common shareholder, entitled to a part of all dividends and assets distributed to the common stock. Yet part of this new interest has been acquired at the expense of the interests formerly represented by the preferred stock; for the preferred must now share all distributions with a larger class of common shares. Each preferred share now represents a smaller proportionate interest in any excess distributions over and above the amount of its preference. Consequently this is a case in which the shareholder undoubtedly does receive an increased proportionate interest in the corporation; but in which the new interest is only partially distinct from the former interest. The new certificate represents partly gain secured at the expense of the common shareholders, and partly the old interest in excess distributions. It seems impossible to say, consistently with the *Eisner* case, that the new shares of common stock received by the holder of participating preferred represent a gain derived from the capital, *severed* from the original capital interest; yet it seems impractical to allow a stockholder to escape taxation on a new and valuable property interest merely because it is imperfectly dissociated from his original capital. As Mr. Justice Holmes said in his dissent in *Eisner v. Macomber*, the purpose of the Sixteenth Amendment was to get rid of nice questions of this kind.[44]

PROHIBITING REFUNDS OF UNCONSTITUTIONAL TAXES*

Under the authority of the unconstitutional Agricultural Adjustment Act,[1] the Internal Revenue Bureau collected processing taxes of approximately a billion dollars.[2] At the time the act was passed the statutory and common law provided for refunds of unconstitutionally-collected taxes regardless of whether or not the tax had been shifted to consumers,[3] and there was no general pro-

and also 10,000 shares of common stock. Suppose that in a given year the earnings are $275,-000, and that these are distributed in cash. The preferred will receive its $5 per share and $20 extra; and the common likewise will receive $25. But suppose that in 5 successive years the directors issue the preferred dividends in common stock and make no further distributions. Now the same $275,000 will be distributed, $5 per share and $13.75 extra; but the share of each preferred shareholder, holding one preferred and 5 common, will be $5 and $107.50 extra. The share of the *preferred stock* has been reduced in the ratio of 25.0 to 18.75; but the share of the *preferred shareholder* has been increased in the ratio of 112.5 to 25.0. The preferred shareholder would make a similar gain with respect to share in the assets on dissolution, or book value.

[44] 252 U.S. 189, 220 (1920).

* For related problems see Field, The Recovery of Illegal and Unconstitutional Taxes, 45 Harv. L. Rev. 501 (1932).

[1] 48 Stat. 31 (1933); 7 U.S.C.A. § 601 *et seq.* (1936), hereafter referred to as the AAA. It was held unconstitutional in United States v. Butler, 297 U.S. 1 (1936).

[2] 14 Tax Mag. 108 (1936).

[3] U.S. Rev. Stats. § 3220 (1878); 45 Stat. 996 (1928); 26 U.S.C.A. § 1670(a) (1) (1935). See notes 14 and 15 *infra*.

vision in the AAA altering this rule.[4] More than two years later, however, Congress passed § 21 (d) of the AAA amendment, providing that "No refund .... shall be made of .... any tax .... which accrued before, on, or after [the date of the amendment] .... unless .... it shall be established .... to the satisfaction of the Commissioner of Internal Revenue .... that neither the claimant nor any person .... under his control .... passed on any part of such amount. ...."[5] Section 21 (d), eliminating numerous existing causes of action against the government and its collectors on taxes paid before the amendment, will probably be contested before the Supreme Court as unconstitutional under the due process clause of the Fifth Amendment.[5a]

Except for *United States v. Jefferson Electric Mfg. Co.*[6] no Supreme Court cases have been found involving a limitation of refunds on taxes paid before the limiting statute was passed. In the *Jefferson* case taxes were paid on the sale of automobile parts later held not to be within the terms of the tax law. A statute, passed after these payments, forbade refunds unless the tax was not shifted, putting the burden of proof on the taxpayer. In suits against both the government and its collectors the Supreme Court, speaking through Mr. Justice Van Devanter, held the statute constitutional almost without discussion. "If the taxpayer has borne the burden of the tax, he readily can show it; ...."[7] In the light of this decision the Court has three courses open to it in the processing tax cases: (1) to distinguish the *Jefferson* case; (2) to reexamine its premises and conclude that they are unsound; or (3) to agree with it and hold the amendments of the AAA constitutional.

