area to state law back to a formal statement on the relevance of that law. Thus the nature of a realization from the sale of a growing crop with the fee has recently invoked brief Supreme Court generalities on the state law problem, Watson v. Commissioner, 345 U.S. 544 (1953) in both majority and dissenting opinions, which are to be compared. See, also, Haley v. Commissioner, 203 F.2d 815 (5th Cir. 1953), where the "niceties of the conveyancer's art" formula is used to dismiss state law in another "closed" area: the characterization of a joint venture for income tax purposes.
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a ghostly emanation of substantive due process linger in this area? Is there
an institutional subconscious recollection of cases such as the one saying
that due process would forbid taxing A's income to B?\textsuperscript{111}

Although recently in a not too far removed area there was a rattling of
chains,\textsuperscript{112} and the ghost may yet walk, certainly the past decade has gener-
ally borne out Professor Magill's prediction\textsuperscript{113} that in matters of federal
taxation the due process appeal would have to be made to the legislature,
not to the courts. Even though the appeal to due process in tax litigation
is not one that, until the recent development mentioned above,\textsuperscript{114} a tax ad-
vocate would have had any great hopes for in the period since \textit{Hallock},
state law has kept on coming in. Is it not likely under the circumstances
that when due process was supposedly buried it really went underground
in a different sense?

It is suggested that if an appeal is cast today so as to present a disregard
of state law bearing on tax liability in such a way as to invoke a "Sense of
Injustice"\textsuperscript{115} the range of values that were once labeled "due process" will
be apt to be inarticulated but motivating factors expressed through a stated
judicial attitude toward one or more of the theories as to compulsive effect
which have been examined. Perhaps George Kennan's\textsuperscript{116} concept of the
function of law in the international community\textsuperscript{117} explains due process here:

\ldots [an] unobtrusive, almost feminine, function of the gentle civilizer \ldots .

If there is a due process element in the state-federal tax compound, it
is one that for some time has not been detectable by the legal litmus paper
customarily used. The legal hunch sniffs it out, but it defies quantitative
analysis.

III. COMPULSIVE EFFECT IN ACTION: AN EXAMINATION OF THE
PROCEDURAL ASPECT

Complaints voiced as early as 1937 against "the nebulous rules govern-
ing the effect of state law on federal tax question"\textsuperscript{118} remain, in general,

\textsuperscript{111} Hoepner v. Tax Comm. of Wisconsin, 284 U.S. 207 (1931).
\textsuperscript{112} Commissioner v. Clark, 202 F.2d 94 (7th Cir. 1953).
\textsuperscript{113} Magill, supra note 110.
\textsuperscript{114} The due process cases bunched in the early thirties; the high-compulsive-effect cases,
sometimes overruling early thirty tendencies to disregard state law, grouped in the later thirties.
\textit{Freuler}, decided in 1933, is really a much narrower case for state law than is \textit{Blair}, decided in
1936, for \textit{Freuler} relied on the command of the taxing statute, to the exclusion of other theories
of compulsive effect; only later was it expanded to support a more amorphous position.
\textsuperscript{115} CAI N, THE SENSE OF INJUSTICE (1949).
\textsuperscript{116} KENNAN, AMERICAN DIPLOMACY 1900-1950, 53-4 (1951).
\textsuperscript{117} Cf. Oliver, Reflections on Two Recent Developments Affecting the Function of Law in
the International Community, 30 TEX. L. REV. 815, passim (1952); Lalive, Some Reflections
on Realism and Truth in International Politics, 22 NORDISK TIDSSKRIFT FOR INTERNATIONAL
RET. 67 (1952) passim.
\textsuperscript{118} Griswold, supra note 17 at 1345.
unsatisfied. The examination of a considerable number of federal tax cases involving the intervention of state "law" of either the broad or the narrow variety has not resulted in the discovery of a clearly expressed procedural principle governing the effect state law is to be allowed to have on a federal tax cause of action. Since the basic policy reasons for federal tax deference sometimes to state law have not been clearly articulated in the decisions, it would perhaps be expecting too much to have that deference described fully and adequately in procedural terms, for in our modern legal society procedure as such is seldom the shaper and the controller of either norms or value-judgments. However, an examination of the law-in-action from the procedural standpoint might, perhaps, light the enigma from another angle. In any event, the approach from procedure could be expected to have a bearing on the question posed earlier as to whether one type of state law is any more compulsive than another. This is because in general law within a single legal system the procedural effects of the individual decision and of the accumulated precedents differ.

