IX. The Judicial Process in Tax Territory

THE EMPHASIS in previous chapters has in the main been upon
the legislative aspects of the history of taxation. The account has
been one of the slow development of an appreciation of the necessity
of taxation in the public mind and in the halls of Congress. The
story of American taxation has been part of the sensational evolution
and expansion of an economy, through war and peace, from simple
agrarian beginnings to complex urban and manufacturing destinations.
Taxation has been constantly at the core of American history, and it
has constantly been increasing its impact and influence upon the life of
the ordinary American citizen. The story began with homespun, colo-
nial gropings; the plot thickened as an imaginative Constitution carried
the Nation through several stormy periods of trial and error; in the
present century the drama finally climbed to a more finished maturity
in progressive income and death taxation. The product is still far from
final; it can never in the nature of things be final. Tax systems, like
other institutions that hope to survive, must constantly adapt themselves
to new needs and crises. In the test of three major wars the Ameri-
can tax system has proved its capacity for adaptation, and the system,
imperfect as it may be, is at least a comforting symbol of the success
of the democratic process. The final test of that process may well be
in the answer to the question whether Americans are willing to pay, in
taxes, the price of the kind of civilization they have chosen for their
own.

But only a part of American tax history is written in acts of Con-
gress, the reports of Congressional committees, and in debates on the
two floors at Capitol Hill. It is the most important part, for it is the
part that has most affected the life and the welfare of the ordinary
man on the streets of America. But it is not the whole story. The
reason is at the same time simple and obscure, easy to state and hard
to explain. It derives from the fact that the English language is an
imperfect tool which not even legislatures may use with the precision
necessary to a product which has to be applied to the infinitely varied
circumstances of individual and business life in a growing America.
There is no such thing as words so plain that they need no interpreta-
tion, even though they have been placed in a statute by the sovereign Congress of the United States. The language of tax statutes, like the language of other mandates of Congress, needed interpretation in application to the circumstances of highly recalcitrant situations which baffled administrator and taxpayer alike. Some of those situations seemed not to have been anticipated by the legislature which passed a statute supposed to have general application. Even then, sometimes years after the event, it became necessary to find a meaning which would translate inept language into effective action.

There is no taxation without legislation. As Judge Jerome Frank has wisely observed, tax law is not a matter of pure reason. It is "a composite of constitutional doctrine and changing statutory provisions each having its history." It begins with statutes, but it does not end there. It will never end there. It could not end with the vague, or even the specific, language of more than a thousand sections of the Internal Revenue Code or the more bountiful language of an interpreting Treasury which has been incessantly obliged to fill interstices by means of Treasury decisions, General Counsel memoranda, and rulings of lesser dignity. Back in 1948 there were 3,000 pages of formal regulations and 54 volumes of published informal rulings. The published rulings are only a fraction of a total that pours ceaselessly from the administrative mill. But even this vast accumulation of material frequently failed to furnish answers to taxpayers' questions. In many cases there were too few words, as in other cases there were too many. Moreover, taxation is an intense subject, and often the obvious implications of the statute or regulations did not suit the taxpayer or the government. The policy of Congress had to have an articulate spokesman who would be able to tell taxpayers and a disagreeing government with a voice of authority what Congress meant to accomplish in particular cases.

There is no constitutional requirement that taxpayers be given a judicial hearing in tax cases; the right to bring an action in the courts to recover taxes may be abolished consistently with the Fifth Amendment if a fair and adequate administrative remedy directly against the government is substituted.1 But from the practical and political viewpoint the job of fact finding and statutory interpretation in tax cases could not be left entirely in administrative hands. On the whole, and over the years, the Treasury has been fair and remarkably judicial in its interpretation of revenue statutes. Sometimes it has been conspicuously liberal; on the other hand, sometimes it has been ungenerous, and even niggardly. But the average taxpayer feels accurately that in the final analysis the Treasury has at least subconscious bias.