The differences between the present cases and the *Jefferson* case are not extensive. There the tax was upon manufactured single items, here upon quantities of fungible goods; but this is of no apparent importance. There the tax was upon sales by sales unit, here upon an operation by units which bear a less obvious relationship to the sales unit; and the processors rely heavily upon this difference as increasing the improbability of accurate proof of non-shifting. Finally, there the illegal act was merely overassessment by a collector, here passage of an unconstitutional act by the Congress; and it may be that the Court will wish to encourage thorough collection by the collectors while discouraging the passage of unconstitutional statutes. These differences, however,

[4] There are provisions for specific limited refunds, as for example, where the processed goods were sold for charitable purposes. 48 Stat. 39, 973 (1933); 7 U.S.C.A. § 615 (5) (c) (1936); see also §§ 615 (a), 616 (a) (2), 617 (a) of the same title.

[5] 49 Stat. 770 (1935); 7 U.S.C.A. § 623 (d) (1936). This section was substantially re-enacted in § 902 of title VII of the Revenue Act of 1936. 49 Stat. 1747 (1936); 7 U.S.C.A. § 644 (1936). Added were rules for presumption of passing-on, discussed later in this note. See note 25 *infra* and text.

[5a] See Lincoln Mills v. Davis, 15 F. Supp. 257 (Ala. 1936) (statute constitutional); Edwin Cigar Co. v. Higgins, 14 F. Supp. 817 (N.Y. 1936) (unconstitutional).

[6] 291 U.S. 386 (1934).

[7] *Id.* at 402.

while useful as a pretext to avoid an express overruling, would hardly lead to a different result if the Court really approves the decision in the *Jefferson* case.

In deciding upon the constitutionality of § 21 (d) under the Fifth Amendment, it is material to consider whether or not the processor has sustained any real loss as a result of the assessment under the AAA. For statutes affecting existing causes of action as well as for other statutes attacked under the due process clause the fundamental constitutional inquiry has been whether or not the plaintiff has suffered financial injury. The courts have generally phrased their opinions, however, in terms of whether or not a cause of action existed and whether the statute interfered with this cause of action itself or merely affected the manner of its enforcement. It is said that while a cause of action is a vested right, the remedy by which it is enforced is not. Hence if only vested rights are property under the due process clause, it must follow that statutes "merely affecting the *remedy*" are constitutional while statutes "impairing the *cause of action*" are not.[8] As in the numerous other rules of law in which the remedy-substance formula is used, the courts have not defined the terms but have relied upon common sense and precedent. For example there could be little hesitation in holding remedial a statute transferring cases involving small amounts from the district court to a small claims court and similarly little in holding substantive one abolishing the right to recover small amounts. The latter attempts to take something away, the former merely to regulate the method of obtaining it. But it is clear that the result aimed at in the latter could be accomplished by transferring all such cases to a court sitting in Hawaii or to a local court having very arduous and expensive procedure, though such a statute would in form merely regulate the method. In other words the rule suggested, if mechanically followed, would lead to contrary results in substantially indistinguishable cases because of unimportant differences in the wording of the laws. For this reason it has been contended that the rule should be that those statutes which are reasonable are constitutional, those unreasonable, not.[9] The same result could be reached by a recognition that *remedial* bears a special, very restricted meaning in this group of constitutional cases. In extreme instances the courts have usually had little difficulty in invalidating retroactive statutes which were apparently remedial but which really injured prospective litigants.[10]

In *Campbell v. Holt*[11] the United States Supreme Court held constitutional a

[8] "But there is no such thing as a vested right to a particular remedy." Chief Justice Shaw in Commonwealth v. Comm'rs of Hampden, 6 Pick. (Mass.) 501, 508 (1828). See also Standifer v. Wilson, 93 Tex. 232, 54 S.W. 898 (1900).