A. The Procedural Effect of the State Decision

1. State decision not a plea in bar

We have seen\(^{119}\) that the state decision comes in to prevent a prior federal decision having the effect loosely termed "res judicata" by the federal courts in tax cases. The additional affirmative compulsive effect that the state decision may have, however, is not achieved through the mechanism of a plea in bar. The state decision does not slam down like a legal portcullis across the path of the tax cause of action; rather, it seems to have some less drastic, but frequently no less effective, consequences.

2. A specific state decision is ordinarily found as a fact

Under the applicable Rules\(^{120}\) it would seem that the Tax Court would be obliged to find the relevant specific state decision in the Findings of Fact, and frequently this is done.\(^{121}\) Tax Court practice regarding Findings of Fact, however, appears to be somewhat flexible\(^{122}\) in this, as in perhaps other situations.\(^{123}\) Techniques for the formal authentication of foreign judgments are not required to bring in the state decision.\(^{124}\)

\(^{119}\) See text at notes 32-55 supra.


\(^{121}\) See note 54 supra.

\(^{122}\) See note 55 supra.

\(^{123}\) Semble, Gillette v. Commissioner, 182 F.2d 1010 (9th Cir. 1950).

\(^{124}\) Compare Tonawanda Power Co., 3 B.T.A. 1195 (1926) (acquiesced) with Rowan, et al., 42 B.T.A. 493 (1940), aff'd, 120 F.2d 515 (5th Cir. 1941).
3. A state decision gives compulsive tax effect to the facts on which it is based

In *Estate of Rhodes* federal estate tax liability turned on whether the decedent owned a fee simple or a life estate. The decedent had been conveyed a fee by a deed absolute on its face, but in a subsequent state proceeding parol evidence was admitted to show that the decedent was intended to have only a life estate. In the Circuit Court the Commissioner argued that the state determination was of a "purely factual issue" and that with respect to such issues involved in state decisions no compulsive effect should be given in the tax case. He lost.

A writer who was of counsel for the Government in the *Rhodes* case has described the Commissioner's difficulties in situations of this sort, and suggested that the "issue of fact" involved in the state decision should be kept open for re-trial in the federal tax case through the instrumentality of the presumption of correctness. The rub is seen from the *Rhodes* case itself: what is fact, what is law? Even if the *Dobson* case be dead, completely so, and even if under Professor Morris' rule-of-thumb we could say that the issue was one thing or the other, a basic difficulty would remain.

The difficulty is that the whole state decision seems analytically to be an operative fact in the federal tax proceeding. Take the *Rhodes* case: the tax norm is made up of a condition (if the decedent had as grantee a property interest that survived her death) and a consequence (then under the Code she ought to be taxed on it). In Kelsenian analysis this condition is "conduct"; conduct is factual. So also it seems to be under the test of an earlier study of the state law-federal tax problem: "Was the legal relationship Congress specified for taxation involved in this case?" Professor Cahn's explanation that state law operates as the minor premise in a tax syllogism (the conclusion being the "ultimate fact" of tax liability, or not) points the same way.

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125 41 B.T.A. 62 (1940).
126 117 F.2d 509 (8th Cir. 1941) *seem*.
127 The Circuit Court held specifically, as against the Commissioner's contention, that the Board did not err in holding itself bound on issues of fact, as well as of law, covered by the state decree.
128 Cardozo, supra note 17.
129 That is to say, the Commissioner's presumption of correctness might be extended by Congress to stay in the federal tax case unless and until the taxpayer had come forward in that proceeding with actual evidence, rather than with a state decision about the facts.
132 The terminology at this point is Kelsenian; I prefer to take his norm concepts from the summary in *General Theory of Law and State* (1945), Index.
133 Oliver, supra note 5 at 550.
134 Cahn, supra note 17 at 816.
Thus, in analytical terms it is seen that the state decision as a whole is involved, without the possibility of effective differentiation between "law" and "fact" under any theory of compulsive effect that refers questions of specific legal characterization to judicial declarations outside the federal orbit. That is to say, the state decision, if compulsive at all, analytically is compulsive as to the factual elements upon which it is based. This means, then, that the Commissioner could be protected (short of appearance in the state proceeding) against manufactured or shaped facts, only by the development of principles authorizing the disregard of the whole state decision under certain conditions.

