Taxation in the Law School

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It is perhaps a sign of the times that in The Law School the course called "Taxation" is a course on federal taxes. In recent years an increasing number of law schools have come to orient their work in taxation around the national tax system. Nevertheless, in reviewing the treatment of taxation in our school, it may be useful to start by noting those aspects of taxation which are not covered by the basic taxation course.

For present purposes, tax problems in the United States can conveniently be divided into five kinds. There are, first, the purely intrastate problems which grow out of the large diversity and number of state and local revenue enactments. Most of these problems are not dealt with at all in the School today, exceptions being the due-process issues coming up under the federal Constitution, which are treated with in the Constitutional Law course, and the state death-transfer taxes, which are given a passing glance in connection with the federal estate tax. The decision to exclude from the basic Taxation course any consideration of local taxes, such as property taxes, sales taxes, franchise taxes, and the like, seems entirely sound. Almost all the legal issues presented by these taxes are peculiar to the particular statutes involved or to the constitutions of the states in question. There are relatively few issues which are common to a substantial group of taxing jurisdictions; and it would be chaotic to try to put together teaching materials dealing with the taxing systems of the thirty-four states from which the current student body is drawn. Conceivably the study of local tax problems could be based upon those which arise in a jurisdiction heavily represented in our student group. One is likely to find, unfortunately, that a tax in that jurisdiction, say, the personal property tax, has fallen into disrepair and that practice pertaining to such a tax cannot be taught in a law school. This very fact, however, suggests that there is a need for examining these taxes to determine whether they are inherently unworkable and, if not, to ascertain what can be done to improve them. A study of this type, to be useful, would have to be concentrated on particular taxes in particular jurisdictions and therefore would have a limited appeal. Taking all these factors into account, it seems that the suggested topic is almost ideal for a seminar or a small course. Perhaps the subject could best be examined as part of a more general course or seminar on the main legal problems connected with municipal government. In any event, the study of local tax problems seems especially appropriate for Illinois in view of the current proposal for amending the revenue article of the Illinois constitution. But these are speculations: state and local tax problems are, by and large, not covered in The Law School.

There are next the problems which might be classed as the interstate or extra-state aspects of state and local taxes. These arise when a taxing body attempts in effect to reach across its state's lines or when a transaction or situation concerns two or more states which are seeking to derive revenue from it. The resulting problems might then be cast in the constitutional form of whether a taxing body has exceeded the limits of due process in trying to extend its jurisdiction or whether it has unreasonably burdened interstate commerce; or the problem might come up under one of the growing number of interstate compacts on taxation. These problems have
long been contained in the curriculum, but they have had a migratory residence. At one time they were simply regarded as a part of the basic Constitutional Law course. Then they became pillars of the Taxation course at a time when it was given by a teacher primarily interested in constitutional law and constitutional history. Still later the jurisdiction issues were included in the Conflict of Laws course on the theory that they were essentially of law questions. And now, after some further rearranging, the whole subject is again back in the basic Constitutional Law course.

Problems of a third kind concern the relationship between state and local taxes, on the one hand, and federal taxes, on the other. The interplay between the national and state tax systems raise important constitutional questions about the power of the national government to tax activities of the state governments, and vice versa, and these are examined in the Constitutional Law course. Otherwise the interplay presents relatively few concerns which are predominantly legal, and the more important of these are touched upon in the Taxation course. For example, attention is paid to the credit allowed against the federal estate tax for state death taxes, to the deductibility of various state and local taxes in computing taxable income under the federal income tax, and to the measures taken by some states to tie their income-tax systems to the federal income tax. These of course are fairly narrow matters. The broader and more troublesome problem of dividing up the whole tax field between the national and state governments is left almost completely untouched, save in the case of gift and death taxes, where brief consideration is given the proposal to confer a monopoly on the states as to these transfer taxes.

Just as the existence of many states within our federal system presents jurisdictional and “double taxation” problems, so the existence of many national states in our world raises these difficulties at the international level. Problems of this fourth kind are steadily and rapidly growing in number and importance as commerce and intercourse among the nations continue to increase. It need only be pointed out that the past decade has seen the development of many international tax treaties and that the United Nations Organization has been inquiring into taxing arrangements which are appropriate for separate nations attempting to live in commercial harmony.

Nevertheless, these international tax problems are still of very limited concern to the American bar in general, and they tend to be regarded as outside the range of the all-round lawyer’s fields of interest. Furthermore, to deal adequately with most of these problems, a fair degree of familiarity with at least the American tax law is a prerequisite, and for this reason the international questions are not very suitable material for a basic taxation course in law school. Again it seems likely that they would constitute excellent content for a seminar, but as yet such a seminar has not been tried.

