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## COMMENTARIES ON PROFESSOR SNEED'S LECTURE

WALTER J. BLUM\*

The task of a commentator is invariably more difficult when he agrees with the views which have been presented. It is always easier to attack and more stimulating to take issue. Unfortunately, I find myself in agreement with most of what Sneed has said, and it is only my emphasis that is somewhat different.

First a general background note. I do not dissent from Sneed's proposition that in the world of today, and most likely in the world of tomorrow, heavy taxes will be with us and maintenance of our position of strength in the world will require them. But I would insert an important caveat. I think we should be careful that what Sneed calls our commitment to greatness is not used as a cover for a wide variety of government activities which make a doubtful contribution to our greatness. Otherwise, the political-economic system which has produced our greatness might itself be weakened and, in the process, perhaps also our greatness.

Turning to Sneed's central theme, no one can doubt that federal tax law has had an important impact on private law and that the impact has taken the three forms that Sneed has so clearly outlined. However, I suggest that his presentation may possibly be misleading if it gives the impression that changes in our private law attributable to our federal tax law bulk large. Substantial they are; but not of giant proportions. In fact, the totality of change which has occurred in our massive body of private law has itself been relatively modest, and this is what might be expected in a society in which private property plays a dominant role and which regards gradual change, rather than revolutionary change, as a major virtue. Lawyers of my generation should not be surprised to learn that while their law school course notes in taxation, labor law and other public law fields are hopelessly outdated, the main body of their notes in agency, torts, contracts, property and evidence probably need only slight updating—provided, of course, they were reasonably well designed at the start. And of that fraction of private law which has changed, I suggest that only a relatively small part has been in response to tax stimuli. As a convenient yardstick for this purpose, it might be observed that two much more potent forces for change in recent decades have been, first, the move to promote uniform private law throughout the states and, second, the ever present drive in some quarters for further codification of decisional law. Nevertheless, it is abundantly clear that the tax induced changes in private law are far from insignificant.

Moving to Sneed's analysis, I cannot get very excited over the matters covered by his first category—the distortion, corruption or reinforcement of private law by tax law. The essence of these operations is clear. Courts sometimes seize upon results in tax cases to justify a decision in a private law

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case without properly considering that the relevant purpose behind the tax rule may be wholly different from the purpose to be served by the private law rule. Sneed is sound in deploring this confusion even when by happenstance it produces a desirable private law result. My lack of excitement over the process is not due to disinterest. Rather it stems from the fact that this kind of confusion can be found all over the judicial lot, and there is nothing particularly novel or provoking when an indiscriminating opinion happens to borrow wrongly from tax law rather than from some other area of law.

The amplification aspect of tax law's impact on private law, Sneed's second category, is to me far more interesting. It is quite intriguing to watch private law struggling to develop rules which are needed only because tax law has posed questions that previously were unrecognized or lacked significance. But in observing this process, we should remain aware that it is only one side of a greater drama. Sharing the stage is the resourcefulness of taxpayers and their advisors in working out the many tax savings arrangements which then call for the amplification of private law. This resourcefulness on the part of tax experts is perhaps most striking when an old form or old device, nearly fallen into obscurity, is resurrected to live a new life under completely altered circumstances. The revival of powers of appointment in estate planning serves as a perfect illustration of this point. What I am urging here is that the wonders of such virtuosity on the part of tax experts should not be neglected when we concentrate on the amplification of private law. To a degree, the amplification of private law is in response not only to taxes but to the ingenuity of tax planners, spurred on by the tax law.

Regarding Sneed's third category, the creative response of private law to tax law, I would emphasize two points. First is the fact that the reaction of state legislatures to a tax stimulus is often surprisingly slow considering its pecuniary potency. It took years before more than a few states moved toward shifting from a common law to a community property system of ownership in order to gain the tax advantage of income splitting for their citizens. Again, the divergent treatment for gift tax purposes of a renounced legacy, on the one hand, and a rejected inheritance, on the other, was pretty old stuff before state laws undertook to put them on an equal tax footing by authorizing the disclaimer of property received through intestate succession. And to take another of Sneed's illustrations, the gift tax implication of support obligations were well publicized before proposed changes in state law appeared on the scene. This is not to say the creative response is never rapid. The recent flood of professional association legislation, following publication of Treasury regulations on the subject, testifies forcefully to the contrary. On the whole, however, the pace of reaction has been moderate and it is my guess that in relatively few instances is it likely to be very swift. But whatever the speed of the legislative reaction, I would not weaken Sneed's package of advice to tax law-makers and private law-makers. His guidelines are fundamentally sound.

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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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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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in the expense account legislation which Dean Hyman has mentioned, we almost had a distortion of federal tax law caused by rules of state substantive law. At one stage the Senate Finance Committee voted to disallow all entertainment expenses except those which a prudent man might incur. After a raft of editorials and speculation, Congress thought better of that idea and retreated to the well established federal tax principles of "directly related" and "associated with," which of course are time honored and clear.

I think Professor Sneed has well illustrated the fact of which many of us practicing in the tax field have been aware that tax pressures do influence results both in litigation and legislation in the development of legal rules, and I think that even if our destiny for this century were not our commitment to leadership of the free world that this would be true anyway. I think taxes play such a significant role in our economy that they are bound to have this effect.