This problem does not exist, of course, regarding "The Law of the State." The danger from "The Law" is that of a basic incompatibility between the generally applicable basis chosen by the Congress for federal taxation and what "The Law" may say as to whether that characterization exists as to a particular taxpayer.

The suggestion that tax-relevant factual issues in state decisions be retried in the federal tax controversy has not appealed to the Congress, to which it was addressed about a decade ago, and judicial doctrine has not evolved so as to permit retrial to take place. We must, therefore, inquire as to the circumstances under which a state decision as a whole will be disqualified as to compulsive effect in a federal tax case, watching for inarticulate major premises, as well as for specific rules.

4. When is a state decision disqualified?

State decision not relevant. The state decision shares with "The Law" of the state vulnerability to intervening doctrinal change from both the federal legislature and the federal Supreme Court. Since both types of law share this risk, it will be deferred, beyond bare mention, to another heading covering procedural aspects common to both types of state law. It is for notation here, however, that if the state decision is to be the minor premise in the tax syllogism, its compulsiveness depends on what syllogism gets constructed. It is difficult to evaluate the frequency with which state decisions are neutralized by being found not in point. The recorded instances appear few and to arise under conditions where the state decisions intervene between two federal tax cases involving the same taxpayer but different taxes.135

Fraud or collusion. In keeping with precedents intimately tied up with

135 Cf. Rabkin and Johnson, Federal Income, Gift and Estate Taxation § 72.07 (3) (1951); Schnitzer, 13 T.C. 43 (1949). There are cases, however, which show that in some classic tax situations it is hard to find a cause of action to take into a state court, e.g., a family partnership under the federal tax tests, Schallcrv. Commissioner, 203 F.2d 100 (7th Cir. 1953), cert. denied, 345 U.S. 995 (1953). But see Marcus v. Commissioner, 201 F.2d 850 (5th Cir. 1953).
giving effect to foreign judgments, texts\textsuperscript{136} say, and sometimes federal courts seem effectively to agree,\textsuperscript{137} that a state proceeding deliberately staged for its ultimate federal tax effect will be disqualified. Yet the realities of the federal-state court institutional relationships are such that an inhibiting delicacy\textsuperscript{138} must be overcome by a federal court before impugning the integrity of the state proceeding. The policy question presented for federal-state judicial relationships is further complicated by customs and attitudes of a professional character. It is not surprising, therefore, that some fairly tax-pointed state proceedings have passed federal muster.\textsuperscript{139}

\textit{Proceeding not adversary.} A more diplomatic way of attempting to cope with the staged state decision would be to disqualify it for lack of a substantial conflict between the parties (not including, of course, the Commissioner). The text-book statement, again, is that a non-adversary state proceeding will not have compulsive effect;\textsuperscript{140} but pocket parts include cases that raise doubts. In \textit{Estate of Beachy}\textsuperscript{141} a state supreme court decision was allowed to control as against the contention that no real fight had been involved. In \textit{Estate of Paul}\textsuperscript{142} the vindication of the disqualifying principle was Pyrrhic, for the state decision was given effect as a correct application of the general law of the state, even if litigation had not been sufficiently hotly waged to qualify the state decision. There is a line of cases to the effect that an appeal makes an adversary proceeding of what had not been such in the court of first instance.\textsuperscript{143} Finally, there are cases excepting probate proceedings from the supposed ban of non-adversary state court action, on the ground of their \textit{in rem} nature.\textsuperscript{144} Even when this immunity for probate proceedings is doubted, federal courts have shown a tendency to give weight to the state decision, because of the binding effect it has upon the fiduciary involved.\textsuperscript{145}

\textit{Decision not authoritative enough.} Though sometimes assumed to exist, there is no rule that the highest court of a state must have spoken before the state decision will be heeded in a federal tax controversy. Thus, after a trial court's \textit{nisi} order had become final, that order precluded giving