[9] See Smith, Retrospective Laws and Vested Rights, 5 Tex. L. Rev. 231, 247–48 (1927), and 6 Tex. L. Rev. 409 (1928), especially at 424–26; 35 Yale L. J. 478 (1926); 2 Austin, Jurisprudence 856 (5th ed. 1885).

[10] Danzer & Co. v. Gulf & S.I.R. Co., 268 U.S. 633 (1925); Chambers v. Gallagher, 177 Cal. 704, 171 Pac. 931 (1918); see Willard v. Harvey, 24 N.H. 344, 354 (1852). But see Gilbert v. Selleck, 93 Conn. 412, 106 Atl. 439 (1919); Orman v. Van Arsdell, 12 N.M. 344, 78 Pac. 48 (1904).

[11] 115 U.S. 620 (1885).

retroactive law increasing the statute of limitations period, which had the effect of reviving a cause of action between private parties previously barred. The statute was considered remedial. In later cases in various fields the Court, speaking through Mr. Justice Brandeis, continued to insist upon a rather mechanical remedy-substance formula, and this insistence reached its peak in *Lynch v. United States*.[12] There the Congress, having passed laws providing for insurance with the government, passed the Economy Act repealing all of these laws. The plaintiff sued as a beneficiary under one of the policies issued, and the government pleaded that it had withdrawn its consent to be sued. The Court held the Economy Act a "repudiation" of the obligation, hence substantive and unconstitutional. But the *dictum* was clear that Congress could constitutionally have achieved the result desired merely by forbidding all courts and administrative officers to hear the claim. This would be remedial because there would still be recourse to the legislative body.[13]

Whether the Court bases its decision on a more or less mechanical application of the remedy-substance formula or inquires primarily into the practical effects upon the taxpayers may depend in part upon which of the possible remedies is pursued. The causes of action which § 21 (d) is alleged to affect unconstitutionally were clearly existing prior to the passage of the amendment to the AAA. Processors had two alternative methods of recovering the taxes illegally exacted: (1) sue the United States,[14] or (2) sue the collector in his individual capacity.[15] Since the amendment applied to both types of suits, either of these actions could now be used to test its constitutionality. But since there are no words of repudiation but merely descriptions of proofs to be required by the commissioner, it is possible that the amendment would be called "remedial," in an action against the government, irrespective of the damage done the processors. For this reason the bulk of the suits have been against the collector in the hope that the court might here adopt the rule of reasonableness since the *dictum* in the *Lynch* case applied only to suits against the government. After a judgment has been obtained against a collector of internal revenue, the govern-

[12] 292 U.S. 571, 582 (1933). See United States v. Babcock, 250 U.S. 328, 331 (1919); Pusey & Jones v. Hanssen, 261 U.S. 491, 497–500 (1922).

[13] Such recourse is not barred by a repudiation either. It is not a right, but a privilege.

[14] The law in effect when the taxes were collected provided that "The Commissioner . . . . is authorized . . . . to remit . . . . all taxes . . . . illegally assessed. . . . ." U.S. Rev. Stat. § 3220 (1878); 14 Stat. 111 (1866); 26 U.S.C.A. § 1670 a (1) (1935). This is weak language to be construed as giving a "right," but a later section clearly provides for court action against the government when the Commissioner refuses to allow the claim. U.S. Rev. Stat. § 3226 (1878); 14 Stat. 152 (1866); 26 U.S.C.A. §§ 1672–73a (1935).

