The William O. Douglas Tax Factor: Where Did the Spin Stop and Who Was He Looking Out For?

I Jay Katz
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I. **INTRODUCTION**

In closing each offering of the *O’Reilly Factor*, also known as the No Spin Zone, Bill O’Reilly makes the following pledge to his viewers: “The spin stops here, because we are definitely looking out for you.” In theory, this means that in consideration of an important issue, O’Reilly solicits the positions of advocates on opposite sides of the issue. Most likely, however, the views and perspectives they offer are spun from the self interest and bias of their respective ideology or political leanings. To counter that spin, essential fair and balanced objective facts are presented so the merits of the opposing positions can be adequately debated and analyzed. Consequently, an informed viewer can achieve a “no-spin” understanding of the issue from which to make a reasoned judgment.
By analogy, a tax controversy between the Commissioner of the Internal Revenue Service (the Commissioner)\(^2\) and a taxpayer is a “spin zone” of differing interpretations of tax statutes reflective of the parties’ competing self interests. This is evident from the two basic types of tax statutes — those designed to increase the tax base (inclusion sections) and those designed to decrease the tax base (deduction sections). Thus, in a federal income tax controversy in which the inclusion of an item in gross income or the allowance of a deduction of an expense is in dispute, the Commissioner and the taxpayer would likely disagree on whether the relevant section is broad enough to include it or allow it, respectively. When a tax controversy reaches the Supreme Court of the United States, the Court should follow the O’Reilly model and consider the merits of the statutory interpretations of the parties who present their respective positions with an obviously biased spin. Since a tax statute is enacted by Congress, the task of the Court is to cut through the spin and render a decision based on an unbiased interpretation of the applicable statutory language that is consistent with the legislative purpose of the statute. Ideally, the Court’s opinion should reflect its fair and balanced “no-spin” analysis of the relevant issues that led to its ultimate conclusion. The decision should also provide prospective guidance regarding the scope of the tax statute in controversy to the Commissioner and all taxpayers.

Contrary to the O’Reilly model, William O. Douglas, wrote a significant number of majority and dissenting opinions in a wide range of tax controversies over the thirty-six plus years that he served on the bench that, with few exceptions, were slanted with the spin of the party he clearly favored.\(^3\) In fact, many Douglas opinions read more like briefs than opinions. In addition to their obvious bias, Douglas’s opinions often lacked well-reasoned analysis, ignored some of his brethren’s compelling counterarguments, and misconstrued, minimalized, or completely ignored contrary judicial, administrative, and legislative authority. Moreover, Douglas’s majority opinions frequently crossed the line of judicial interpretation into judicial legislation that often lead to absurd outcomes and punitive consequences to the losing party.

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2. For purposes of this article, the terms “Commissioner,” “Treasury,” and “Government” are used interchangeably.

3. Justice Douglas served on the Supreme Court bench from April 16, 1939-November 11, 1975. He was much better known for his opinions regarding constitutional law and individual liberties than for his opinions relating to tax issues.
Early in Douglas's judicial tenure, his opinions were decidedly spun in favor of the Commissioner as he implemented judicial interpretations of tax statutes that often resulted in inequitable consequences to the taxpayer.\(^4\) Then, inexplicably, shortly after he rendered arguably his harshest majority opinion against the taxpayer,\(^5\) Douglas's allegiance shifted from the Commissioner to the taxpayer.\(^6\) Although throughout this period Douglas's opinions were generally spun in favor of the taxpayers' position — with some notable exceptions — they were more balanced than his Pro-Commissioner Period opinions; they were also the most well-reasoned tax decisions of his judicial career. In his final years on the bench, Douglas's zeal for the taxpayers' position was nearly unconditional as he became the Court's de facto taxpayer advocate in rendering extremely biased pro-taxpayer opinions.\(^7\)

The purpose of this article is to critique the evolution of Douglas's tax legacy as his judicial spin shifted from being a staunchly pro-Commissioner, rogue Justice early in his judicial tenure to an equally zealous pro-taxpayer, rogue Justice at the end of his career. In doing so, the article engages in a comprehensive analysis of a cross section of Douglas's prominent majority and dissenting opinions from all three periods.

Part I of the article provides an in-depth analysis of Douglas's opinions in the Pro-Commissioner Period. Specifically, Section II(A)(1) discusses two cases that exemplified his tendency to render overreaching judicial interpretations of tax statutes favorable to the Commissioner in a manner that crossed the line into judicial legislation. Next, Section II(A)(2) provides a thorough examination of four majority opinions in which Douglas's judicial interpretations resulted in absurd outcomes that were not only inequitable to the taxpayer, but also contrary to congressional intent. Section II(A)(3) analyzes Douglas's majority opinion in Textile Mills Secur-

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4. The author refers to this period, 1939-44, as the “Pro-Commissioner Period” throughout this article.

5. See generally Virginian Hotel Corp. of Lynchburg v. Comm'r, 319 U.S. 523 (1943).

6. The author refers to this period, 1944-58, as the “Pro-Taxpayer Period” throughout this article.

7. See Bernard Wolfman, Jonathan L. F. Silver & Marjorie A. Silver, *Dissent Without Opinion: The Behavior of Justice William O. Douglas in Federal Tax Cases*, 122 U. Pa. L. Rev. 235, 276 (1973). In an excellent analysis of Douglas's conduct in tax cases as well as in other areas of law, the authors divided Douglas's judicial tenure into the following four periods: Period 1, 1939-1943: The Government Years; Period 2, 1943-1959: The Shift to the Taxpayer; Period 3, 1959-1964: The Extreme Years; and Period 4, 1964-1973: Tempered Rebellion. *Id.* This article's author refers to the period 1958-75 as the Taxpayer Advocate Period throughout this article.
ities Corp. v. Commissioner," in which he implemented an over-reaching Treasury Regulations per se ban on the deductibility of lobbying type expenditures in the absence of any statutory authority to do so. Section II(B) discusses Douglas's Pro-Commissioner majority opinion in Virginian Hotel Corp. of Lynchburg v. Commissioner, in which he ignored congressional intent in arguably his most unduly harsh opinion with punitive tax consequences to the taxpayer decided near the end of the Pro-Commissioner Period.