\textsuperscript{136}RABKIN AND JOHNSON, \textit{supra} note 135, \S 71.08(5).
\textsuperscript{137}Saulsbury v. U.S., 199 F.2d 578 (5th Cir. 1952).
\textsuperscript{138}Note the careful isolation of the state tribunal from the charge in the case just cited.
\textsuperscript{139}\textit{Cf. Thomas Flexible Coupling Co.}, discussed in text at notes 32-40; \textit{Blair}, 300 U.S. 5 (1937).
\textsuperscript{140}RABKIN AND JOHNSON, \textit{op. cit. supra} note 135-6.
\textsuperscript{141}15 T.C. 136 (1950).
\textsuperscript{142}16 T.C. 743 (1951).
\textsuperscript{143}Kelly Trust et al. v. Commissioner, 168 F.2d 198 (2d Cir. 1948); others collected in the cumulative supplement to RABKIN AND JOHNSON, \textit{op. cit. supra} note 135, \S 71.08(3).
\textsuperscript{144}Such as Henricksen v. Baker-Boyer Nat. Bank, 139 F.2d 877 (9th Cir. 1944); Goodwin's Estate v. Commissioner, 201 F.2d 576 (6th Cir. 1953); Estate of Vose, 20 T.C. No. 81 (1953); but see \textit{Saulsbury}, 199 F.2d 578 (5th Cir. 1952).
\textsuperscript{145}Channing v. Hassett, 200 F.2d 514 (1st Cir. 1952).
"res judicata" effect to a previous Tax Court opinion involving the same trust. The state order must be a final one, of course.

Resting his case at a lower judicial echelon in the state does, however, subject the taxpayer to the danger that the federal court might be tempted to disagree with the application of "The Law" to the situation. There are instances where the Tax Court has done this. Cases exist which hint that deliberately planned resorts to state law to control federal tax liability are usually carried, for safety's sake, beyond the state trial court level. Appeal not only increases federal court respect for the specific declaration of state law; but it also, as noted, seems to immunize it against the charge that it is non-adversary.

B. The Procedural Effect of the Law of the State

1. In general

"The Law" could not, of course, be thought of as having the plea-in-bar effect that a state decision might in one way or another be accorded. Likewise, "The Law" is vulnerable (a) to being found not to govern and (b) to a change in federal tax doctrine under the Sunnen rationale. "The Law" is hardly susceptible of being disqualified on the grounds of fraud or collusion, although the Supreme Court may not have been far away from this in connection with an ersatz community property system. Some of the temptations Congress has set before the state legislatures may eventually strain the present niceties.

"The Law" does not depend for compulsive effect upon specific decisions, but outside the area of judicial notice, the federal courts are not prone to engage in lengthy inquiry into what the state law is, preferring to take it from fairly current decisions of the highest court of the state concerned.

2. "The Law" cannot control the tax-facts

There are observable differences in treatment between "The Law" and a state decision with respect to the facts upon which tax liability might turn. Previous discussion has indicated what they are. It is necessary here to stress that only where the tax question is very clean-cut and dependent on a clear relationship will "The Law" have as much effect in practical

146 Estate of Balzerelt, 46 B.T.A. 959 (1942). In the situation of estates in administration and trusts still under judicial control, finality would not require complete disposition of the case, Commissioner v. Crawford's Estate, 139 F.2d 616 (3d Cir. 1943), but only a final order.
147 See, for example, Estate of Carey, 9 T.C. 1047 (1947).
149 Note 94 supra, suggests an area where this might happen.
150 Contrast the majority per curiam opinion with the lengthy dissent in Commissioner v. Goodan, 195 F.2d 498 (9th Cir. 1952). The Tax Court has stated that it will work from "all available data" to find the state law; but recall the attitude revealed by the Supreme Court in the Church and Spiegel cases, note 27 supra.
151 See text at notes 50, 120-134 supra.
operation as will the *ad hoc* state decision, even though analytically both types of state law are minor premises in the federal tax syllogism.\textsuperscript{152} This is why it has been found better to concretize "The Law" into a specific state decision where the local rules are sought to be relied on to prevent federal tax liability.

