

**Income Tax—Change of Status before Passage of Retroactive Tax—[Wisconsin].—** Plaintiff was assessed under a special emergency tax law,<sup>1</sup> taxing income of the preceding year, enacted several months after the plaintiff had ceased to reside in Wisconsin. The tax was on the basis of plaintiff's income derived from property located outside the state as well as that owned in the state. *Held* (two judges dissenting), the tax was valid. *Scobie v. Wisconsin Tax Commission*.<sup>2</sup>

Apparently the income tax is the only tax which still retains a multiple basis for taxation.<sup>3</sup> It is no longer open to question that the residence of the recipient of income is a valid basis,<sup>4</sup> and it has long been established that control of the property which is the source of the income taxed is a basis.<sup>5</sup> This result would seem to follow whether the income tax is regarded as a composite property, personal and excise tax<sup>6</sup> or as a tax *sui generis*.<sup>7</sup> It has been stated that there is no third basis of income taxation for states,<sup>8</sup> and in the instant case when the tax was enacted Wisconsin had neither basis, but it did have clear right to tax the plaintiff unless the removal nullified the effect of plaintiff's residence while receiving the income.

The retroactive features of the tax aside from the plaintiff's removal should be distinguished from the problem of legislative jurisdiction. The constitutional prohibition of *ex post facto* laws has been construed to apply to penal laws exclusively,<sup>9</sup> but nevertheless it is felt that the "impairment of obligations" clause, and the "due process" amendments limit the legislative power to pass retroactive laws.<sup>10</sup> Tax laws may be retroactive unless unreasonable.<sup>11</sup> Although retroactive property,<sup>12</sup> excise,<sup>13</sup> gift,<sup>14</sup> and inheritance tax laws<sup>15</sup> have been held unconstitutional, yet no income tax law has ever

<sup>1</sup> Wis. L. (Sp. Sess.) 1931-1932, c. 29.

<sup>2</sup> 275 N.W. 531 (Wis. 1937).

<sup>3</sup> Jacobson, *State Jurisdiction to Tax Income*, 85 U. of Pa. L. Rev. 795 (1937).

<sup>4</sup> Maguire v. Trefry, 253 U.S. 12 (1920); Lawrence v. Mississippi, 286 U.S. 276 (1932); Cohn v. Graves, 300 U.S. 308 (1937).

<sup>5</sup> Shaffer v. Carter, 252 U.S. 37 (1920); Whitney v. Graves, 299 U.S. 366 (1937).

<sup>6</sup> Maguire, *Relief from Double Taxation of Income*, 32 Yale L. J. 757, 760 (1923); Smith, *Residence in New York under the State Income Tax Law*, 9 Tax Mag. 168, 170 (1931).

<sup>7</sup> State v. Frear, 148 Wis. 456, 134 N.W. 673 (1912); Brown, *The Nature of the Income Tax*, 17 Minn. L. Rev. 127, 143 (1932).

<sup>8</sup> Dewey v. Des Moines, 173 U.S. 193, 204 (1899); Fitch v. Wis. Tax Comm., 201 Wis. 383, 230 N.W. 37 (1930); 1 Beale, *Conflict of Laws* 638 (1935); Stimson, *Jurisdiction and Power of Taxation* 86 (1933); 1 Cooley, *Taxation* 219 (4th ed. 1924); 4 Cooley, *id.* at 3489.

<sup>9</sup> U.S. Const. art. 1 § 9; Kentucky Union Co. v. Kentucky, 291 U.S. 140 (1911).

<sup>10</sup> Smith, *Retroactive Laws and Vested Rights*, 5 Tex. L. Rev. 231 (1926); 6 Tex. L. Rev. 409 (1927).

<sup>11</sup> Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935).

<sup>12</sup> First Nat. Bank of Covington v. Covington, 103 Fed. 523 (C.C. Ky. 1900).

<sup>13</sup> Forbes Boat Line v. Bd. of Commissioners, 258 U.S. 338 (1922); Lowenhaupt, *The Power of Congress to Impose Excise Taxes Retroactively*, 21 St. Louis L. Rev. 109 (1936). *Contra*: U.S. v. Hudson, 299 U.S. 498 (1937).

<sup>14</sup> Blodget v. Holden, 275 U.S. 142 (1927); Untermeyer v. Anderson, 276 U.S. 440 (1928).

