

4-1-1963

## Commentaries on Professor Sneed's Lecture

Ernest J. Brown

*Harvard University Law School*

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### Recommended Citation

Ernest J. Brown, *Commentaries on Professor Sneed's Lecture*, 12 Buff. L. Rev. 261 (1963).

Available at: <https://digitalcommons.law.buffalo.edu/buffalolawreview/vol12/iss2/4>

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## IMPACT OF FEDERAL TAXATION

The second point I would emphasize in connection with the creative aspect of tax law is that the responses of private law are sometimes in themselves distortions. They represent legislative decisions on private law matters which probably would not have been acceptable in the absence of tax considerations. What is good for taxation is not necessarily otherwise good for the country.

I am somewhat disappointed that time did not permit Sneed to develop the point that tax law has spawned a sizable amount of friendly state-court litigation designed to recast transactions or to reform instruments in order to put the friendly group of litigants in a better federal tax position. Perhaps only in a strained sense can such judicial activity be considered an alteration of substantive private law. This sympathetic judicial response, however, has an important bearing on the operation of our system of private law. It tends to set a tone that is not easily forgotten. The actual magnitude of such sympathetic response is very hard to gauge inasmuch as many of the decisions go unrecorded or unnoticed. But there is ample evidence that numerous state courts have repeatedly been more than lenient, if not virtually compliant, in back-stopping poor draftsmanship or bad planning, all at the expense of the federal revenues. I cannot believe that such performances increase the prestige of the judiciary or produce a desirable climate for the dispensation of justice.

Finally, I join Sneed in predicting that the processes of what he terms fiscalizing our private law in response to tax law probably will continue unabated. In many respects our federal tax system seems to have a dominant characteristic: it continues to keep moving in the direction it is already going.

ERNEST J. BROWN\*

I can't enter into whatever area of disagreement there may be between Mr. Sneed and Mr. Blum on the amount or pace of change the tax law has brought into private law. It exists, and that is perhaps the most significant thing. I am interested in exploring elements which may be obvious. But it may be of some advantage to make them explicit. These are the elements of the framework of Mr. Sneed's very fruitful inquiry. It is, as so many things are with us, an exploration into our federalism. Of course, it is nothing new to have taxes and tax law influence private law and private institutions. The feudal equivalent of taxation was at least one of the stimuli that ultimately resulted in the law of trusts. In our own country when the Supreme Court was unable to discover constitutional restraints of any great rigor on the rather ambitious reach of state inheritance taxation and state franchise taxation, the personal holding company emerged as a check on the former and the intricate proliferation of subsidiary and affiliated business corporations helped to check

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\* Professor of Law and Chairman, Committee on Graduate Studies, Harvard University Law School. A.B. 1927, Princeton University; LL.B. 1931, Harvard; former Professor of Law (1937-42) and Assistant Dean (1946), University of Buffalo School of Law.

the latter. It is of interest, perhaps ironic interest, that the income tax in turn made those institutions less useful by making them considerably more expensive than they had been.

It is also true, as Mr. Sneed pointed out, that the tax law must reflect the society on which it operates and its institutions, including some, but I would emphasize not all, of its private law manifestations. But what makes our problem noteworthy and really quite new as such things go is that it is only within recent years, as at least some of us can remember, that the taxation which has the heaviest and most immediate and—this I think is significant—the most highly *conditioned*, the most intricately *conditioned* impact on millions of persons and corporations, is now federal taxation, whereas private law and legal institutions are for the most part products of state government or in the custody of state government. Now with two governments operating in the same field, the problem, of course, is more difficult. If we are concerned with state taxation and state law there is a possibility to coordinate, to adjust the balance, if one seems to be overly important with respect to the other. But the federal system produces a greater difficulty and, of course, it is much enhanced when we consider that private law is the product not of one state government but of fifty. I should say “for the most part,” and that qualification will be assumed, because, of course, there is some private federal law. This seems to me, as it does to Mr. Sneed and perhaps to a lesser extent to Mr. Blum, to be a new problem and since we have to deal with it, I would like to explore for a moment how the approach might be organized.

