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Retroactive Federal Inheritance Tax

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COMMENT ON RECENT CASES

CONSTITUTIONAL LAW—DUE PROCESS—RETROACTIVE FEDERAL INHERITANCE TAX.—[United States] In 1907 Mr. and Mrs. J. R. Coolidge of Boston, Massachusetts, conveyed without consideration valuable real and personal property to trustees, who were to pay the income thereof to the settlors for life, and, after the death of both, to divide the property among their children. In 1917 the settlors assigned their entire interest in this trust to the children. In 1917 Mr. and Mrs. Coolidge conveyed other valuable real estate, used by them as residences, to the children as a gift, taking back a lease for one year at a nominal rental. It was understood that annual renewals of this lease would be made as long as the lessees desired, but there was no binding agreement to this effect. When these transfers were made they were not taxed by any federal statute. The federal revenue act of Feb. 24, 1919,[1] purported to tax transfers of this character, whether made before or after its passage, as intended to take effect in possession or enjoyment at or after the death of the transferrer, and for the purposes of the tax valued such property at its value at the time of the transferrer's death. The tax, a percentage of the net value of the estate (including such transfers), was made a lien upon the entire estate (including such transfers), but only the estate distributable at the owner's death, if sufficient, was made ultimately liable for the tax. Rights of reimbursement against the distributable estate and of contribution against other transferees, if such estate was insufficient, were given to transferees who paid any part of the tax. The federal collector compelled the executors of Julia Coolidge, the surviving settlor, to pay inheritance taxes upon all of the above property, valued at her death at over $700,000, though her net distributable estate amounted to only $103,000. In a suit against the collector in the Massachusetts district court[2] the executors recovered these taxes, and this was affirmed by the United States Supreme Court in *Nichols v. Coolidge*[3] on May 31, 1927.

Mr. Justice McReynolds (for five judges) held the tax law, as applied to prior transfers, so arbitrary, capricious, and confiscatory as to violate the Fifth Amendment. Justices Holmes, Brandeis, Sanford, and Stone concurred in the result without opinion. The opinion of McReynolds stressed the unfairness of such a tax upon a transaction not taxable when it took place, not made in contemplation of death, and not with any possible design of evading a tax which did not then exist; and especially the capricious and burdensome effect of valuing the property for taxation at the time of the transferrer's death, when it might have been transferred many years before when worth but a fraction of its present value. "Different estates must

1. 40 Sts. 1057, ch. 18 secs. 401-2, 408-9.
2. *Coolidge* v. *Nichols* (1925) 4 Fed. (2nd) 112.
3. (1927) 47 Sup. Ct. Rep. 710.

bear disproportionate burdens determined by what the deceased did one or twenty years before he died."[4] To the argument that Congress was not really taxing these prior transfers, but merely using them to measure the tax upon the estate possessed by the decedent at death, the same answer was made as to a similar claim under the Fourteenth Amendment in *Frick v. Pennsylvania,*[5] where that state tried to measure the amount of an inheritance tax upon Pennsylvania property by a percentage of the value of the whole estate, part of which consisted of chattels situated in New York:

"Of course this was but the equivalent of saying that it was admissible to measure the tax by a standard which took no account of the distinction between what the state had power to tax and what it had no power to tax, and which necessarily operated to make the amount of tax just what it would have been had the state's power included what was excluded by the Constitution. This ground, in our opinion, is not tenable. It would open the way for easily doing indirectly what is forbidden to be done directly, and would render important constitutional limitations of no avail."[6]

The case is the first one squarely holding a federal taxing act invalid under the Fifth Amendment. Various other federal taxes have been held void: (1) because levied upon forbidden subjects of taxation, such as exports[7] or the governmental functions of a state;[8] or (2) because levied in a manner specifically forbidden, such as an unapportioned direct tax;[9] or (3) because exercising an improper regulatory effect upon conduct reserved by the Constitution solely to state control, such as the child labor tax[10] and the tax upon trading in grain futures;[11] but no federal tax has heretofore been held bad as a violation of due process of law only. Indeed, some of the language of Mr. Justice White in earlier cases seemed to deny that this clause was a limitation upon the taxing power of Congress, unless the latter was exercised in so outrageous a way as to be not really taxation at all.[12] That the requirement of due process in the Fourteenth Amendment is a limitation upon state powers of taxation has been often held, and there is no good reason why the Fifth Amendment should not similarly limit the United States—though of course the limitations may not be exactly the same, due to the fact that the United States has diplomatic, treaty, and war powers at its disposal denied to the states.[13]

4. 47 Sup. Ct. Rep., at 714.
5. (1925) 268 U. S. 473.
6. 47 Sup. Ct. Rep., at 713.
7. *Fairbanks* v. *United States* (1901) 181 U. S. 283.
8. *Collector* v. *Day* (1871) 11 Wall. 113; *Ambrosini* v. *United States* (1902) 187 U. S. 1.
9. *Pollock* v. *Farmers' Loan & Trust Co.* (1895) 157 U. S. 429.
10. *Child Labor Tax* Case (1922) 259 U. S. 20.
11. *Hill* v. *Wallace* (1922) 259 U. S. 44.
12. See some of his observations in *McCray* v. *United States* (1904) 195 U. S. 27, 61-64; *Brushaber* v. *Union Pacific R. R.* (1916) 240 U. S. 1, 40.
13. See *United States* v. *Bennett* (1914) 232 U. S. 299; and *Cook* v. *Tait* (1924) 265 U. S. 47; comparing *Union Refrigerator Transit Co.* v. *Ken-*

On the facts the decision was not difficult, as the life estate of the grantors, reserved by the first conveyance of 1907, had been entirely divested by the second conveyance of 1917, leaving only the final distribution of the trust fund to be postponed to the death of the grantors at the time the tax law was passed. This circumstance was made the sole ground of decision in the lower federal court and was probably the ground of concurrence of the four judges who agreed "in the result." It is noteworthy, therefore, that McReynold's opinion does not even mention this circumstance (save in the preliminary recital of facts), but would apparently have been as applicable had no conveyance of the donors' life interest been made, either upon the ground (1) that the transfer in 1907 of the future remainder in fee after the donors' reserved life interest left nothing that could constitutionally be the subject of a later federal succession tax, or (2) that the mode of taxing this remainder (i. e. valuing it at the time it came into possession instead of when created) was so unreasonable that it could not be used, even if a tax upon its passing into the enjoyment of the donees, enacted after its creation, would otherwise be valid.