1 Anniston Manufacturing Co. v. Davis, 301 U.S. 337 (1937).
It has been entrusted with the grave responsibility of rule-making power, but its function is also to collect revenue. Its representatives may emphasize this function more under one Commissioner or under one Administration than under another, but the most elementary principles of human conduct indicate the necessity of some highly qualified independent tribunal or agency which will impartially examine and decide controversies arising between government and taxpayer in revenue cases.

Few lawyers realize how close we came in the twenties, and later in the thirties, to a denial of taxpayer recourse to the courts. In the Texas Pacific Coal and Oil Company case\(^2\) in the Court of Claims, in which I was representing the taxpayer, the government demurred to the claimant’s petition for a refund of income taxes on the ground that the Court of Claims had no jurisdiction to review the determination of the Commissioner of Internal Revenue. In the same case, and the companion Hewitt case, the government argued that the taxes involved could not be recovered because they were not paid under protest and duress. I argued the Texas Pacific case before a full Court which half-heartedly overruled the government’s demurrer without prejudice to the right of the government to renew the contention later in the case. In the later case of Sara L. Meyer v. United States\(^3\) the government again made the contention that the findings of the Commissioner were conclusive, and might not be overruled by the Court of Claims. The Court disagreed. By this time the government argument seemed so clearly untenable as to obviate any need of discussion. To so hold would be to deprive taxpayers of a right accorded them by statute and leave them without remedy where remedy was provided.” An express provision of the 1924 act eliminated all question as to the necessity of protest and duress as a condition precedent to the maintenance of a suit to recover taxes.

The 1924 act, creating the Board of Tax Appeals, solidified the right of taxpayers to a judicial determination of their income, estate, and gift tax liability and a fair day in court. But this first statute failed to eliminate the cumbersome procedure of retrial in the Federal District Court. This result came with the 1926 act, which made provision for direct appeal from the Board to the Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia. It is now established that taxpayers may also secure a judicial determination of tax liability by suing in the Federal District Courts and the Court of Claims for the recovery of taxes paid after denial of a claim for refund or a period of six months of inaction on

\(^2\) 59 Ct. Cls. 984 (1924).
\(^3\) 60 Ct. Cls. 474, 485 (1925).
the part of the Commissioner. Appeals go from the District Courts to
the Courts of Appeals of the various circuits and the United States
Court of Appeals for the District of Columbia. The Supreme Court
may permit an appeal from decisions of the Court of Claims, but the
taxpayer has no absolute right of appeal as he does from the District
Court and the Tax Court to the Courts of Appeals. The Supreme
Court may also permit an appeal from decisions of the Courts of Ap-
peals.

A short-lived threat to the continuance of court review appeared
again in 1938 when Under-Secretary Magill assembled a group of ex-
perts to work on the compilation of the Internal Revenue Code and
new revenue legislation. The principal members of the group were
Roger Traynor, now of the California Supreme Court, and Hessel
Yntema, Professor of Law at the University of Michigan. At Magill’s
request I checked with the group from time to time, and gave consult-
ing advice. At one point I found the group working strenuously on a
plan which would give complete fact-finding jurisdiction to the Treas-
ury. Yntema was especially fond of the plan.

Finally, in 1938 the Columbia Law Review published an article by
Judge Traynor containing a proposal that the scope of review by the
Board of Tax Appeals be restricted. Under the Traynor plan both
the taxpayer and the Commissioner would be limited in proof to the
grounds, documents, and facts outlined in the taxpayer’s protest and
the Commissioner’s findings of fact, and the Board’s consideration
would be limited to the issues presented by the Commissioner’s findings
of fact. Judge Traynor also suggested a coordination of deficiency and
refund procedure under which the Board would have jurisdiction of
refund cases, and I renewed this suggestion in 1942 when I was Gen-
eral Counsel of the Treasury. The Traynor plan also called for the
decentralization of the Board to match the current decentralization of
the Bureau of Internal Revenue, and a single Court of Tax Appeals.