First of all I take it we have to find the framework of the problem. Now this is fairly simple. The constitution gives Congress the power to tax, and for some time Congress has been exercising that power and I presume it will continue to do so. Article VI provides that federal law is controlling, and that includes tax law. The second part of the framework is that so far as I know there has never been a wholly neutral taxing *statute*. People react to fiscal exactions, and when they are conditioned they react the more intricately. I don't think you can have a fiscally fertile law which is institutionally sterile. It can be the other way around very easily, but not fiscally fertile and institutionally sterile. Those are the two major parts of the framework.

Now I don't take it that it is constitutionally amiss that Congress knows and gives thought to the results, either in law or institutions, that a taxing law may produce. Some of you may disagree with that, but the fact is it will produce them, and I find it difficult to think that Congress is forbidden to use its intelligence in imagining what the results will be. And in anything I say, I am more concerned with the unintended results rather than the intended. I may argue with the wisdom of specific Congressional action which does shape local law, but that wisdom is for argument there, and I don't mean to impugn the power.

If that is the framework of the problem, we must also decide what

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are the desiderata, what are the objectives. I can name two that seem to me fairly important. You may not agree with them, but they are, I think, primary, if you do. One is that federal tax law should be, as far as may be, uniform. This isn't only because the Constitution suggests that at least some federal taxes should be uniform, but because it is fair, wise and politic that federal taxation should be so in its impact. Of course there are economic variations, but one won't find many apologists for an explicitly checkerboard effect in federal taxation.

The second desideratum is that the control of private law should, for the most part, remain with the states. I am no herald of revolution, and I assume that most of us think that it is, and should be for the states, considering the variety and size of this country, in large areas to make their own decisions for creativity, caution, differentiation and experimentation. This does not suggest that every state's boundary is exactly ordained from on high, but they are there and the country varies richly. We may want in many cases a greater uniformity of private law. I am not against the Uniform Sales Act, either new or old version, but I think most of us will assume that for the time it is wise that the states should have a large degree of power in making these decisions.

Now I don't think I am arguing for contradictory things, as it might appear, because I am both for uniformity and for variety. If I were, they could be adjusted and the problem of adjustment would, of course, be for someone, probably Congress. But I think I am arguing for a uniform tax law which permits variety in the states, and so I don't think that there is any inconsistency.

Now if my statement of the framework is correct, the responsibility, I think, lies where responsibility usually lies, that is, where the power lies, and that is with the federal government, if we are to achieve these objectives which I at least assume we desire. I say federal government advisedly because that includes Congress, the courts, including the Tax Court, of course, and the administrators, and if Mr. Lubick isn't displeased, I will include the people who propose statutes among the administrators. At least they can't enact them. But on all three levels it seems to me that there is responsibility. Now that responsibility is not easily assumed, and I am not saying that every failure is shameful. Take those things we all admire: thought, wisdom, and restraint. Sir Isaiah Berlin remarked a few years ago that there seemed to be a worldwide shortage in sages, and so not all difficulties will be overcome.

But let's turn to a few specifics that have been mentioned before. When the institutions of private law vary fundamentally, of course, adjustment of the tax law to be uniform in its impact is the more difficult. The obvious, the conventional example, will be the difference between the community property states and the common law states which existed for years. Both my predecessors have mentioned that. Now as we all know there was a divergence which was very significant, and as the rates in the graduation grew higher, the divergence