Section III focuses on the Pro-Taxpayer Period. First, Section III(A) examines the mellowing tone of Douglas's final majority opinion of the Pro-Commissioner Period that was a precursor of the more moderate pro-taxpayer opinions he later delivered during Douglas's Pro-Taxpayer Period. Section III(B) then explores a series of cases in which Douglas's dissenting opinions advocated the consistent application of judicially-created doctrines in a manner favorable to the taxpayer. Section III(C) examines two of Douglas's "no-spin" majority opinions in which his literal interpretation of the accrual accounting sections of the Internal Revenue Code ironically resulted in inequitable outcomes for the taxpayer and Commissioner, respectively.10

Section IV critiques Douglas's strongly biased pro-taxpayer opinions written during the Taxpayer Advocate Period; the final phase of his judicial career. Section IV(A) begins with a discussion of several of Douglas's dissenting opinions in which he criticized the majority's pro-Commissioner judicial interpretations of tax statutes that in his view crossed the line into judicial legislation. Interestingly, Douglas's criticism of judicial interpretations extended only to cases in which the outcomes were inequitable to the taxpayer. Section IV(B) explores several distinct areas of tax law in which Douglas was definitely biased in favor of the taxpayer including the deductibility of traveling expenses and a taxpayer's rights against intrusive IRS examinations. Section IV(C) analyzes two of Douglas's opinions in which he took different views of whether the substance or the form of the transaction was determinative of the ensuing tax consequences. Finally, Section IV(D) analyzes Douglas's unequivocally pro-taxpayer dissenting opinions in three landmark tax cases decided by the Court during the Taxpayer Advocate Period.

10. For purposes of this article, all references to sections of the "Code" are to substantially similar, earlier versions of sections of the Internal Revenue Code of 1986.
II. **DOUGLAS OPINIONS IN THE PRO-COMMISSIONER PERIOD**

A. **Going Rogue: Douglas’s Judicial Interpretations of Tax Statutes Crossed the Line into Judicial Legislation.**

During Douglas’s judicial tenure, many of the tax controversies decided by the Court involved the interpretation of an imperfectly drafted tax statute. This is because inartful statutory language often left open questions regarding the scope and reach of the statute. For example, a tax statute Congress enacted to achieve a specific tax result in a particular transaction or event, through “design or oversight,” might also be susceptible to an interpretation that unduly prejudiced the Commissioner or the taxpayer.

In dealing with ambiguously drafted tax statutes, Justice Frankfurter, a contemporary of Douglas, cautioned that even though tax statutes should be interpreted as literally as possible, the “literalness of meaning affixed merely to a particular word or phrase may itself distort what the provision as an entirety and in context conveys and therefore commands.” Accordingly, if a literal interpretation of a tax statute (a Literal Interpretation) would lead to an absurd result, it would be appropriate for the Court to render a judicial interpretation consistent with the intended purpose of the statute (a Judicial Interpretation). Yet in spite of the merits of that approach, the Court should not render a Judicial Interpretation of a tax statute that crosses the line and becomes the equivalent of judicial legislation. Therefore, no matter how rational, a Judicial In-

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11. See Lewyt Corp v. Comm’r, 349 U.S. 237, 249 (1955) (Frankfurter, J., dissenting) (commenting on the imperfections of tax statutes and stating that “[r]evenue laws are notoriously not expressions of an ordered system of reason and fairness. There has probably never been a revenue statute which, by design or oversight, has not favored some groups and laid the basis for a claim of unfairness to other similarly situated.”).

12. Id.

13. In his dissenting opinion in Commissioner v. Clifford, Justice Roberts summarized the appropriate role of the Court as follows:

If judges were members of the legislature they might well vote to amend the act... but, as judges, they exercise a very different function. They ought to read the act to cover nothing more than Congress has specified. Courts ought not to stop loopholes in an act at the behest of the Government, nor relieve from what they deem a harsh provision plainly stated, at the behest of the taxpayer. Relief in either case should be sought in another quarter.

309 U.S. 331, 341-42 (1940) (Roberts, J., dissenting). Similarly, in Commissioner v. Maguire, Circuit Judge Kerner stated:

Every statute is to be construed with reference to its intended scope and to the purpose of the legislature in enacting it, and where language is used which admits of more than one meaning, it is to be taken in such a sense as will conform to the scope of the act and carry out the purpose of the statute, being mindful, however, that it is not permissible under the pretense of interpretation to make a law, either by extension or restriction, which shall depart from legislative intent.

111 F.2d 843, 845 (7th Cir. 1940).
interpretation that effectively amends the underlying statute should give way to a Literal Interpretation and be left to Congress to clarify any unintended result through legislative amendment.\textsuperscript{14}

Virtually every majority and dissenting opinion written by Douglas during the Pro-Commissioner Period was based upon an overreaching Judicial Interpretation. The following three prong test derived from the majority opinion of Justice Jackson, a Douglas contemporary, in \textit{Commissioner v. Griffiths},\textsuperscript{15} would have provided a useful guideline for Douglas to consider in evaluating whether his Judicial Interpretations crossed the line into judicial legislation (the Judicial Interpretation Test). Applying that test, a Judicial Interpretation would not be appropriate depending upon the extent it conflicted with (1) a substantial body of prior court decisions interpreting the statute; (2) previously promulgated Treasury Regulations and pronouncements purporting to interpret and implement the statute; and (3) legislative history relevant to Congress’ approval of the judicial and administrative interpretations of the statute (\textsuperscript{1} and \textsuperscript{2} above) (the Three Branch Authority).

Unfortunately, in many of Douglas’s Pro-Commissioner Period opinions, he ignored, misconstrued, or trivialized the weight of compelling Three Branch Authority in rendering Judicial Interpretations that would not have passed muster under the Judicial Interpretation Test. In those opinions, often with limited or no analysis, Douglas tended to minimize or completely disregard such authority in rendering a Judicial Interpretation favorable to the Commissioner.

1. \textit{Two Cases Decided in the Pro-Commissioner Period Exemplified Douglas’s Judicial Interpretations.}

In \textit{Commissioner v. Hallock},\textsuperscript{16} and \textit{Commissioner v. Griffiths},\textsuperscript{17} the Commissioner asked the Court to apply a Judicial Interpre-

\textsuperscript{14} In addition, a Judicial Interpretation would also be inappropriate if it extended an application of the underlying statute to a situation not contemplated by Congress. For example, in \textit{Orr v. United States}, the Fifth Circuit held that the taxpayer was not entitled to depreciate an automobile and airplane used in his charitable work. 343 F.2d 553 (5th Cir. 1965). The court reasoned that depreciation was not a “payment” within the meaning of I.R.C. § 1-170(a)(1) (allowing for a deduction for “any charitable contribution . . . [the] payment of which is made within the taxable year”). \textit{Id.} In doing so, the Fifth Circuit stated, “It is entirely possible, as the taxpayer suggests, that Congress and its Committees were not thinking of depreciation when they used the word ‘payment.’ The absence of any evidence as to whether Congress focused on this problem provides no basis for extending the meaning of payment to include depreciation.” \textit{Id.} at 556.

