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Some Reflections about the Impact of Federal Taxation on American Private Law

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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to learn that while their law school course notes in taxation, labor law and other public law fields are hopelessly outdated, the main body of their notes in agency, torts, contracts, property and evidence probably need only slight updating—provided, of course, they were reasonably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 undiscriminating 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.
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 backstopping 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.

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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