<sup>15</sup> Helvering v. Helmholz, 296 U.S. 93 (1935); Binney v. Long, 299 U.S. 280 (1936); Coolidge v. Long, 282 U.S. 582 (1931); Nichols v. Coolidge, 274 U.S. 531 (1927). *Cf.* Third National Bank v. White, 287 U.S. 577 (1932).

run afoul the federal Constitution because of retroactivity.<sup>16</sup> An income tax on the preceding year's income as in the instant case is not lacking in "due process,"<sup>17</sup> and a tax retroactive for two and a half years has been upheld.<sup>18</sup> A recent New York statute, the validity of which has not been tested, is retroactive seventeen years.<sup>19</sup> A retroactive income tax is usually not considered objectionable because an income can not be determined until the end of a year and then only on the whole year's income;<sup>20</sup> or because it is not really retroactive, but only uses a series of past transactions as a measure for a person's ability to pay a present tax;<sup>21</sup> or because of the supposition that such an income tax never deters a person from attempting to get an income.<sup>22</sup> This last rationale is weakened in several instances: (1) where the taxpayer might have shifted the tax to somebody else;<sup>23</sup> (2) where the taxpayer might not have continued to reside in the state if the tax rate had been higher; (3) where the taxpayer might not have realized an accumulated income in the particular period.<sup>24</sup>

To assert jurisdiction here puts a strain on the traditional definition of jurisdiction.<sup>25</sup> But there are many situations in modern law where personal jurisdiction is successfully asserted, although at the time the jurisdiction is exercised the person is not within the territorial limits of the state.<sup>26</sup> Perhaps the most celebrated examples are *Hess v. Pawloski*<sup>27</sup> and *Young v. Masci*,<sup>28</sup> which establish a state's personal jurisdiction over an absent and non-resident motorist for causes of action out of his, or his agent's, operation of the motor vehicle over the roads of the state. Although not clearly established by the authorities the better view would seem to be that removal from a state before the

<sup>16</sup> Ballard, *op. cit. supra* note 11; see *Cooper v. U.S.*, 280 U.S. 409 (1930); *Brushaber v. Union Pac. R.*, 240 U.S. 1 (1916). *Cf. Smith v. Dirckx*, 283 Mo. 188, 223 S.W. 104 (1920) (state constitution).

<sup>17</sup> *Stockdale v. Insurance Co.*, 20 Wall. (U.S.) 323, 331 (1873) (dictum); *Stanley v. Gates*, 179 Ark. 886, 19 S.W. (2d) 1000 (1929); *West v. Tax Comm.*, 207 Wis. 557, 242 N.W. 165 (1932); *Appeal of Van Dyke*, 217 Wis. 528, 259 N.W. 700 (1935).

<sup>18</sup> *Welch v. Henry*, 223 Wis. 319, 271 N.W. 68 (1937).

<sup>19</sup> N.Y.L. 1935 c. 933. See *Cohn v. Graves*, 271 N.Y. 353, 3 N.E. (2d) 508 (1936).

<sup>20</sup> 23 Va. L. Rev. 953 (1936).

<sup>21</sup> *Smith, Retroactive Income Taxation*, 33 Yale L. J. 35 (1923).

<sup>22</sup> *Neuhoff, Retrospective Tax Law*, 21 St. Louis L. Rev. 1, 10 (1935).

<sup>23</sup> See *Burnett v. Wells*, 289 U.S. 670 (1933).

<sup>24</sup> Ballard, *op. cit. supra* note 11, at 599.

<sup>25</sup> 1 Beale, *op. cit. supra* note 8, 274 *et seq.*; *Barnett, Definition of Jurisdiction*, 47 Am. L. Rev. 518 (1911); *McDonald v. Mabee*, 243 U.S. 99 (1917); see note 8 *supra*.

<sup>26</sup> By consent. Rest., Conflict of Laws § 80 (1934). Residents temporarily outside state. *Becker v. Becker*, 218 S.W. 542 (Tex. Civ. App. 1920). Over a corporation which has withdrawn from business conducted in the state. *Mutual Reserve Co. v. Phelps*, 190 U.S. 147 (1903); *Western Grover Co. v. N.Y. Oversea Co.*, 296 Fed. 269 (D.C. Cal. 1924); *Flour City Co. v. General Bronze Co.*, 21 F. Supp. 112 (1937). Over an absent citizen. *Cook v. Tait*, 265 U.S. 47 (1924) (income tax); *Blackmer v. U.S.*, 284 U.S. 421 (1931). For acts done within state. Rest., Conflict of Laws § 77(e) (1934); *Doherty v. Goodman*, 294 U.S. 623 (1935).