**C. Both Types of State Law and "Burden of Proof"

It has been suggested, though without citation of authority:\textsuperscript{153}

"... Where a state court has not passed on the question of ownership in the particular case and the Government contends that the decedent had an interest in property at the time of his death, the taxpayer must overcome the presumption of correctness of the Government's contention."

The implication is that a state decision "will overcome" the presumption of correctness (whatever that latter may amount to independently of the Tax Court Rule\textsuperscript{154} on burden of proof), whereas "The Law" would not. This implication draws too fine a line between the two types of local law.

The state decision is not confined in effect, it is clear, to that which it might have in causing the presumption of correctness "to vanish."\textsuperscript{155} It has the additional effect of carrying the taxpayer's general burden of establishing that the Commissioner's assertion of a deficiency is erroneous.\textsuperscript{156}

\textsuperscript{152} Professor Cahn's term, see note 134 *supra*.

\textsuperscript{153} WARREN AND SURREY, FEDERAL ESTATE AND GIFT TAXATION 80 (1952).

\textsuperscript{154} Rule 32 states that the burden of proof is on the petitioner, meaning that he must introduce sufficient evidence to make a prima facie showing that the Commissioner has erred as alleged in the petition and to overcome the proofs submitted by the Commissioner. C.C.H. 1953 Fed. Tax Rep. ¶ 1685.02. Compare the listings at ¶ 1685.033, of cases decided against the petitioner for insufficient evidence or lack of evidence, with those at ¶ 1685.044 holding the petitioner had introduced insufficient evidence to overcome the presumption of correctness in favor of the respondent.

\textsuperscript{155} The procedural effect of the Commissioner's presumption of correctness is not without its ambiguities, especially where other principles for allocating evidentiary burdens overlap it; see the comment in 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION § 6.01 (Supp. 1946) regarding the presumption of correctness in relationship to the presumption that gifts made within two years of death are presumed-in-fact to have been made in contemplation of death (now INT. REV. CODE § 811(1)): "the two-year presumption may be compared to a handkerchief thrown over something covered by a blanket also." As between the presumption of correctness and Tax Court Rule 32, *query*: which is the blanket and which the handkerchief? The presumption of correctness, however, applies to taxpayers' suits for refund, see cases collected in 1 PAUL, *ibid*. It seems clearly established that, whatever else it may be, the presumption of correctness is not evidence; thus, once the taxpayer comes forward, the presumption "vanishes," i.e., cannot properly be given any probative value thereafter, Gillette v. Commissioner, 182 F.2d 1010 (9th Cir. 1950) and the other Ninth Circuit cases there cited: *Thomas Flexible Coupling Co.*, 14 T.C. 803 (1950); *semble*, Helvering v. Taylor, 293 U.S. 507 (1935).

\textsuperscript{156} 9 MERTENS, *op. cit. supra* note 120, ¶ 50.93. Under the reigning concept that the presumption of correctness is not to be weighed as evidence but is to vanish once the taxpayer comes forward, it would seem that anything the taxpayer adduces adequate to bring about the vanishing act is entitled to some weight as evidence if it is a fact. A state intervening decision can have this effect, *cf. Thomas Flexible Coupling*, 14 T.C. 803 (1950). Does that mean the state decision is an evidentiary fact? Certainly the cases do not show any such confined scope for the state decision. It will be noted, however, that the Commissioner's presumption of correctness is not confined to matters of evidence, whereas the Tax Court's Rule 32 seems to be entirely an evidentiary rule.
Likewise, the cases show that taxpayers who rely on "The Law" in their favor do not have verdicts directed against them for failure to come forward, and, they sometimes also have carried the day on persuading the Tax Court to decide for them.

Thus it appears that both the presumption of correctness and the burden of proof rule require merely that, with respect to both types of state law, the taxpayer bestir himself sufficiently to call it to the Tax Court's attention that under either a specific case involving his relationship or, under a line of decisions in his state, the particular relationship involved is not the one that Congress has commanded to be taxed.

The foregoing tends to confirm the view that neither type of state law is restricted, as it comes into the federal tax case, to an evidentiary or quasi-evidentiary function. Indirect confirmation can be found in those instances where the Commissioner, despite the presumption in his favor, has come forward with state law principles or decisions to justify his demand.\textsuperscript{157} Other support comes from the observable fact that when state law comes into the federal tax dispute legal technique shifts from proof to argument.