Unless the present case may be thought to decide the first point, it has not yet been passed on by the federal Supreme Court, though several state decisions deny the validity of such a tax enacted after the creation of the remainder but before the termination of the preceding life interest.[14] A succession tax upon vested distributive shares, passed after the death of the owner of the estate but before distribution in the settlement of the estate, has been upheld in several states and by the Supreme Court of the United States.[15]

The second point, if valid, may very arguably apply to transfers made after the passage of the taxing act, as well as those made before, and the opinion of the court specifically reserves judgment as to this.[16] Suppose A transfers to B today the remainder in fee to a farm worth $10,000, reserving to himself a life interest. Twenty-five years from now a deposit of copper ore is found on the farm, and it becomes worth $1,000,000 at the death of A, the life tenant. Could A's estate be validly compelled to pay a tax upon a valuation of $1,000,000 for the passage of this remainder into the possession of B, an interest created 25 years before and then worth only $10,000? B perhaps might not unfairly be required to pay such a tax upon the occasion of his coming into the enjoyment of his remainder (whether called a succession tax or not), but it might wipe out A's entire estate to pay it, while its amount, as contrasted with either A's

tucky (1905) 199 U. S. 194; *Barclay & Co.* v. *Edwards* (1925) 267 U. S. 442; comparing *Royster Guano Co.* v. *Virginia* (1920) 253 U. S. 412.

14. In re *Pell* (1902) 171 N. Y. 48; In re *Craig* (1904) 97 App. Div. 289, affirmed in (1905) 181 N. Y. 551; *Hunt* v. *Wicht* (1917) 174 Calif. 205; Matter of *Potter* (1922) 188 Calif. 55; In re *Lyon* (1922) 233 N. Y. 208; In re *Houston* (1923) 276 Pa. 330 (semble). Contra: *Safe Deposit Co.* v. *Tait* (1923) 295 Fed. 429.

15. *Galsthorpe* v. *Furnell* (1897) 20 Mont. 299; *Levy's Succession* (1905) 115 La. 377; *Cahen* v. *Brewster* (1906) 203 U. S. 543.

16. 47 Sup. Ct. Rep., at 714.

ability to pay or his responsibility for its sum, would be purely accidental. Is not the running of such a risk too harsh a penalty to require A to pay for making such a conveyance? Compare *Schlesinger* v. *Wisconsin* (1926) 270 U. S. 230.

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LIBEL AND SLANDER—CONDITIONAL PRIVILEGE—JUDICIAL PROCEEDINGS.—[New York] In *Campbell* v. *New York Evening Post*,[1] the New York Court of Appeals held in an action for libel that the defendant newspaper was conditionally privileged to publish the substance of a complaint that was withdrawn by the plaintiff before the judge had taken any action thereon. The court recognized this as an extension of the protection of privilege beyond its limits in England and in nearly all of the American jurisdictions. The appellate division had sustained the defendant's plea of privilege and dismissed the complaint. The court of appeals held that there was error in dismissing the complaint, but approved the view of the court below in favor of the privilege. Since the case was sent back to be tried again, the rule announced may be taken as the one the court expects to follow.

The decision was based on the interpretation of section 337 of the civil practice act which provides that:

"An action, civil or criminal, cannot be maintained against a reporter, editor, publisher, or proprietor of a newspaper, for the publication therein of a fair and true report of any judicial, legislative or other public or official proceedings, without proving actual malice in making the report."

The court took the position that the protection of the statute extends to every part of a judicial proceeding, and since an action starts with service of a summons, the filing of a complaint is a part of the proceeding. The court might well have construed "judicial proceeding"[2] to exclude the contents of pleadings that have not come to the attention of the judge, and this part of the statute would have been declaratory of the common law. However, dissatisfaction is expressed in the opinion with the distinctions[3]

1. (1927) 157 N. E. 153.

2. "The term 'judicial proceeding' means and includes any trial, hearing, inquiry, or investigation, by or before any judicial tribunal, whether in open court or in private, and whether of a final, or of an interlocutory or preliminary character, and whether ex parte or inter partes." *George Spencer Bower* "A Code of the Law of Actionable Defamation" (2nd ed. 1923) art. 28 and art. 35 (VI). See *Hale* "Law of the Press" (1923) p. 95.

3. "Thus with each state tending to introduce one refinement after another not only will the phrase 'judicial proceeding' have a great variety of legal meanings, but there will be lost to the law the important element of predicability which seems here desirable." 24 Mich. Law Rev. 489, at p. 492.

Strictly it seems that a newspaper should not be privileged to publish the substance of a pleading unless the judge's action required an examination of its contents. This view has not prevailed. The course of decisions may be attributed, in part, to a desire to state a rule that can be applied without too much difficulty. The attempt to attain certainty may result in unnecessary injustice. The question in the *Campbell* case is whether the court