<sup>27</sup> 274 U.S. 352 (1927).

<sup>28</sup> 289 U.S. 253 (1933). See *Gessell v. Wells*, 134 Misc. 331, 236 N.Y. Supp. 381 (1929). Note that in these cases the law was in force when the acts were done.

assessment day, but after the taxable period does not avoid the tax.<sup>29</sup> The decision in the instant case seems to involve no great extension of the term, jurisdiction,<sup>30</sup> but merely an alignment with those who maintain that jurisdiction is determined by considerations of fairness rather than technical requirements of sovereignty.<sup>31</sup>

Considered separately neither the retroactivity of the tax nor the absence of the taxpayer when jurisdiction is sought to be exercised are fatal. Nor should the two occurring in the same case be objectionable, unless, as the dissent contends,<sup>32</sup> the combination creates an unusually harsh and arbitrary case of retroactivity. But any hardships arising from the levying of the tax would have been equally as great if the plaintiff had continued to reside in Wisconsin, and apparently, unlike personal property<sup>33</sup> and poll taxes,<sup>34</sup> the state into which the plaintiff moved would not be able to tax plaintiff's entire income for the year 1931 on the basis of residence in that state the last few days of the year or on the assessment date.<sup>35</sup> The plaintiff has enjoyed the same protection from the laws of Wisconsin while receiving his income which those who remained in the state enjoyed, and considerations of fairness would seem to justify treating the plaintiff the same as those who continued to reside in the state.

In support of the court's position there are cases where the validity of a retroactive income tax upon the income of a taxpayer losing his taxable status before the passage, but after the effective date, of the tax has been upheld.<sup>36</sup> In *Brady v. Anderson*,<sup>37</sup> one who had received income after the effective date, but who died prior to the passage of the Income Tax Statute of 1913, which was imposed on citizens and residents, was held, although recognized as not being either a citizen or a resident at the time of the passage of the statute, subject to the tax, since the effect of making it retroactive was to apply it the same as if it had been enacted on its effective date. And similarly, the complete dissolution of a corporation before the passage of a retroactive income tax statute does not release the stockholders from liability for the tax on income received by the corporation between the dates when the statute became effective and the corporation dissolved.<sup>38</sup>

In view of the many states passing income tax laws, and the frequent rate changes in income tax laws, the decision is of more than momentary importance. Nor can the

<sup>29</sup> *McCarty v. Tax Comm.*, 215 Wis. 645, 255 N.W. 913 (1934).

<sup>30</sup> *Stumberg*, Conflict of Laws 68, 91 (1937).

<sup>31</sup> *Ross*, The Shifting Basis of Jurisdiction, 17 Minn. L. Rev. 146 (1932); *Scott*, Jurisdiction over Non-Residents Doing Business within the State, 32 Harv. L. Rev. 871 (1919); *Learned Hand, J.*, in *Smolik v. Philadelphia and Reading Coal Co.*, 222 Fed. 148 (C.C.A. 2d 1915); *Feyerick v. Hubbard* 71 L. J. K. B. 509 (1902).

<sup>32</sup> P. 536.

<sup>33</sup> *Harding*, Double Taxation of Property and Incomes 53 (1933), and cases there cited.

<sup>34</sup> *Stimson*, *op. cit. supra* note 8.

<sup>35</sup> *Greene v. Tax Comm.*, 221 Wis. 531, 266 N.W. 270 (1936); *Hart v. Tax Comm.*, 240 Mass. 37, 132 N.E. 621 (1922); *Kennedy v. Comm. of Corp. and Tax'n.*, 256 Mass. 426, 152 N.E. 747 (1926). *Cf.* 59 *McKinney Ann. L. N.Y. c. 350* (7) (1936).

<sup>36</sup> See *Messinger v. Tax Comm.*, 222 Wis. 156, 267 N.W. 535 (1936) (distinguished by the majority, p. 534).