\textsuperscript{15} Comm’r v. Griffiths, 318 U.S. 371, 402 (1942).


\textsuperscript{17} Comm’r v. Griffiths, 318 U.S. 371 (1942).
tion that would overrule prior decisions. In both cases, the requested Judicial Interpretation arguably crossed the line into judicial legislation. In the former case, the majority (Douglas joining) adopted a Judicial Interpretation to overrule two Supreme Court precedents.\(^8\) Conversely, in Griffiths, the majority (Douglas dissenting) rejected the Commissioner's request and applied what it believed to be the correct Literal Interpretation in refusing to overrule *Eisner v. Macomber.*\(^9\) In both cases, Douglas embraced the Judicial Interpretations advocated by the Commissioner. Because those cases were replete with Three Branch Authority contrary to those Judicial Interpretations and showcased the contrasting judicial philosophies reflected in the majority and dissenting opinions, the following detailed discussion of those decisions is warranted.

a. *Commissioner v. Hallock*\(^{20}\)

Although Douglas did not write the majority opinion, the essence of the decision in *Hallock* set the tone for Douglas's opinions written during the Pro-Commissioner Period. In *Hallock,* decided shortly after Douglas was appointed to the Court, Justice Frankfurter's majority opinion adopted a Judicial Interpretation that was arguably unsupportable against the weight of substantial contrary Three Branch Authority. On the other hand, in a scathing dissenting opinion, Justice Roberts advocated a Literal Interpretation consistent with Three Branch Authority and criticized the majority's Judicial Interpretation as crossing the line into judicial legislation.\(^{21}\) The *Hallock* decision involved the interpretation of the following italicized words set forth in the predecessor of § 2037(a) providing the inclusion in the decedent's gross estate of “'any interest . . . of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death . . . .'”\(^{22}\) Applying a Literal

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\(^8\) Those cases were *Commissioner v. St. Louis Union Trust Co.*, 296 U.S. 39 (1935), and *Becker v. St. Louis Union Trust Co.*, 296 U.S. 48 (1935).


\(^{20}\) As discussed *infra* notes 214-20 and accompanying text, in a dissenting opinion rendered in the Taxpayer Advocate Period, Douglas directly contradicted these early opinions by rejecting Judicial Interpretations as being an inappropriate exertion of judicial power preferring to leave "to Congress the correction of any inequities in the tax scheme." United States v. Skelly Oil Co., 394 U.S. 678, 689 (1969) (Douglas, J., dissenting). He also expressed his regret for voting with the majority in *Hallock:* "Perhaps the most egregious error that we made in my time (one for which I take partial blame) was *Helvering v. Hallock* . . . ." *Id.* at 690, n.2 (citations omitted).

\(^{21}\) *Hallock*, 309 U.S. at 123.

\(^{22}\) *Id.* at 110 n.1 (emphasis added).
Interpretation of the italicized words within the context of the statute, if a decedent made an inter vivos transfer to a beneficiary of an interest in property that did not completely mature into possession or enjoyment until or after the decedent's death, the underlying property would be included in the decedent's gross estate. Conversely — still under a Literal Interpretation — if the beneficiary's interest in the underlying property did completely mature prior to the decedent's death, it would not be included in the decedent's gross estate.

Prior to the Hallock decision, in separate cases, the Court had applied a Literal Interpretation of the predecessor of § 2037(a) to factually different transfers and reached opposite results. In the first case, Klein v. United States, the decedent, by deed, conveyed land to his wife for life retaining the beneficial interest in the land. If, at the decedent's death, his wife survived him, as she ultimately did, the land would become vested in her in fee simple. Because the transferred interest did not mature into ownership until the decedent's death, the Court held the property was included in the decedent's gross estate pursuant to the predecessor of § 2037(a).

Subsequently, in two cases involving similar transfers (St. Louis Trust cases), decedents transferred property into an irrevocable trust with income to be paid to their children for life, with various remainder interests to pass to other beneficiaries. In the event the decedent's children-beneficiaries did not survive the decedent, the property would revert back to the decedent. Unlike the Klein case, however, in which the beneficiary's interest did not mature until the decedent's death, in the St. Louis Trust cases, the children-beneficiaries' interests in the transferred property were established at the time of the transfer with only the possibility of reversion if the children-beneficiaries failed to survive the decedent. From that perspective, the children-beneficiaries' already established interests would not be affected by the fact that they survived the decedent. Therefore, based upon a Literal Interpretation of the predecessor of § 2037(a), the Court held that the underlying property was not included in the decedent's gross estate.

24. Id. at 233.
25. Id. at 234. In reality, the amount included in the gross estate was the value of the land less the value of the life estate. Id. at 233.
27. Hallock, 309 U.S. at 112-17.
Arguably, the real difference between the *Klein* case and the *St. Louis Trust* cases was in form not substance, because in each case, the final impediment to the beneficiaries' absolute right to the complete acquisition of the underlying property was not removed until the decedent's death. Yet, based upon a Literal Interpretation of the predecessor of § 2037(a), the Court reached opposite results.

In *Hallock*, the transfers resembled those in the *St. Louis Trust* cases, and, thus, the question before the Court was whether it should: (1) affirm the results reached in those cases based upon a Literal Interpretation of the predecessor of § 2037(a), or (2) overrule the *St. Louis Trust* cases and adopt a Judicial Interpretation that would elevate substance over form. From the tone of Justice Frankfurter's opinion, it was clear the majority of the Court (including Douglas) believed the *St. Louis Trust* cases were wrongly decided and should be overruled.\(^28\) Yet, in light of compelling adverse Three Branch Authority, doing so would arguably cross the line into judicial legislation.