[15] White v. Hopkins, 51 F. (2d) 159 (C.C.A. 5th 1931); Holmes, Federal Income Tax 936 (1922). Section 910 of the 1936 Revenue Act abolishes the liability of the collector in his individual capacity for the return of the AAA taxes, but processors continue to sue the collector and the federal judges ignore the provision. Being clearly substantive in language and referring to existent causes of action, it is unconstitutional under the discussion here made unless the Court discards the notion of collector's individuality.

ment becomes, for all practical purposes, the principal debtor. The issuance of a "certificate of probable cause" by the trial court operates as a perpetual stay of execution against the property of the collector and obligates the Commissioner of Internal Revenue to pay the judgment.[16] But Mr. Justice Holmes, speaking for the Court, has insisted that a suit against a collector is a purely personal matter, is not in fact against the government.[17] While this is historically accurate and the reasons given are not entirely without force, it is hard to believe that history and these reasons were the real grounds for the decision. In effect the emphasis upon the individuality of the collector seems to spring from a desire to protect the taxpayers by avoiding what the *dictum* in the *Lynch* case sought to establish—the government's extreme freedom from liability.[18] If a suit against a collector is personal, the rule of sovereign's immunity does not apply to it and recovery cannot be foreclosed by congressional action; and further, the collector is not really injured because the administration will realize, for political if not moral reasons, that it must play square with its collectors. It is probable, then, that the Court will not base its decision, in a suit against a collector, on nomenclature—"remedial" or "substantive"—but may adopt the increasingly popular rule of reasonableness. If the proof requirements in question have the effect of depriving processors of refunds which they otherwise would and should have received, they are unconstitutional.

But the necessity for showing that he *should* have received these refunds may well prove fatal to the processor's case. There is little doubt that he was entitled to a refund under the old law. Doubtful, however, is the policy behind such refunds. Though the action for money had and received is a common law action, its rules are principally equitable. Recovery is denied unless the unjust enrichment complained of was at the financial expense of the complainant.

[16] For a detailed discussion of the legal relationship of the parties after the certificate is issued, see Dunnegan v. United States, 17 Ct. Cl. 247 (1881). See also Nixon v. United States, 18 Ct. Cl. 448 (1883).

[17] Smietanka v. Indiana Steel Co., 257 U.S. 1 (1921). Four reasons were given for denying an action against a collector's successor in office: (1) "When the suit is begun, it cannot be known with certainty that the judgment will be paid out of the Treasury." This is not forceful because the government will protect its collectors and the Commissioner is instructed to reimburse them for judgments collected against them. 45 Stat. 996 (1928); 26 U.S.C.A. § 1670 (b) (1935). (2) "A stranger to an unwarranted transaction" (the successor in office) cannot be made answerable. (3) A suit against the collector survives his death and can be revived against his executrix. Patton v. Brady, 184 U.S. 608 (1901). In the Patton case the contention was merely that the action for refund was a tort action and hence that it abated on the death of the collector. (4) A "collector may be liable for interest." Today the government is also liable for interest. 42 Stat. 316 (1921); 28 U.S.C.A. § 284 (1928).

[18] For the reasons behind such an immunity see United States v. Lee, 106 U.S. 196, 206 (1882), and Dodge, How To Sue the Government, 8 Marquette L. Rev. 267, 273 (1924). The rule, wisely or not, seems to be axiomatic and impregnable. Pelkey v. United States, 71 F. (2d) 21, 222 (App. D.C. 1934). Congress, as well as the courts, is aware of the citizen's disability. See remarks of Senator Bankhead, 79 Cong. Rec., pt. 10, 11403 (July 18, 1935). This immunity, however, is strictly "remedial," as the decision in the Lynch case proves. See note 12 *supra* and text.

This principle has been carried over to tax refund cases where the nominal taxpayer is a conduit for monies paid to him merely to be repaid to the government.[19] If he did not *in fact* sustain a loss by the payment he is not "in equity and good conscience" entitled to a refund. The government will probably contend that the Agricultural Adjustment Act was passed on the assumption that the processor would not pay the tax but would pass the burden on to his vendee, and that in most cases the price of processed goods was indeed increased by substantially the amount of the tax.[20] Hence he is a mere "conduit" and has no cause for complaint. But while increased price necessarily involves increased burden on the consumer, it does not necessarily involve decreased burden on the processor. If the price charged was increased, the amount sold must also have decreased to some extent, and since the unit profit was not increased, the total profits must have decreased in proportion to the drop in sales. How much financial burden the processor actually bore in any particular instance is extremely difficult if not impossible to ascertain with any precision.[21] The ability to "shift" a tax tends to vary inversely with the degree of monopoly,[22] the elasticity of demand, the difference in efficiency between marginal and average producers,[23] and to vary directly with the elasticity of supply. Other variables which must be taken into account are quality of the product, seasonal and secular trends, credit terms and discounts, the general market and the market in related industries. Processors argue that since it is impossible to assess numerical values to these factors, § 21 (d) set up an impossible condition and