Although the international problems are not dealt with academically, some aspects of them are repeatedly con-

sidered in connection with actual problems of our students, visitors, and teaching fellows. Over the last five years I can recall that such personal questions required looking into our tax relations with England, Australia, Canada, Holland, France, Germany, Austria, Norway, Sweden, and Brazil. It is a good guess that the general community will not be far behind the University community in becoming interested in the international aspects of taxation. (The personal tax problems of our students sometimes also necessitate learning about the domestic tax laws of other countries. No doubt when increased attention is paid to the international issues there will follow a heightened interest in what might be regarded as the comparative law aspects of taxation.)

There remain the tax problems of a fifth kind—those concerning our national tax system. With the exceptions already noted, the content of the existing basic Taxation course is built almost entirely around them. Even so, great areas of our national tax system are by-passed. Virtually no consideration is given to the tariffs, excise taxes, stamp taxes, and the like. These subjects are omitted not because they are unimportant; the fact is they constitute highly significant segments of our national tax system. However, they are not likely to offer any challenging problems for any large number of lawyers. The architecture of these taxes is in the main relatively simple, and understanding of them comes fairly easily. The operating legal problems by and large are shallow, and often they are tied in with the organization or practices of a specified industry. It perhaps is not too much of an overstatement to conclude that the only really difficult and interesting question about these taxes is whether we ought to continue them. This issue is better examined in the context of economic analysis, and from time to time this has been done in the Law School course in Economics.

One omission which is more debatable is the social security tax portion of the national tax system. Obviously this is gaining in significance, and lawyers more and more are coming into contact with it. It, too, is relatively simple in architecture, and this might be reason enough for doing nothing major with it in a law school. But the whole social security program is now so extensive, and affects so many persons, that it cannot reasonably be left on the academic sidelines. The social security taxes, while perhaps not meriting attention as taxation matters, certainly should be included in an examination of our social security system in its entirety.

Thus the basic Taxation course is largely confined to the federal income tax, both individual and corporate, and the federal gift and estate taxes. The inclusion of the income tax is a natural. It is today our most important tax: it is by far the largest producer of revenue, and it brings into the tax system the largest number of taxpaying units. The architecture of the tax is highly elaborate, the provisions being greatly structuralized and interrelated in innumerable respects. There is much room

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under the tax for maneuvering by taxpayers in the sense that alternative lines of conduct, characterized by different forms, frequently entail vastly different tax consequences. The areas of conduct affected by the tax, moreover, are very extensive. Under these circumstances there are bound to be a large number of legal questions, and these are likely to concern many persons in many different connections. It is clear that the common saying that today “taxes are everywhere” has reference primarily to the federal income tax.

The case for including the gift and estate taxes in the basic Taxation course obviously cannot be as strong, but it is persuasive. These transfer taxes also are highly structuralized and have a depth which tends to produce difficult legal issues. While they do not affect nearly as many persons as the income tax, they impinge upon persons in a large number of situations, and their bite is substantial. They are, furthermore, closely related to the income tax in many respects, and a sound approach to income-tax problems frequently requires an appreciation of gift and estate tax matters. Finally, the transfer taxes and the income tax have an element in common which distinguishes them from all the other taxes and intensifies conflict over them: they are the progressive and direct elements in our tax system.

But it is somewhat misleading to say that the basic Taxation course is largely “confined” to these taxes. The difficulty in constructing the course is not that too much has been left out; rather it is that the boundaries staked out offer too many attractions. These direct taxes have a bearing on practically every other substantive law subject in the School’s curriculum, and in many instances it would be dangerous to employ one’s knowledge of such subjects without being aware of the tax implications. Last year, for example, the materials studied in Taxation were directly connected with transactions or situations taken up in Property, Contracts, Torts, Agency, Domestic Relations, Commercial Transactions, Trusts and Future Interests, Competition and Monopoly, Labor Law, Business Organizations, and Bankruptcy and Reorganization. It is no wonder that Taxation has been regarded by students as a course to be tackled only in their last year in school.