As to judicial authority, the first prong of the Judicial Interpretation Test, there was a substantial body of case law with holdings consistent with the *St. Louis Trust* cases, including three earlier Court cases.\(^29\) Moreover, in the years between *May v. Heiner* and the *St. Louis Trust* cases, there were eight Board of Tax Appeals decisions,\(^30\) five of which were affirmed by the court of appeals,\(^31\) as well as three other court of appeals decisions affirming district court decisions\(^32\) — all of which followed at least one of the court cases. Finally, in the five years between the *St. Louis Trust* cases and the *Hallock* case, there were a total of thirty-one decisions from courts that were also consistent with the holding of the latter cases.\(^33\)

\(^28\) *Id.* at 114-22. Justice Frankfurter believed the only difference between the transfer in *Klein* and the transfers in the *St. Louis Trust* cases was the wording of the conveyances. *Id.*


\(^31\) Comm'r v. Duke, 62 F.2d 1057 (3d Cir. 1933); Comm'r v. Wallace, 71 F.2d 1002 (2d Cir. 1934); Comm'r v. Dunham, 73 F.2d 752 (7th Cir. 1934); Comm'r v. Austin, 73 F.2d 758 (7th Cir. 1934); Comm'r v. Bonney, 75 F.2d 1008 (2d Cir. 1935).

\(^32\) Tait v. Safe Deposit & Trust Co., 74 F.2d 851 (4th Cir. 1935); Tait v. Safe Deposit & Trust Co., 78 F.2d 534 (4th Cir. 1935); Comm'r v. Helmholtz, 75 F.2d 245 (D.C. Cir. 1934).

Although Justice Frankfurter acknowledged the substantial amount of negative case law had the weight of stare decisis, he believed that the doctrine embodied in the *St. Louis Trust* cases should give way to the sounder doctrine of extending the scope of the predecessor of § 2037(a) to *St. Louis Trust* case type transfers. Conversely, in the dissenting opinion, Justice Roberts scoffed at the majority’s casual dismissal of the role of stare decisis, stating as follows:

If there ever was an instance in which the doctrine of *stare decisis* should govern, this is it . . . . To nullify more than fifty decisions, five of them by this Court, some of which have stood for a decade, in order to change a mere rule of statutory construction, seems to me an altogether unwise and unjustified exertion of power.

Additionally, as to the second and third prongs of the Judicial Interpretation Test, in the aftermath of the *St. Louis Trust* cases, Treasury pronouncements and congressional action were consistent with the Court’s holdings in those cases. For example, there were Treasury Regulations explicitly adopting the Court’s holding in those cases. Also, throughout the period in which courts decided numerous cases consistent with the *St. Louis Trust* cases, Congress amended other portions of the statute without making any changes to overrule the holdings in those cases. First, in May 1931, one day after the Court had reaffirmed *May v. Heiner*, a *St. Louis Trust* type case, Congress amended the predecessor of § 2037(a) without making any change to overrule the Court’s holding in the *St. Louis Trust* cases. Then, one year later, Congress reenacted the statute without change. Subsequently in 1934, Congress amended a different subsection of the predecessor of § 2037 leaving § 2037(a) intact.

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1259 (1937); Mitchell v. Comm'r, 37 B.T.A. 1 (1938); Stone v. Comm'r, 38 B.T.A. 51 (1938); Harter Bank v. Comm'r, 38 B.T.A. 387 (1938); White v. Comm'r, 39 B.T.A. 593 (1938); Donnelly v. Comm'r, 39 B.T.A. 1234 (1938); Pyeatt v. Comm'r, 39 B.T.A. 774 (1939); Dravo v. Comm'r, 40 B.T.A. 309 (1939); Old Colony Trust Co. v. United States, 15 F. Supp. 417 (D. Mass. 1936); Myers v. Migrader, 15 F. Supp. 488 (D. Md. 1936); Chase Nat’l Bank v. United States, 28 F. Supp. 947 (S.D.N.Y. 1939); Comm'r v. Brooks, 87 F.2d 1000 (2d Cir. 1937); Bollard v. Comm'r, 90 F.2d 144 (7th Cir. 1937); Welch v. Hassett, 90 F.2d 833 (1st Cir. 1937); United States v. Nichols, 92 F.2d 704 (1st Cir. Mass. 1937); Mackay v. Comm'r, 94 F.2d 558 (2d Cir. 1938); Comm'r v. Grosse, 100 F.2d 37 (9th Cir. 1938); Comm'r v. Hallock, 102 F.2d 1 (6th Cir. 1939); Comm'r v. Kaplan, 102 F.2d 329 (1st Cir. 1939); Rothensies v. Cassell, 103 F.2d 834 (3d Cir. 1939); Corning v. Comm'r, 104 F.2d 329 (6th Cir. 1939); Rheinstron v. Comm'r, 105 F.2d 642 (8th Cir. 1939).

35. Id. at 129-30 (Roberts, J., dissenting).
36. Id. at 123.
38. Hallock, 309 U.S. at 131.
Finally in 1936, one year following the *St. Louis Trust* cases, Congress amended a subsection of the predecessor of § 2037 in response to the Court's decision in *White v. Poor*, a case decided on the same day the Court announced its opinion in the latter cases. Again, Congress made no change contrary to the holding in the *St. Louis Trust* cases.

Not surprisingly, Justice Frankfurter and Justice Roberts disagreed on the significance of Congress's numerous missed opportunities to amend the statute. Justice Roberts understood it to be a sign of Congressional approval of the *St. Louis Trust* cases stating, "it is familiar practice for Congress to amend a statute to obviate a construction given it by the courts." Conversely, Justice Frankfurter had no specific response other than his contention that any conclusions drawn from Congressional inactivity were merely speculative and, thus, non-determinative.

Thus, perhaps blinded by his desire to eliminate what he believed to be a defective form over substance, Justice Frankfurter adopted a Judicial Interpretation to cure it despite the weight of substantial Three Branch Authority to the contrary. Moreover, Justice Frankfurter, like Douglas, was obviously not concerned that aggressive Judicial Interpretations often crossed the line into judicial legislation.

b. *Commissioner v. Griffiths*  

The *Griffiths* case, in which Douglas wrote a scathing dissenting opinion advocating an overreaching Judicial Interpretation, involved a then recently enacted statute subjecting certain stock dividends to taxation. The issue was whether as a consequence of its enactment the Court should overrule *Eisner v. Macomber*, the seminal case on the taxation of stock dividends. In *Macomber*, the Court held that a common stock dividend issued on common stock was not taxable income within the meaning of the Sixteenth Amendment because it effected no change to the shareholder's interest in the corporation (*Macomber* Stock Dividends). Shortly af-

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41. *Id.* at 130.  
42. *Id.* at 120, n.7 (majority opinion). The only positive point Justice Frankfurter extracted from the legislative history supportive of his Judicial Interpretation was the fact that Congress had not specifically reenacted the predecessor of § 2037(a) in the five years following the *St. Louis Trust* cases.  
ter that decision, Congress enacted § 201(d) of the Revenue Act of 1921 barring the taxation of any type of stock dividend. Then, in the Revenue Act of 1936, Congress changed course and enacted § 115(f)(1) to provide that “'[a] distribution made by a corporation to its shareholders in its stock . . . shall not be treated as a [taxable] dividend to the extent it does not constitute income . . . within the meaning of the Sixteenth Amendment . . . .'”45 Subsequently, in 1938 and 1939, Congress reenacted § 115(f)(1) without any change in the above quoted language.