[19] See Richardson Lubricating Co. v. Kinney, 337 Ill. 122, 168 N.E. 886 (1929). Though Van Antwerp v. State, 218 N.Y. 422, 113 N.E. 497 (1916), *contra*, has not been overruled by the New York Court of Appeals, it has been criticised and ignored in other jurisdictions.

[20] ". . . . when Congress was considering the subject of processing taxes, it was very well understood that such taxes would be passed on to the consumer. . . . . I assert that the processor who did not pass on the tax on the goods he sold is an incompetent business man. . . . ." Senator Murphy in 79 Cong. Rec., pt. 10, 11458 (July 19, 1935).

[21] See E. R. A. Seligman, Shifting and Incidence of Taxation, especially at 338–55 (3d ed. 1910); Fagan, Tax Shifting and the Laws of Cost, 47 Quart. J. Econ. 680, 691 ff. (1933).

[22] Since an increase in variable expense does not change the point of maximum net profit, a monopolist, who charges the price which nets him the greatest profit, will not change his price because of the imposition of an excise tax, a variable expense. The profit, then, will be decreased by exactly the amount of the tax paid. Tobacco processors did not see fit to alter their prices upon the passage of the AAA. Business Week, Jan. 18, 1936, p. 7. For a discussion of the price policy of the "Big Three" cigarette companies see Fortune, December, 1936, especially at 158. These are monopolistic in the sense that their sales are not seriously affected by price-cutting competition and their prices are set at the point of maximum net profit.

[23] If the same number of units continued to be sold, the price would be raised by the amount of the tax since there would be the same marginal producer and his costs would be increased by the amount of the tax. But as the price increases, the amount demanded ordinarily decreases, and the marginal producers are eliminated. Being more efficient, the new marginal producers do not have to raise their prices by the amount of the tax and will tend to be forced by competition not to raise them that much. As the differential in efficiency between successive marginal producers increases, the amount of necessary price-change decreases and the decrease in profit because of the tax increases.

left them to the arbitrary whims of the commissioner.[24] In amending § 21 (d) by § 907 of the Revenue Act of 1936,[25] Congress attempted to avoid this complaint by establishing presumptions for ascertaining whether or not a processor passed on the tax. For instance if the processor can show that his average margin of profit per processed unit was lower during the tax period than before and after, there is a presumption that he bore the tax to that extent. Otherwise there is a contrary presumption. Either of these presumptions is rebuttable, presumably by proof of such facts as change in production rate or customary seasonal fluctuations. It must be confessed, however, that even with the presumptions the inconvenience and expense of proof are very great and yet little better than an approximation of the processors' losses can ever be made. Profit rates are affected by so many apparently unrelated and practically unassessable factors that a profit change from the tax period to the no-tax period cannot be put with any precision upon the cessation of the tax. What numerical value, for instance, should be put upon the passage of the soldiers' bonus bill,[26] a lag in reduction of prices after the invalidation of the tax and consequent customer displeasure,[27] or the drop in general markets because of the demise of the AAA?[28]

Sections 21 (d) and 907, then, do take away causes of action that once existed and do injure the processors to some extent. But if the Supreme Court adopts the rule of reasonableness, it must find not only that holding the act constitutional will injure the processors but that holding it unconstitutional will not cause greater injury to the public. It is generally conceded that much of the tax was shifted.[29] Since in most cases the processors' customers will have no re-

[24] See brief of counsel for petitioner on petition for *certiorari* in Rickert Rice Mills v. Fontenot (297 U.S. 110 (1936)) 23–30.