The next attempt to limit review of tax decisions came in 1943
from the Supreme Court. In Dobson v. Commissioner4 that Court,
without attempting to conceal its distaste for tax cases, severely re-
limited the reviewability of Tax Court decisions in the Circuit Courts
of Appeals. It is almost impossible briefly to summarize Justice Jack-
son’s opinion in the Dobson case. It criticized appellate courts, in-
cluding the Supreme Court, for having failed in the past to pay the
same scrupulous deference to Tax Court decisions which the courts had
paid to the decisions of other tribunals. After a journey into the
mystical, and fragile, distinction between questions of law and fact,
and a cryptic reference to mixed questions of law and fact, the Court

finally announced to an astonished tax bar a new way of tax life. Determinations of the Tax Court having "warrant in the record" and "a reasonable basis in the law" were to be final and safe from the damage of review. "Accounting" questions were classified along with questions of fact for the Tax Court to determine finally. Outside the area of constitutional law, or the bounds of a controlling statute or regulation, the Tax Court's determination of law questions seemed to secure immunity from review, at least in cases in which the reviewing court could not identify a clear-cut mistake of law—that is, unless the Tax Court was plainly wrong.

Few decisions of the Supreme Court have aroused more vigorous protest within the tax bar itself. My article in the *Harvard Law Review,* supplemented and brought up to date in the Supplement to *Federal Estate and Gift Taxation*, published in 1946,* was the first published analysis of the Supreme Court opinion. Other articles followed, almost all of them in critical vein. The bewilderment of Federal judges gradually became objection to the Dobson doctrine. Finally, partly at the instance of the American Bar Association, Congress amended Section 1141(a) of the Internal Revenue Code to provide that decisions of the Tax Court shall be reviewable "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." In effect, this provision read into the Internal Revenue Code the provisions of Rule 52(a) of the Federal Rules of Civil Procedure that findings of fact of the trial judge shall not be set aside unless clearly erroneous.

One further line of observation and comment should accompany any summary of the contribution of the courts to the development of tax law. The topic idea is that the contribution has been, in one sense, peripheral and unimportant. There is a combination of reasons why this is true. By and large, in the area outside constitutional law the Federal tax questions presented to the courts have not been questions affecting the average taxpayer in the street. Issues of moment to these taxpayers are usually decided in the halls of Congress or by administrative ruling. Examples of this type of question are the questions whether we shall have a sales tax, withholding, how large the personal exemption shall be, and whether a medical deduction should be allowed. One example of an untested, but long standing, administrative ruling with far-reaching effect is the ruling that premiums paid by employers on group insurance policies on the lives of employees, the beneficiaries of which are designated by the employees, are de-


*§14.22A.
ductible by employers, but are not income in the form of compensation to the employees. In large part the courts have dealt with narrower problems of the law of exchanges and reorganizations, corporate distributions, personal holding companies, family partnerships, and the like. These are problems mostly affecting the small number of taxpayers in the relatively high brackets to whom the difference in tax involved in the question presented was enough to justify the trouble and expense of litigation. For this reason and from this standpoint the story of taxation in the courts is a story of relatively narrow interest.