As Professor Blum has pointed out, taxes are not unique in their effect upon development of private substantive law. Changing social views and economic pressures of all kinds have always shaped the development of private law. Anyone, I think, can come up with a number of instances from the law of torts, contracts or property. The first year law student case of *MacPherson v. Buick* dealing with liability of manufacturers in tort, I think, is an illustration of the impact of changing ideas and changing factors on the development of private law. Often times familiar rules are distorted to reach a particular result. Without giving a good bit of thought to it, I recall my first year class in contracts from Professor Brown where we discussed the charitable pledge cases where doctrines of consideration were changed and yielded to pressures to reach a particular desirable result. So I agree largely with Professor Blum that it is neither undesirable nor unexpected that tax factors are going significantly to effect the development of our private law; and I also agree, I think with all of my colleagues here, that the state courts must follow precedents carefully, studying and applying prior decisions in their proper context, but after all this is basically the best technique of the common law process.

And of course where state substantive rights become significant for the first time, as in the illustrations of the marital deduction cases, and the cases involving the obligation of support, it is necessary for the courts to think through and weigh carefully what they are doing. Again this is a phenomenon which we can observe in many other areas. The influence of labor relations, I dare say, has had a lot to do with the development of the law of third party beneficiaries' rights to sue on collective bargaining agreements, and so forth.

Now I am most concerned, of course, at the present time with the legislative role in this process, and I agree that it is important to those engaged in the legislative process not to pivot a significant tax distinction on insignificant features of local law or those features which cannot simply bear the strain, such as making significant tax consequences turn on definition of an obligation

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to support. I do want to say that for those engaged in the legislative process at the federal level, it is, however, frequently difficult to see these issues clearly enough, early enough, and I think I ought to defend for Professor Brown the role of the draftsman in his legislative work. The professional draftsmen on the Congressional committee staffs are unsung heroes, I think, of the tax process. They are among the most capable, expert draftsmen that anyone could ask for to be preparing vital legislation. They operate, however, under very difficult conditions and pressures not only of time. Decisions are frequently made by the Congressional committees in rather vague terms. A decision is made that we ought to disallow entertainment expenses in certain categories, then it is up to the draftsmen to fill in all of the chinks that have been left open, to try, as faithfully as they can, to carry out the legislative intent. These men are dedicated, hard working and excellent craftsmen. I think it is important that you know that most of the ambiguous drafting that we undoubtedly have in the Internal Revenue Code is not the fault of the draftsmen.

I would like to say a little bit about the role of the federal tax law in our economy. I think I would agree wholeheartedly with Professor Brown that our object is uniformity. We want to allocate the tax burden as fairly as possible among all of our citizens. However, we must recognize that, as Professor Brown has said, the tax law can really never be neutral. And so I think it is also desirable that the tax system be used to induce particular desirable social or economic purposes where those purposes are tied to a broad popular consensus of what is a desirable social purpose and that it be so used in situations where the tax law can be used appropriately to deal with the problem and non-tax approaches are not as suitable.

Let me illustrate with a couple of examples. During the consideration of the Trade Expansion Act of 1962, the trade bill, there was a good deal of pressure in order to provide tax benefits for industries and firms that were injured by import competition, and one of the usual tax devices, if you will, that, it was suggested, would be desirable in this situation is the five-year write-off of the cost of equipment, or rapid depreciation. Now it seems to me that this is a situation where there is a desirable social purpose, trying to help import-injured industries and firms to re-adjust because of the governmental action of changing tariffs which had allowed them to achieve a certain degree of prosperity. However, it seems to me that this is a case where the appropriateness of using the tax system is limited. Proper aid to the import-injured industries calls for a discrimination which it is not possible to achieve through the tax system. For example, those businesses which were most hurt would be ones that would be showing losses, and therefore an extra depreciation deduction would not be of use to them. By granting them across the board, you might help some, but much of the deductions would have been granted where not needed. It was not possible to use the tax system in the discriminating way that would be called for in that situation.

On the other hand, perhaps the consensus is that the use of a deduction for contributions to charitable organizations is a useful way to use the tax system to influence decisions. It may be desirable to encourage private philanthropy and to avoid close governmental regulation in these areas, and therefore we may have a situation where the tax law quite properly can be used to induce the particular result. Now this in turn, this tax policy, has certainly encouraged the growth of charitable institutions, among them private foundations. Here is an area where the states ought to respond to a federally tax induced situation to regulate, but the states have abdicated their responsibility. There have been many cases of abuses of charitable foundations, and because the states have not exercised control, it may be necessary again for the federal government to step in through changes in the tax system or otherwise.

I would agree finally with Professor Sneed that the economic interests and pressures generated by the impact of taxation are such that we are always going to have a vying to induce certain results through changes in the tax law. I think I have a more optimistic view than he does. By and large I think that in the end it is all going to work out all right. We have seen a period of a tax structure with very high rates which has led to many inroads in the tax base which have produced and created a lot of these distortions about which Professor Sneed has been talking, but I think the atmosphere is such and the consciousness of people in our country today is such that the pendulum is swinging the other way; and I think that now counterpressures have been set in force which will induce a correction of some of these, the greatest of the distortions and an awareness of the possible effects of the tax law; and I think that not only in the administrative end of government but in the legislative end there is a new awareness of the problems requiring careful use of tax policy to induce or prevent a tax inspired response. I can say again for the Secretary that we are looking forward next year not only to a rate revision which will mean a reduction in personal and corporate income taxes from top to bottom but also a correction of some of the factors which have been productive of some of the distortion; and hence we may expect toward a greater uniformity of taxation than we have had in recent years, with more heed paid to the admonitions of Professor Sneed to weigh carefully the reaction which tax action will induce.