In addition to serving as a complement to virtually the balance of the substantive law courses, these direct taxes are ideal materials for other study purposes. They form an excellent vehicle for a study of administrative law. It has often been observed that administrative law problems are best explored in the context of a specific body of law, since the role of an administrative agency is to be understood in the light of the nature of the particular problems which society is attempting to handle through law. The great merits of the income tax, in this respect, are that it presents a wide variety of problems and that the development of the law is taking place at a rapid pace. The role of the Bureau of Internal Revenue, including its relationship to the courts, in the matter of interpreting and applying the law lends itself to analysis that superbly highlights the fundamental aspects of rule by administration in our society. The income and transfer taxes are equally rich material for exploring the workings of the legislative process. Each year living examples are provided ready made for observing how legislation comes about, the limitations on rule by statute, the compromises and ambiguities which are inherent in the legislative process, and the extent to which the legislature can effectively control the courts and an administrative agency. Add to these factors the scope and intricacies of the statutory law, and it can be perceived why these taxes also afford a grand opportunity for gaining insight into the process of statutory interpretation by judicial action. The reading of almost any paragraph of these taxes is almost necessarily a venture in statutory interpretation.

The three direct taxes invite attention to other facets of legal training. They are unsurpassed as texts for acquiring the various skills now fashionably lumped under the caption of “planning.” I suspect that many persons now automatically associate “planning” with “tax planning.” Inasmuch as every lawyer is constantly facing a barrage of tax-planning literature from the trust companies and publishing houses, there is no need to elaborate on the special adaptability of the income and transfer taxes to forward-looking action on the part of farsighted counsel. But it should be observed that the plasticity of these taxes makes them valuable training material in other ways. They furnish a golden opportunity for the student to watch the ingenious legal mind at work. The tax cases are replete with wonderful illustrations of what a flexible lawyer can do for his clients and equally telling examples of what a too flexible lawyer can do to his clients. And the same plasticity, along with the high stakes involved, forever points up for students some of the most persistent questions of legal ethics. Of all the casebooks with which I am acquainted, those in federal taxation seem to be most constantly challenging to the morality of the bar.

In addition to offering all these possibilities, the taxation material almost inevitably lures the inquiring mind to reflect upon the relationship of law and economics. With the possible exception of the antitrust laws, in no other area in a law curriculum is the student reminded so often that there is an economic dimension to the legal matters under consideration. More and more the principal controversies in taxation get stated in terms of economic principles or doctrines. One simply cannot go very deeply into taxation without coming upon what purports to be economic analysis.

With all these lively elements inhering in the direct federal taxes, an almost limitless number of combinations for a basic Taxation course could be fashioned. We have experimented with a few, both to improve the package and to guard against any calcification. While the course has been undergoing periodic modification there has been emerging a general prescription for teaching
taxation, and it can be thought of as containing ten ingredients:

1. Students are made acquainted generally with a huge amount of substantive tax law and caused to visualize the full range of the situations or events which might bring into play the various tax rules. This broad-brush method seems most likely to make one aware of where to expect tax issues and consequences.

2. From the plethora of rules the central skeleton and the chief concepts of each of the three taxes are abstracted and emphasized. No beginner can reasonably hope to remember more than a small fraction of the substantive rules, but he can expect to understand the main architecture of the structure and the nature of the main building blocks that are employed. Stress therefore is laid on the concepts of gross income and net income; the principles of tax accounting; the pattern of taxing gains from property (that is, capital gains); the methods of taxing income derived by or through legal entities such as trusts, partnerships, and corporations; and the arrangements for relating the tax on the income of an entity to the income derived from it by its owners. A good grasp of those fundamentals enables one to analyze the source of a tax problem, and this, after all, is more important for the student than knowing the specific answer to it which happens to prevail at the moment. In law one is more apt to come up with the correct answer if he fully understands what there is about the structure of the law that produces the particular issue in question.

3. An effort is made to get students to appreciate the variety of consequences which flow from the fact that the tax law distinguishes between certain types of dollars. There is a strong tendency for students to think of the tax law without thinking of how persons are likely to shape their conduct to the distinctions which it makes. Tax law ought always be viewed through the eyes of not only the tax collectors but also the taxpayers. Tracing the full impact of any one significant distinction drawn by the law, such as that between ordinary income and capital gains, tends to direct attention to human responses to tax rules. And it assists greatly in getting hold of the main concepts on which the law rests.

4. The areas that are the storm centers in the law are emphasized, particular attention being given to why interests are likely to clash in those places. By understanding why, for example, the penalty tax on unreasonable large corporate accumulations is apt to produce controversy, one can better fit together the decided cases and appraise current situations. Concentration on the storm centers also serves to further comprehension of the central skeleton of the law.

5. The whole range of factors which might enter into tax planning in typical situations is assayed. To make this experience realistic, it seems advisable to concentrate each year on one or two hypothetical cases in which a generous supply of ersatz flesh-and-blood facts is given. For the past several years it has been my practice to crib from the panel discussions at the annual University of Chicago Tax Conference (which, incidentally, has become such an attraction that last year it was unfortunately necessary to turn down almost a hundred applications because space was not available). The discussions on tax planning are useful in counteracting the tendency to read cases from the viewpoint of litigation and not of counseling. To some extent they remind students that sound tax advice depends on a sense of good judgment as well as knowledge of the rules.