IV. SUMMARY AND RECOMMENDATIONS

The primary objective of this paper has been descriptive analysis. It is hoped that it has charted the general course of some drifts not systematically recorded now for some time.

The broad pattern seems to be this:

(1) The problem arises in connection with certain values in our federal system which tend to be contradictory.

(2) Despite assumptions that state law characterizations of transactions for federal tax purposes have been on the decline, recurring situations indicate a present situation and a trend opposite to the assumption.

(3) The reasons for giving compulsive effect to state law in federal tax cases have been poorly formulated in the institutional utterances of the federal courts, especially in the federal courts of first instance for tax controversies.

(4) Lack of articulated awareness of the problem in these decisions, the existence of two lines of basic Supreme Court decisions, and the present absence of tax leadership from the Supreme Court have created in fed-

\textsuperscript{157} Commissioner v. Goodan, 195 F.2d 498 (9th Cir. 1952), is a recent example. There the Commissioner's effort was to use state oscillations in attitude toward a modernized version of the ancient, feudal Doctrine of Worthier Title to his advantage. Unaccountably, all his efforts to place an income tax burden on the settlor-trustees of a trust for themselves for life, remaindered over, with end limitations to their heirs, failed. Before taxpayers wax gleeful, however, they should note (a) the reaction against federal use of state law in tax cases engendered within the Court that decided this case and (b) the lurking traps in state property law that an astute Bureau can avail itself of to assert tax liability where in all innocence none has been suspected; cf. Oliver, \textit{op. cit. supra} note 3 at 505, 506.
eral tax law another significant area where prediction must be derived, not from the application of doctrine, but from the classification of phenomena and the analysis of typical reactions.\footnote{This is especially true of the efforts of federal courts in tax cases to come to grips with the issue of “real” versus “sham” characterizations of transactions, and tax-lawmen are adjusting to the seemingly inevitable lack of doctrinal certainty in such situations. Cf. Rice, Judicial Techniques in Combating Tax Avoidance, 51 Mich. L. Rev. 1021 (1953), opening paragraph.}

(5) However, unlike the situation in certain other federal taxation areas where such a situation prevails, there is a tendency in this area for mechanistic solutions to be adopted by the federal courts\footnote{In terms of “res judicata,” estoppel by judgment, intervening doctrinal change, and the like, where real policy objectives can only be achieved by judicial manipulation of the grounds for accepting or denying doctrine which itself, if it is applicable, is not thought to permit \textit{ad hoc} evaluation. With what has been described herein, the split response of the Tax Court in \textit{Lynch}, 20 T.C. No. 146 (1953) to res judicata in a family partnership situation should be compared and contrasted. See Comment, 22 L.W. 1046 (1953).} in which the mass of tax opinions are produced.

This last, it is submitted, is by far the least desirable aspect of the pattern, but its correction would appear to require considerable readjustment elsewhere in the design also.

We can take it that in our federal way of life certain basic values will be incongruent. If we are aware that conflicting values exist and have to be coped with, perhaps we shall do a better job in an area where too much has been assumed, or believed, regarding the supremacy of the one over the other. It would not be amiss in this connection for policy planners, legislative and otherwise, to consider that changes in fashion of expression do not always bring about a corresponding change in value-judgments.