Thus, whereas prior to the amendment of § 201(d) no stock dividends were taxable, § 115(f)(1) provided for the taxation of some stock dividends. Literally interpreted, § 115(f)(1) defined a taxable stock dividend as any stock dividend other than one that did not constitute income within the meaning of the Sixteenth Amendment. So, if the statute’s reference to the Sixteenth Amendment was indicative of Congress’ approval of the Macomber holding, the apparent intent of the statute was to tax all stock dividends other than Macomber Stock Dividends. Conversely, the Commissioner argued that by enacting §115(f)(1), Congress had rejected the Macomber holding because it believed Macomber Stock Dividends were taxable income within the meaning of the Sixteenth Amendment.46 Thus, consistent with Treasury Regulations promulgated in 1940, the Commissioner sought to tax the Macomber Stock Dividends that the taxpayer(s) in Griffiths had received in 1939.

Writing for the majority, Justice Jackson rejected the Commissioner’s interpretation of § 115(f)(1) and found that no disapproval of Macomber could be implied from the Literal Interpretation of the statute. In a well-reasoned opinion, Jackson’s thorough examination of relevant Three Branch Authority revealed that the Court, the Treasury (prior to the 1940 amendment of the Regulations), and Congress were in complete agreement as to the validity of the Macomber decision; thus, it was clear that Congress’ intention in enacting § 115(f)(1) was to tax stock dividends other than Macomber Stock Dividends.

As to case law, Jackson noted sixteen cases including Macomber all affirming that Macomber Stock Dividends were not taxable.47 Additionally, Jackson cited numerous opinions in the fifteen years

46. Id. at 372, 394.
47. Id. at 381. Ironically, those cases were cited in a legal memorandum authored by the Acting Chief Counsel of the Bureau of Internal Revenue and presented to Congress during the process of enacting section 115(f)(1). Id. at 380-81.
following the *Macomber* decision in which the Court identified stock dividends other than *Macomber* Stock Dividends as being taxable income within the meaning of the Sixteenth Amendment had Congress chosen to tax them.  

As to Treasury pronouncements, prior to the 1940 amendment, long standing Treasury Regulations dating back to the Revenue Act of 1921 not only acknowledged the validity of *Macomber*, but also included three types of *Macomber* Stock Dividends including the type the taxpayer received in the *Griffiths* case as examples of non-taxable stock dividends.  

Finally, an exhaustive review of the legislative history of the 1936 amendment to § 201(d) of the Revenue Act of 1921 as well as the 1938 and 1939 reenactments of § 115(f)(1) left no question of congressional approval of the Court’s holding in *Macomber*.  

Overwhelmingly, the legislative history clearly demonstrated that the primary reason for amending the statute was to assure that stock dividends, other than *Macomber* Stock Dividends, were taxable.

Despite the weight of Three Branch Authority to the contrary, in a dissenting opinion, Douglas completely endorsed the Commissioner’s position and admonished the majority for not overruling the *Macomber* decision. Perhaps his obvious bias explained his contrived Judicial Interpretation of § 115(f) in which he demeaned the *Macomber* holding. According to Douglas’s faulty logic, Congress enacted § 115(f)(1) to tax all types of stock dividends. Because *Macomber* held the taxation of *Macomber* Stock Dividends was unconstitutional, however, short of amending the Constitution, the only way Congress could definitively establish its authority to tax such dividends would be via a court decision overruling the case in the event the amended statute was ever challenged.

All of Douglas’s arguments took out of context, misconstrued, or completely ignored the Three Branch Authority supportive of the majority’s Literal Interpretation of the statute. For example, in declaring the vitality of the *Macomber* decision was waning, Douglas noted that “numerous decisions by lower courts had made inroads on the *Eisner v. Macomber* doctrine” and had eroded its

48. *Id.* at 374.

49. *Id.* at 387-88.


51. See infra note 57.


53. *Id.* at 407.
broad scope. Yet, Douglas failed to articulate exactly what the “Eisner v. Macomber doctrine” was or to provide any citations to the “numerous” lower court decisions. If those decisions were the cases cited by Jackson in the majority opinion, they were Supreme Court decisions, not lower court decisions, pointing out types of stock dividends other than Macomber Stock Dividends that could be constitutionally taxed. In reality, those decisions had not eroded Macomber, but rather explained the decision was limited to Macomber Stock Dividends.

In defending the Treasury’s 1940 amendment of the Regulations from which the language approving Macomber was deleted, Douglas stated, “it certainly did not indicate that the Treasury construed the statute more narrowly than the Constitution itself.” That statement, however, was misleading as it failed to take into account the only recently amended, long-standing regulations that had implemented the holding of Macomber in the Treasury’s application of the statute.

Finally, as to the legislative history of the 1936 amendment to the statute, Douglas ignored and made no reference to the multiple favorable references to the Macomber holding in Congressional hearings quoted and discussed at length in the majority opinion. Instead, he focused on an excerpt from an exchange between Congressman Treadway and Congressman Vinson regarding the scope of the amended statute. In response to Congressman Treadway’s question regarding the type of dividends that would be taxable under the amended statute, Congressman Vinson replied, “We take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxation, and if they are not such stock dividends and are not taxable income under the sixteenth amendment, they are not subject to taxes.”

Commenting on Congressman Vinson’s response, Douglas stated he did not view it as “any intimation that Eisner v. Macomber rather than the Constitution marked the reach of the new legislation.” Significantly, Douglas’s recounting of that exchange failed to include Congressman Vinson’s statement made to Con-

54. Id.
55. Id. at 374 (majority opinion).
56. Id. at 408 (Douglas, J., dissenting).
57. Id. at 376-94 (citing over eighteen pages of discussion of the legislative history of the amendment to the statute).
58. Griffiths, 318 U.S. at 381 n.21 (emphasis added) (citations omitted).
59. Id. at 406 (Douglas, J., dissenting).
gressman Treadway immediately prior to the latter's question regarding the scope of the 1921 statute, to wit, "[he] under[stood] the gentleman's explanation to be that the language of the act was too broad. . . . [Not] too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision."