<sup>37</sup> 240 Fed. 665 (C.C.A. 2d 1917) *cert. denied*, 244 U.S. 654 (1917).

<sup>38</sup> *U.S. v. McHatton*, 266 Fed. 602 (D.C. Mont. 1920); *Updike v. U.S.*, 8 F. (2d) 913 (C.C.A. 8th 1925) *cert. denied*, 271 U.S. 661 (1926).

problems presented be considered academic after the recent decision *Milwaukee County v. White Co.*<sup>39</sup> holding tax judgments entitled to full faith and credit, and in view of the further possibility that tax assessments made with "due process of law" may be accorded an extraterritorial effect.<sup>40</sup>

**Income Tax—Distinction between Gift and Compensation—[Federal].**—All the stockholders of *A* Corporation joined in forming *B* Corporation, transferring to it funds of *A* Corporation, which were then used to purchase assets of *C* Corporation. *C* Corporation then acquired the entire stock of *A*. *B* Corporation then distributed \$607,500 of the corporate assets to petitioner and other designated former and present employees of *A* "as a bonus. . . in recognition of the valuable and loyal services" rendered *A*. *B* charged these payments to its surplus account; no attempt was made by the corporations involved to deduct them for federal income tax purposes. The taxpayer treated the payment as a gift deductible from gross income.<sup>1</sup> The Board of Tax Appeals and the Circuit Court of Appeals agreed with the Commissioner of Internal Revenue that the payment to petitioner was not a gift but was compensation. On appeal, *held* (four justices dissenting), reversed. Although the question was a mixed one of law and fact, there was *no evidence* to support a finding that the payment was compensation. *Bogardus v. Helvering*.<sup>2</sup>

If the payment is treated as compensation, it is taxable to the recipient as income<sup>3</sup> and is deductible by the payor as expense in computing his income tax.<sup>4</sup> If the payment is treated as a gift, it is not taxable to the recipient, is not deductible by the payor in computing his income tax, and is taxable to the payor as a gift.<sup>5</sup> Which determination will yield maximum revenue depends upon the particular case.<sup>6</sup>

On payments up to approximately a million dollars the income tax rate is decidedly greater than the gift tax rate.<sup>7</sup> So sharp a difference in treatment suggests a difference

<sup>39</sup> 296 U.S. 268 (1935).

<sup>40</sup> Goodrich, *Conflict of Law Since the Restatement*, 23 Am. Bar A. J. 119, 121 (1937); Hazelwood, *The Full Faith and Credit Clause as Applied to Enforcement of Tax Judgments*, 19 Marq. L. Rev. 10 (1934); 22 Marq. L. Rev. 54 (1937); 45 Yale L. J. 339, 350 (1936); cf. *Moore v. Mitchell*, 30 F. (2d) 600 (C.C.A. 2d 1929) *aff'd* on other grounds, 281 U.S. 18 (1930).

<sup>1</sup> 48 Stat. 686 (1934), 26 U.S.C.A. § 22 (1934). "§ 22. Gross Income. (a) General definition: 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal services, of whatever kind and in whatever form paid . . . (b) Exclusions from gross income. . . (3) Gifts, bequests and devises. The value of property acquired by gift, bequest, devise, or inheritance . . . ;"

<sup>2</sup> 302 U.S. 34 (1937), reversing 88 F. (2d) 646 (C.C.A. 2d 1937).

<sup>3</sup> In such a case the recipient may also be subjected to an increased rate if the payment moves him into a higher bracket.

<sup>4</sup> 48 Stat. 687 (1934), 26 U.S.C.A. § 23 (1934); see *Lucas v. Ox Fibre Brush Co.*, 281 U.S. 115 (1930).

<sup>5</sup> 48 Stat. 758-761 (1934), 26 U.S.C.A. §§ 550-551 (1934).

<sup>6</sup> For example, a payment of \$100,000 to a single recipient will produce \$13,940 more revenue if treated as compensation; but the same payment if made in \$5,000 shares to twenty recipients will yield \$4,060 more revenue if treated as a gift.

<sup>7</sup> 48 Stat. 684 (1934), 26 U.S.C.A. §§ 11-12 (1934); 48 Stat. 758-761 (1934), 26 U.S.C.A. §§ 550-551 (1934).