Doctrinal improvement and clarification of the bases of judicial action will also require more systematic attention to the state law problem at the stage of legislative reference, or legislative denial of reference, to non-federal characterizations for determining federal tax liability. Draftsmen of federal tax statutes will have to face up to the necessity of more precisely defining their terms\footnote{Cf. Surrey, lecture delivered at Univ. of So. Calif. Inst. on Fed. Taxation, Oct. 23, 1953, \textit{The American Law Institute Income Tax Project, Major Tax Problems of 1954}; Surrey and Warren, \textit{A Proposed Revision of the Federal Income Tax Treatment of Trusts and Estates—American Law Institute Draft}, 53 Col. L. Rev. 316 (1953). These descriptions indicate that the work of the American Law Institute group usually lies in the direction of clarification and expansion of the statutory material, overcoming “...the defects which the very compactness of present law has created through its confusing ambiguities and its silence on many important points,” article last cited at 373. It is difficult to tell, however, just how much the problem has been thought by this group in terms of the problem under reference here. An impression from the descriptive literature cited is that the state law problem has not been a first-line pre-occupation.} and of blocking out the open and closed\footnote{Should not a revised Internal Revenue Code enumerate and describe tax areas relatively “open” to state law, through incorporation by reference, and those fundamentally “off limits” for it?} areas or
of calculating more accurately than they sometimes appear to have the risk of having definition come from "The Law" of the single, or of the several, states. In order to perform this operation, tax draftsmen must, of course, be fully aware of the range of possibilities in order to know what to guard against, what to refer to, and so on. This means they have to know, or know where to find, more law than just tax law, and to equate more policies than just tax policies.

More attention to the problem will also tend toward giving course and direction to the presently somewhat aimless conduct of federal courts in tax cases involving the possibility of taking tax characterizations from state law. It is believed that more frequent judicial articulation as to the existence in such situations of a very real problem would contribute to its socially effective resolution in particular cases and to the reduction of the number of opinions in the area of conflict which appear to involve the mechanistic choice of either the Burnet v. Harmel or the Blair case formula.

Control of the state decision through procedural disqualification by the inferior federal courts hardly seems adequate in view of the institutional realities involved. To the extent, of course, that state courts think of themselves as a part of one single justice-dispensing American institution and to the degree that state judges can look through or around the cause of action before them to its setting in a federal tax context, control from another source exists. But so to state the procedural possibilities is to appraise them as alone insufficient to the need.

Far more useful, it is submitted, would be the re-examination of the bases in policy and in precedent for letting the state decisions come in, sometimes. The truth should be faced: the intervening state decision declaring a particular tax-relevant relationship may be consciously used to avoid the real command of the federal taxing statute and to subvert the ideal of fiscal justice and even that of national uniformity. It should be admitted that the problem of dealing with the state decision in such circumstances is delicate and serious. Certainly the problem should not be left to be resolved as a by-product of a federal exercise in conclusiveness for a prior federal tax judgment. It might be well, for instance, for the federal courts in federal tax cases to take care to exclude the possibility of elision (from the prior federal to the intervening state decision) in their thinking about doctrines of conclusiveness. It may be that complete re-examination of the doctrine of doctrinal change as applied to intervening state (as possibly distinguished from intervening federal) declarations of law, is called for. This latter we should probably have to have from the Supreme Court, because, as we have recalled, the doctrine originated with the Court's giving intervening state decisions this effect in the articulated due process era.
Only later extended to intervening alterations\(^{102}\) in federal tax law, where today it probably serves the growth of the law, the doctrine would appear susceptible to circumscription only at the level of its conception.

It is obvious that giving compulsive effect to state decisions and to variant state general law conflicts with geographic uniformity. Feeling has tended to run more strongly against an entrenched position for state law, though, when its effect is to require different tax treatment for persons in substantially equivalent economic power positions. In the past, perhaps this has been the strongest effective social force against the admission of state law, exerting more counter-force, it seems, than the needs of the fisc or even administrative convenience. Thus we have cases dealing sternly with local law differences between remainders subject to conditions precedent and those subject to conditions subsequent. Thus our concern about community property was cast in terms of taxpayers' inequalities, rather than in terms of loss of revenue. It is suggested that while attention has been concentrated on this interest, trenching to an unnecessary degree in some instances on the utility of the limited dispositive devices available with which to exercise a permitted degree of free will about wealth, the actual institutional operation of state law in federal taxation has gone unattended, with policy consequences at least as serious as any of those that have been more fully considered in the past.

Whatever else should be, there should be no mystery about the relationship of state law to federal taxation. Far too often have references to the matter sounded in puzzlement\(^{103}\) and in vague generality. Solutions can only come after estimates of the situations have been prepared. That has been the effort here.


\(^{103}\) See Kennedy, Federal Income Taxation of Trusts and Estates § 1.01 (1948) for the sounding of this theme at the beginning of a federal tax study. The author's reference there to "... that field of quasi-knowledge known as federal income taxation ..." states a basic problem in another way.