grew more significant. Now where the responsibility for that lay originally, I don't know. It wasn't explicit in the statute, but it was in the statute as the Supreme Court read it in *Poe v. Seaborn*. Some of my colleagues would tell you where I would put the responsibility if I conceived the result to be wrong. We needn't explore that today; but whether it was Congress or the Court, after the Court did it, it was certainly up to Congress to rectify the error either of its own or the Supreme Court's making. It was unsupportable that the country should be divided in this fashion. Now I think that Pennsylvania, Nebraska and such other states as there were—and, as I recall, New York did a little exercise in brinksmanship, too, and came close to the border—I think they were rash in abandoning the centuries old heritage of common law property. Nevertheless, the responsibility lay with Congress, and unless Congress was trying to induce the adoption of community property law all over the country, as I can't believe it was, then it had to do something about it. It did do something about it fairly well and fairly effectively in 1948. It took a long time, but it did it. With that having become a quite fundamental policy, then it seems to me it is incumbent on the administrators and the judges not to reverse it by nibbling away. And I use considerable restraint when I say that I think, for instance, the Supreme Court was unwise in its quite casual decision in the *Davis* case last spring which broadens the gap between the community property and the common law states in the matter of the tax aspect of divorce settlements. I happen to know, because I read the government's brief, that the brief is very restrained. The court went much further in giving the government a victory that it didn't press for, than the request had been. The casual manner with which the court said: "It's true it creates a difference between common law and community property states," the casual nature with which the court did that, seems to me, shall I say, unfortunate. The same decision also magnified the tax aspect of divorce settlements, a difficult matter at best. And again this was neither necessary nor in my estimation required.

Congress has made some mistakes. Professor Sneed mentions the marital deduction and the allowance for dependents. Now here I think the responsibility lies solely with Congress. I think it is clear that the crux of the purpose of the marital deduction and the limitations on it are fairly simple. The draftsmen and the Congress, which adopted their work, came up with an over-elaborate device which may or may not have been someone's idea of a way to achieve a fairly simple result, but experience has shown it to be a very unfortunate and a very intricate and complicated device in which many difficulties have grown up, most of them nonfunctional, most of them unrelated to the purpose of the limitations on the marital deduction. This seems to me to have been over-expertness become inexpertness. I also question whether Congress was wise in its dealing with the stock option provision. On somewhat larger grounds, it has done something which has induced a number of states to amend their statutes, to take advantage of this rather questionable legislative bounty.

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The *Hardenbergh* Case which Mr. Sneed has mentioned is a case differentiating between renunciation of legacies and renunciation of an intestate's succession. It is a case in which it seems to me that a court, the Tax Court originally, fell into a trap, into a difficulty which a sense of judicial responsibility should have avoided. It was faced, perhaps as I read between the lines of its opinion, with a decision of a Court of Appeals with which it disagreed, in the case of *Brown v. Routzahn*. Instead of facing that disagreement, it turned to this quite specious difference between vesting subject to divesting and not vesting at all. Now indeed it is almost inconceivable that any rational person could have felt that this had any function to perform with respect to the federal gift tax statute, whether the legatee or heir should or should not pay a gift tax. But the Tax Court adopted it; it was affirmed by a different Court of Appeals, and the tax differences are now such as to move the states to eliminate at best a meaningless differentiation. Whether this should move the states or whether it just differentiates the states seems to me not particularly significant. All I am saying is that with the difference turning on perhaps a bit of terminology, and not much more than that in state law, it is certainly something that a conscientious court might have turned away from.

When I say courts I should broaden the responsibility, because it is the responsibility of lawyers as well. I take it that it is the first responsibility of the lawyers in the Treasury and Department of Justice to administer the tax law wisely. Their responsibility for winning cases lies within the ambit of that first responsibility. They present such points to the federal courts, and in doing so they certainly seem to me to be departing from that wise overall policy of reconciling uniformity and diversity. I think both of these can be achieved. We may ultimately want to do away with the diversity. But while we have it, tax uniformity with diversity of law can be achieved. They do take restraint and some measure of thought. But I for one don't think that the achievement is likely to be inconsistent with the call to greatness which Professor Sneed has mentioned.

DONALD C. LUBICK\*

Dean Hyman, the accident of alphabet makes it rather difficult for me to add anything to the comments which we have been fortunate to receive from three of the best and leading scholars in the tax legal field in the country. However, I perhaps can bring you a message that is even better, since yesterday my boss, the Secretary of the Treasury, emphasized that next year we will have both lower taxes and greatness, and the sooner we have them, the sooner I can get back to Buffalo. We have heard a good deal today about the distortions of state law by federal tax rules. You may not know that

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\* Tax Legislative Counsel, U.S. Department of the Treasury. A.B. 1945, University of Buffalo; LL.B. 1949, Harvard University Law School; Lecturer in Law (1950-1960) University of Buffalo School of Law.