Thus, taken in its full and proper context, the thrust of Congressman Vinson's responses and the purpose of the amended statute was to tax stock dividends other than Macomber Stock Dividends (untaxed by the 1921 statute), and not as Douglas suggested, a rejection or minimization of the Court's holding in that case.

The second part of Douglas's dissenting opinion was consumed by his contention that Macomber had been wrongly decided. Yet, whether the case was correctly decided was beside the point. The overwhelming weight of the Three Branch Authority indicated Congress, the Court, and the Treasury (until the 1940 amendment to the regulations) were in total agreement with regard to the validity of the Macomber decision. Moreover, it was also clear that in enacting the 1936 amendment, Congress had no intention of disturbing the Court's holding. Thus, Douglas's Judicial Interpretation, spun in favor of the Commissioner, crossed the line into judicial legislation.


a. The Clifford Trust Cases

Decided on the same day, Douglas's majority decisions in Commissioner v. Clifford and Commissioner v. Wood both involved a short term trust providing for the distribution of income to the grantor's wife over its term at the end of which the principal would revert back to the grantor (a Clifford Trust). Considering the economic and ownership interests the grantor retained and continued to enjoy during the trust term, the trust income was arguably taxable to him pursuant to § 61(a). On the other hand, self-contained in a separate part of the revenue statutes, Supplement E of the Revenue Act of 1934 set forth provisions related exclusively to the taxation of trusts and beneficiaries. According to the relevant sections

60. Id. at 382-83 n.21 (majority opinion).
61. Id. at 409-411 (Douglas, J., dissenting).
of Supplement E, trust income distributed to a beneficiary was taxable to her.\textsuperscript{64} There were, however, two types of trusts in which the grantor, not the trust or beneficiaries, was taxable on the trust income.\textsuperscript{65} A Clifford Trust was not one of those trusts.

So, in Clifford, Douglas had to decide whether the trust income was taxable to the grantor under the general authority of § 61(a) or, in the alternative to the beneficiary under the specific authority of the relevant provisions of Supplement E. In a pro-Commissioner majority opinion, applying an overreaching Judicial Interpretation of § 61(a), Douglas concluded the trust income was taxable to the grantor. In the first part of his analysis, Douglas justified his conclusion based on the significant economic and ownership interests the grantor retained over the trust term.\textsuperscript{66} Then, he dismissed the potential conflict between § 61(a) and the relevant provisions of Supplement E as not being a question of “taxing or not taxing grantors of [Clifford Trusts].”\textsuperscript{67} Instead, he characterized the provisions of Supplement E, taxing grantors on the income of certain trusts, as carving out of § 61(a) “a defined group of cases to which a rule of thumb would be applied.”\textsuperscript{68} Consequently, Douglas reasoned that despite there being no provision in Supplement E taxing the grantor of a Clifford Trust on trust income, Congress had nonetheless retained its authority to tax the grantor under § 61(a).\textsuperscript{69}

Douglas’s Judicial Interpretation was flawed for a number of reasons. Perhaps the most obvious reason was it rendered Supplement E superfluous. As discussed above, the provisions of Supplement E provided that, subject to two specific exceptions, beneficiaries, not grantors were taxed on trust distributions. Yet, as Douglas intimated, even without those exceptions, § 61(a) was sufficiently broad to tax grantors on the trust income.\textsuperscript{70} Thus, simply to adopt an unnecessary rule of thumb, Douglas’s analysis led to the absurd conclusion that Congress enacted a specific statute under a separate statutory scheme dealing with the taxation of trusts and

\textsuperscript{64} See \textit{id.} §§ 161(a)(2), (b) (referring to § 142 “return made by beneficiary”); \textit{id.} §§ 162(b), 163(b) (credit against trust’s net income for trust income included in a beneficiary’s net income); \textit{id.} § 164.

\textsuperscript{65} See \textit{id.} §166 (revocable trust); \textit{id.} §167 (trust from which income could be accumulated and/or paid for the benefit of the grantor).

\textsuperscript{66} \textit{Clifford}, 309 U.S. at 334-37.

\textsuperscript{67} \textit{ld.} at 337.

\textsuperscript{68} \textit{ld.} at 337-38.

\textsuperscript{69} \textit{ld.at} 339.

\textsuperscript{70} \textit{ld.} at 337.
beneficiaries to achieve the same result as § 61(a) already achieved.\footnote{71}

Additionally, Douglas's Judicial Interpretation gave in to the Commissioner's overreaching and heretofore unsuccessful efforts to tax the grantor of a Clifford Trust that had previously been rejected by Congress. As the dissent noted in a slightly different context, the effect of the Court's opinion was to amend the Revenue Act of 1934 on behalf of the Commissioner, "under the guise of [seeking statutory] construction."\footnote{72} Specifically, between 1916 (the year in which the predecessor of Supplement E was first enacted) and 1934, the Treasury made multiple requests to Congress to enact provisions taxing the income of certain trusts to the grantor, rather than to the trust or its beneficiaries. Pursuant to the Revenue Act of 1924, Congress acquiesced and enacted the first provision taxing the grantor of a certain type of trust. Then prior to the passage of the Revenue Act of 1934, the Treasury asked Congress to enact provisions taxing the grantors of both revocable trusts and Clifford Trusts. In response, Congress enacted a provision taxing the grantor of the former trust, but not the grantor of a Clifford Trust.\footnote{73} Not dissuaded by congressional inaction, as expressed by the dissent, in an effort to achieve the amendment denied to it by Congress, the Commissioner sought the assistance of the Court by virtue of a favorable Judicial Interpretation.\footnote{74}

Thus, in the final analysis, Clifford, like Hallock, was an example of Commissioner-spun Judicial Interpretations that crossed the line into judicial legislation. In both cases, Justices Frankfurter and Douglas were willing to supplant a Literal Interpretation of a tax statute that was consistent with Three Branch Authority with an unsupportable Judicial Interpretation. From this perspective, in Clifford, the Judicial Interpretation adopted by Douglas was even more extreme than in the Hallock case because in the former case there was an actual statutory scheme for taxing beneficiaries of trusts with specific exceptions for taxing grantors of certain types of trusts.