Moreover, most taxpayer-government controversies never reach the courts; if they did, the courts would be completely unable to handle the problem of tax litigation. In the fiscal year 1952 taxpayers filed protests with respect to adjustments proposed by examiners in 35,684 income, profits, and estate tax returns. Cases involving 26,644 of these protests were closed by agreement with the revenue agents' offices. Statutory deficiency notices were issued in 4,355 cases because of lack of agreement and 8,701 cases went to the Appellate Staff for further consideration. The Staff and taxpayers settled 4,634 cases by agreement. These total figures do not include hundreds of thousands of cases in which the taxpayers made no protest against adjustments proposed in income, profits, estate, and gift tax returns. Nor do they include special relief cases arising under Section 722 of the Internal Revenue Code, which cases are subject to the jurisdiction of the Excess Profits Tax Council. A large number of cases docketed in the Tax Court are also settled by the Appellate Staff without trial. In the fiscal year 1952 the Staff disposed of 3,373 cases by stipulation; only 944 cases before the Tax Court required a decision on the merits in the same fiscal year. Thus the vast majority of the cases docketed with the Tax Court do not require an actual trial or disposition on the merits. These figures show, of course, that a very large proportion of tax controversies is disposed of at the lower administrative levels, and that the top of the tax pyramid is unimportant, though only relatively, in terms of cubic content.

But these statistics present too restricted a view of the value of the courts to the taxing process, especially in late years. There is another orbit of life in which the courts are a vital, even an indispensable, factor in that process. Federal taxes now absorb more than 30 percent of the national income. Income taxes begin at a low level of income, and are now almost at the level of World War II. They are voluntarily assessed in the sense that taxpayers file their own returns. Only a minor fraction of these returns can be carefully audited and checked.  

5 See page 598.
It is, therefore, essential that taxpayers feel satisfied that they are being fairly treated. The existing system of court review helps to give taxpayers this feeling. They know that they make take their grievance to an impartial tribunal which will adjudicate their case on the merits. The courts are, therefore, in a potential sense an indispensable part of the taxing process in that they promote and conserve taxpayer willingness and satisfaction without which no income tax, involving the high rates and the number of taxpayers reached by the existing Federal system, could ever be administered. In addition, the courts, sometimes with agonizing slowness, evolve rules which keep in some degree of order a vast and chaotic number of conflicting interpretations of ambiguous statutes provided in a necessarily scrambled process of administration.

The importance of the judicial process of tax review may also be judged from the quantitative standpoint. In spite of the fact that relatively few tax controversies reach the courts, tax cases are now the principal business of the Federal courts. As Justice Jackson has pointed out, no less than thirteen sources with diverse aims, backgrounds, and equipment are contributing to the stream of tax law that vexes lawyer and taxpayer alike. More than sixty-seven volumes are required to record the findings and opinions of the Tax Court (formerly the Board of Tax Appeals); in addition, thousands of memorandum opinions of that Court are reported in unofficial services. Over its history many tax cases have been handled by the Court of Claims.

The multiplication of the work of the courts can be shown from the available statistics. For the year 1920 a leading tax service catalogued only 300 decisions of the Federal courts having to do with Federal taxation. By September 30, 1952, the Tax Court had disposed of 145,040 income, profits, estate, and gift tax proceedings docketed in the period beginning July 16, 1924. The gross deficiency claimed by the government in these proceedings was $4.861 billion. The disposition of these cases left pending 12,382 proceedings involving gross deficiencies of $924 million. Needless to say, a diligent Tax Court has considerable difficulty keeping abreast of this sizable docket. The appellate courts (including the Supreme Court) are also constantly busy with tax litigation. On July 1, 1951, there were 354 Tax Court appeals pending in the Courts of Appeals for the various circuits and the Supreme Court; one year later this total had risen to 419 cases. The appellate courts closed 269 cases. In 126 of these cases the decision was favorable to the Commissioner and in 272 it was favorable to the taxpayer. In 18 other cases the lower court decision was modified.

The above figures do not include 367 cases involving tax issues de-
decided during the fiscal year 1952 by the Federal civil courts (exclusive of bankruptcy, receivership, insolvency, compromises, and liquor cases) which arose in the district courts and the Court of Claims or which came to the appellate courts from those courts. Of this total 178 decisions were in favor of the government and 173 against the government. As of June 30, 1952, there were 2,447 civil cases involving tax questions pending in the district courts, 324 in the Court of Claims, 78 in the Courts of Appeals, and 2 in the Supreme Court.