[25] 49 Stat. 1751 (1936); 7 U.S.C.A. § 649 (1936).

[26] "However, men's wear markets became very active, when it was ascertained that congress would override the veto on the bonus bill." Woolsley, Cotton Goods Prices Lowered to Eliminate Processing Tax, Dun & Bradstreet Monthly Review, February 1936, p. 36.

[27] See *ibid.*

[28] In judgments on the importance of this and similar factors no precision whatever can be attained. One measure of the farm market, Sears Roebuck & Co. sales, shows receipts of $25,644, 816, in the four weeks ending Jan. 29, 1936, a drop of $22,400,000 from the preceding four weeks. The Butler decision, invalidating the AAA, was handed down on Jan. 6, 1936. A drop is to be expected after the Christmas season, however, and these sales were 16.1 per cent better than those of the corresponding period in 1935. But it was the largest drop since 1930 ($23,500,000), and the drop in the preceding year had been only $16,000,000. And the period was, relatively speaking, a boom period. See generally Business Week, Feb. 8, 1936, p. 6.

[29] Even Senator George, opposed as he was to the limitation on refunds, thought the tax was shifted. He contended, however, that it was shifted not to the consumer but, in reverse, to the producer by a drop in the price paid by the processor for raw materials. 79 Cong. Rec., pt. 10, 11449 (July 19, 1935). See also Seligman, *op. cit. supra* note 21, at 373, 339. Ezekiel and Bean, supporting the AAA for the Administration, estimated in 1933 that over 75 per cent of the tax on cotton could be shifted. Economic Bases for the Agricultural Adjustment Act 60 (U.S. Dept. of Agric. 1933), quoted in Richards, Cotton under the Agricultural Adjustment Act 101 (Brookings Institution 1934).

course even if able to prove that the prices were raised because of the tax,[30] the refunds will prove a windfall to the processors. On the other hand in spite of any injury to the processors it cannot be denied that the public also "paid" the tax in increased expenditure and decreased consumption. If the refunds were enforced, the administration would have to levy new taxes which taxpayers would again pay. Favorable to the processor is the argument that an administration will not hesitate overmuch to levy unconstitutional taxes if the money collected need not be returned. A rule which encourages a Congress to disregard the protective clauses of the Constitution is ordinarily to be frowned upon. Furthermore the courts will hesitate even less than now to enjoin the collection of doubtful taxes if there is an express condition to refunds, thus preventing efficient financial administration. Unfavorable, however, is the fact that the processing taxes were unconstitutional not of themselves, but merely because they were part of the unconstitutional AAA.[31] Processors injured by the tax and not otherwise by the AAA have no more complaint, really, than any other taxpayer. And since the government relied upon these taxes in planning its budget, enforced refunds would prove an unsettling factor in public and private finance. This argument should not be emphasized too much, but it is given some force by the popular approval of the New Deal legislative policies manifested at the November election. After considering all these elements the Supreme Court might reasonably conclude that the principles upon which the *Jefferson* case was decided were sound and are here applicable, and that §§ 21 (d) and 907 are constitutional.

[30] In Heckman & Co. v. Dawes & Son Co., 12 F. (2d) 154 (App. D.C. 1926), the buyer was denied recovery because the court refused to admit that the tax was "paid" by anyone except him who handed the money over to the government, *i.e.*, the seller. Even Wayne County Prod. Co. v. Duffy-Mott Co., 244 N.Y. 351, 155 N.E. 669 (1927), frequently cited as *contra* to the Heckman case, was strictly limited to cases "where the promise of the buyer is to pay a stated price and to put the seller in funds for the payment of a tax besides." Otherwise "the buyer is without remedy. . . . ." Relatively few contracts expressly separated the tax from the rest of the price, and it was difficult to do so because the tax was not upon sales by unit but upon a manufacturing operation by volume. But see the uniform contract suggested by the Millers' National Federation.

[31] United States v. Butler, 297 U.S. 1, 58, 79 (1936).