\footnote{71. As discussed in more detail, infra note 75 and accompanying text, the Treasury had unsuccessfully attempted to persuade Congress to amend Supplement E to include a provision taxing grantors of Clifford Trusts. Douglas minimized its significance so as in the words of the dissent, to "write into the statute what is not there and what Congress has omitted to place there." Clifford 309 U.S. at 341 (Roberts, J., dissenting).}
\footnote{72. Id at 339.}
\footnote{73. See id at 339-41.}
\footnote{74. See id. at 340.
The consequences of Douglas’s flawed opinion in *Clifford* were also manifested in his majority opinion in *Wood*. In fact, Douglas’ opinion in *Wood* was perhaps the most nonsensical opinion he ever delivered. The only significant difference between the two cases was that in the latter case, the Commissioner sought to tax the grantor of the *Clifford* Trust pursuant to § 166 of the Revenue Act of 1934, one of the aforementioned exceptions under which the grantor of a revocable trust rather than the beneficiary was taxable on trust income.\(^{75}\)

In *Wood*, the Commissioner contended that a *Clifford* Trust was significantly similar to a revocable trust.\(^{76}\) In his view, the key element of a “revocable trust”, as defined by § 166, was the power “at any time . . . to revest in the grantor title to . . . the corpus.”\(^{77}\) So, because in a *Clifford* Trust, the revesting of the corpus to the grantor at the end of the trust term had been established at the time it was created, the Commissioner argued that the grantor should be similarly taxed under § 166.\(^{78}\)

In deciding the case against the Commissioner, Douglas engaged in a painstaking analysis of the congressional intent that directly contradicted his analysis in *Clifford*. For example, in *Wood*, Douglas noted that the similarity in substance between a power to revest or revoke and a reversion must give way to the distinction Congress had drawn between them by failing to include the latter in the statute.\(^{79}\) Douglas reasoned that, due to that distinction, in enacting § 166, Congress did not intend to tax the grantor of a *Clifford* Trust on the trust income.\(^{80}\) Ironically, in his *Clifford* opinion, Douglas did not similarly conclude that Congress intended the beneficiaries (rather than the grantor) to be taxed on the *Clifford* Trust income under the other relevant provisions of Supplement E based on Congress’s failure to include the grantor of a *Clifford* Trust under § 166.

In the final analysis, Douglas’s majority opinion in *Wood* was nonsensical. Although the decision could have been viewed as a victory for the taxpayer, such a “victory” was illusory at best for all other taxpayers because the Court simply held that the grantor of a *Clifford* Trust was not taxable under § 166 of the Revenue Act of

\(^{75}\) Comm’r v. Wood, 309 U.S. 344, 346 (1940).
\(^{76}\) *Id.* at 346.
\(^{77}\) *Id.* at 346 n.4 (citation omitted).
\(^{78}\) *Id.* at 346-47.
\(^{79}\) *Id.* at 347.
\(^{80}\) *Id.*
1934. On the other hand, Clifford held the grantor was taxable on the trust income pursuant to § 61(a). In Wood, the only reason Douglas did not consider inclusion under § 61(a) was due to the Commissioner's failure to raise the point below.81 Had Douglas considered the inclusion under § 61(a), the outcomes in both cases would have been the same. So rather than being a true taxpayer victory, the Wood decision served as a guide for what the Commissioner should avoid to achieve success in future cases. In other words, the decision was a lesson to the Commissioner to rely on Clifford as the authority to tax the grantor of a Clifford Trust pursuant to § 61(a) rather than § 166.

b. Cases Determining the Basis of Property Acquired From a Decedent

In his majority opinions in Maguire v. Commissioner,82 and Commissioner v. Reynolds,83 Douglas's Judicial Interpretations expanded the scope of the underlying statute well beyond the literal meaning of its language. In Maguire, Douglas's strained Judicial Interpretation of the relevant statutory language was based solely on his supposition of legislative intent. In Reynolds, Douglas's Judicial Interpretation was contrary to the weight of compelling Three Branch Authority and clearly crossed the line into judicial legislation.

i. Maguire v. Commissioner Similar to many other Douglas opinions, in Maguire, Douglas rendered a Judicial Interpretation without addressing a compelling counterargument. Pursuant to the predecessor of § 1014, as amended by the Revenue Act of 1928, the basis of personal property passing by a general bequest "was the value of the property at the time of distribution to the taxpayer."84 Otherwise, for all other property, the basis was its fair market value as of the date of the decedent's death.85 Prior to the amendment, the statute provided the basis of all property obtained by bequest, devise, or inheritance was the fair market value "at the time of such acquisition."86 The issue presented was whether the change of the

81. Wood, 309 U.S. at 349.
82. Maguire v. Comm'r, 313 U.S. 1 (1941).
85. Id. at 4.
86. Id. at 5 (citations omitted).
wording in the statutory language should be construed as a substantive amendment to the statute.87

In Maguire, the decedent died in 1903 with a will leaving his residuary estate comprised of personal property in trust for the benefit of his surviving spouse and children.88 In 1905, the decedent’s estate was closed at which time the personal property was transferred to the trustees.89 Finally, in 1923, the trust terminated and the trustees distributed the property originally received from the decedent in addition to property purchased by the trustee during the term of the trust to the taxpayer.90 In 1929 and 1930, the taxpayer sold some of the property the trustee had received from the decedent’s estate.91

As to the basis of such property, the taxpayer argued the words “at the time of distribution to the taxpayer” meant the fair market value of the personal property as of the date the taxpayer actually received the property from the trustees. Conversely, the Commissioner contended those words meant the basis of the property was its fair market value at the time it was distributed from the executors to the trustees. Because the fair market value of the personal property at the time the taxpayer received it was greater than it was on the much earlier date it was distributed to the trustees, the taxpayer’s taxable gain would be significantly less if the former date established the property’s basis.92

Of relevance, but not discussed by Douglas, was Commissioner v. Gambrill,93 a Second Circuit case involving the same statute. In that case, Judge Hand proffered a Literal Interpretation that was supportive of the taxpayer’s interpretation. In interpreting the phrase “fair market value of the property at the time of distribution to the taxpayer,” Judge Hand took the word “taxpayer” to mean the “person subject to a tax imposed by this Act . . . .”94 Similar to

87. Id. at 7.
88. Id. at 2 n.2.
89. Id. at 2.
90. Maguire, 313 U.S. at 2.
91. Id. at 2-3.
92. Nowhere in Douglas’s opinion did he actually explain the parties’ contrary positions on the basis issue. The substance of the dispute was implied from Douglas’s analysis and ultimate holding.
93. Comm’r v. Gambrill, 112 F.2d 530 (2nd Cir. 1940). The Commissioner’s appeal of that decision was decided on the same day as Maguire. Comm’r v. Gambrill, 313 U.S. 11 (1941). The Court decided Commissioner v. Campbell, 313 U.S. 15 (1941), on the same day as well. Douglas wrote the majority opinion in all three cases.
Maguire, the taxpayer was the beneficiary who ultimately sold the property. Therefore, Hand reasoned the words “the property” must have referred to the property the beneficiary/taxpayer received from the trustee, and subsequently sold, not the property received by the trustees from the executors.\(^9\) Therefore, based upon the plain meaning of the entire phrase, Hand concluded the basis of the property was its fair market value at the time it was distributed by the trustee to the beneficiary/taxpayer.\(^9\)