6. At least once each year an ingenious scheme proposed or executed by someone else for minimizing taxes is explored intensively. We have in the past worked on the collapsible corporation, the sale and leaseback device, and the three-generation insurance trust arrangement (and, I should add, a couple of intricate schemes whipped up by our Dr. Szilard, the atomic scientist who as a hobby is still seeking to discover a new formula for converting ordinary income into capital gain). These bright devices, in addition to buoying up the spirits of the class, are perfect for focusing attention on some of the hard ethical questions to which a lawyer should address himself.

7. An attempt is made to impart to students a sense of the abundant change that tax law is constantly undergoing. With the income tax being changed every year by legislation and sometimes twice a year, and with administrative and judicial change more than keeping pace, it is important for those on the way to becoming lawyers to get a feel for the spots and directions in which change is probable. The transactions planned or executed today very likely will be subject to a markedly different tax law of tomorrow, and the student should therefore at least mildly feel the need for anticipating what the law might come to be. To this end considerable attention is devoted to marking out the paths which changes have followed in the past and to analyzing recent and contemporary proposals for change which have been urged by responsible sources.

8. In connection with past and prospective changes, the legislative process and the role of the courts and the Bureau of Internal Revenue in effectuating change is carefully observed. It has seemed fruitful to inquire into the relative advantages and disadvantages of elaborating in great detail a statutory provision, a procedure that appears to have become more prevalent in recent years, and the alternative of couching tax legislation in general terms and leaving the details up to the Bureau or the courts.

9. While considering changes, an investigation of the standards that are available for determining whether a given change is good or bad or neutral is made. In an area where the law is undergoing rapid change it is all the more important that lawyers, who as a group are highly influential in shaping the development of the law, should understand and analyze the principles on which the law is founded. Most change in the tax field, other

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Beecher Hall To Be New Law School Dormitory and Center

With the opening of the Autumn Quarter, 1952, Beecher Hall will become a Law School dormitory and center for student activities of the School. Located immediately opposite The Law School, the building will provide living quarters for law students, eating facilities for those who wish to eat there regularly, and a central lounge for all law students. The use of Beecher Hall as part of the Law Center plan will further the program of the School, particularly with respect to the informal faculty-student seminars and the meetings between students and members of the Bar and the Judiciary.

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than that designed to bring about greater clarity, is offered on the ground of making the tax more equitable. But to view a shift in relative tax burdens as working equity, one must have accepted some standard of fairness in taxation. And the fairness standard necessarily must call into question the ultimate justice of the distribution of the tax burden in our society. It is for this reason that discussion in the Taxation course probes deeply into this question of justice—even to the extent of calling the progressive tax principle itself into issue.

10. The economic factors which bear upon taxation are taken into account. Apart from justice in the distribution of tax burdens among individuals, the only other ultimate consideration in taxation is the economic impact of a tax. Our tax laws cannot avoid having a bearing upon the level of productivity and the stability of employment in our society. At present rates of tax and at the existing level of government spending the economics of taxation is rightly a matter of concern for lawyers. An informed judgment, for instance, on the proposed constitutional amendment to limit income taxes to 25 per cent of income calls for an acquaintance with monetary and fiscal theories and programs. The same is true as to many other less far-reaching proposals. In introducing students to the economics of taxation, we have in the past been very fortunate in getting Roy Blough of the Department of Economics (but now on leave as a member of the Council of Economic Advisers to the President) to act as co-leader in the class discussions; and I look forward to resuming this arrangement again next year.

This prescription probably sounds like a large order; and perhaps it is, even though the basic course is allotted 80 classroom hours (and thus is exceeded only by Property, which wins on tradition and seniority). However, in spite of the coverage and pace, there is a gratifying amount of enthusiasm displayed by contemporary law students for work in taxation. I suppose that this too has an explanation close to the purse: it appears that law students (or their families) have more tax problems than any other type of legal problems!

There is one other phase of taxation in The Law School that deserves brief mention. Each year one or two seminars in advanced work in federal taxation are given. The seminars are organized around large themes which are surrounded by clusters of knotty problems. The last few seminars have been on such troublesome matters as the tax aspects of estate planning, compensation for executives, and getting profits out of closely held corporations.

To round out the picture, I should add that the nearest we have come to the brink of complete obscurity was a seminar on the present excess profits tax. Unlike the tax itself, the seminar probably was profitable.