As stated above, Douglas’s opinion failed to consider the merits of Judge Hand’s Literal Interpretation.\(^9\) Instead, Douglas adopted the Commissioner’s version of the meaning of the statutory language with a Judicial Interpretation based entirely on his analysis of the legislative history. In recounting it, Douglas noted that the congressional purpose in amending the statute was to clarify the meaning of the term “at the time of such acquisition” as it had appeared in earlier versions of the statute.\(^9\) Apparently Congress intended that term to mean the “fair market value of the property at the date of the decedent’s death . . . .”\(^9\) To achieve clarity, the House of Representatives endorsed a uniform value-at-death rule to apply to all property acquired from a decedent. The Senate, however, was concerned that such a rule would not be appropriate in case of a general bequest of personal property. Consequently, in the final version of the amended statute, Congress inserted the value-at-distribution rule applicable to general bequests.\(^1\)

Citing no authority, Douglas construed “the time of distribution” language to be a “limited deviation” to the value-at-death basis rule and refused to infer from it a congressional intent to create an exception that could delay the setting of basis for the indefinite time lapse between the transfer of the property from the executors to trustees and its ultimate distribution to the beneficiaries. Thus, Douglas interpreted the words “time of distribution to the taxpayer” to mean the date the property was transferred by the executors to the trustees for the benefit of the taxpayer.\(^1\)

95. Id.
96. Id.
97. See supra note 93. Douglas never considered the Second Circuit’s Literal Interpretation in any of those cases cited in note 93, including the Gambrill case.
98. Maguire, 313 U.S. at 5-6 (quotation omitted).
99. Id. at 5.
100. Id. at 5-6.
101. Id. at 7.
Despite Douglas's failure to consider the merits of Hand's Literal Interpretation, Douglas's other rationale for his decision at least had some merit. Douglas was concerned that a Literal Interpretation would lead to abuse because trustees would decide to sell property received from the decedent's estate or distribute it in kind based on the most advantageous tax consequences. Absent a clear legislative directive, Douglas was unwilling to infer a congressional intent to allow such manipulation.102 Such manipulation, however, would also be available to an elderly or terminally ill taxpayer considering whether to sell property prior to his death based on similar considerations. Obviously, selling high basis property during life would be more tax advantageous than selling low basis property that would receive a basis step up to date-of-death fair market value.103 Thus, Douglas's concern for the possibility of tax manipulation was arguably selective.

ii. Commissioner v. Reynolds In contrast to Maguire, in which Douglas rendered a merely questionable Judicial Interpretation, in Reynolds Douglas adopted a Judicial Interpretation that clearly crossed the line into judicial legislation.104 The relevant statute was the predecessor of § 1014 providing the basis of property "acquired by bequest, devise, or inheritance... shall be the fair market value of such property at the time of such acquisition."105 Specifically, at issue was the meaning of the words "time of such acquisition."106

In Reynolds, the taxpayer's father, who died in 1918, created a testamentary trust in which the taxpayer had a contingent remainder.107 In 1934, the taxpayer received securities from the trust including some received by the trustee from the father's estate and some subsequently purchased by the trustee after the father's death.108 In that same year, the taxpayer sold some of the securities that the trustee had originally acquired from his father's estate.109

102. Id. at 8.
103. See I.R.C. § 1014(a)(1).
105. Id. at 430. (quoting Revenue Act of 1934, Pub. L. No. 73-216, § 113(a)(5), 48 Stat. 680, 706 (1934)).
106. Id. (quoting Revenue Act of 1934, Pub. L. No. 73-216, § 113(a)(5), 48 Stat. 680, 706 (1934)).
107. Id. at 429.
108. Id.
109. Id. .
As to the taxpayer's basis in the securities, in interpreting the words “time of acquisition,” the taxpayer reasoned that as a contingent remainderman, he had acquired no interest from the decedent until the securities were actually distributed to him. Thus, the taxpayer contended the basis should have been the securities’ fair market value at the time they were actually distributed to him. Conversely, relying on the applicable Treasury Regulations, the Commissioner argued the taxpayer’s basis for all property acquired by bequest, devise, or inheritance dated back to the decedent’s death even if at that time the beneficiary’s interest in the property was contingent.

Yet, in spite of ample Three Branch Authority to the contrary, Douglas’s majority opinion endorsed the Commissioner’s basis determination. First, from the perspective of prior case law and administrative pronouncements, that determination was unsupportable. In Commissioner v. San Joaquin Fruit & Investment Co., the Court considered the meaning of the word “acquired” as it appeared in the general basis section. In defining the word, Justice Roberts, writing for the majority, stated, “the word ‘acquired’ is not a term of art in the law of property but one in common use. The plain import of the word is ‘obtained as one’s own.’” Thus, the Court’s previous definition of “acquired” was at odds with a contingent interest in property. Moreover, in addition to the San Joaquin case, there were multiple court cases all holding that a beneficiary with a contingent interest did not acquire the underlying property. Also, between 1920 and 1935, the Treasury had consistently viewed a contingent interest as not being the equivalent of ownership of the underlying property.

Finally, as to the legislative history, the dissent in Reynolds noted the consistency of the phrase “property . . . acquired” in all

111. Id. at 431.
112. Id. at 430.
114. Id. at 497 n. 1. For example, § 204(a) of the Revenue Act of 1924 stated “the basis determining gain or loss from the sale or other disposition of property acquired after February 28, 1913.” Pub. L. No. 68-176, § 204(a), 43 Stat. 253, 258 (1924) (emphasis added). Revenue Act of 1924 § 204(a).
115. San Joaquin, 297 U.S. at 499.
116. See Lane v. Corwin, 63 F.2d 767 (2d Cir. 1933); Pringle v. Comm’r, 64 F.2d 863 (9th Cir. 1933); Hopkins v. Comm’r, 69 F.2d 11 (7th Cir. 1934); Becker v. Anchor Realty & Inv. Co., 3 F. Supp. 22 (E.D. Mo. 1933), aff’d 71 F.2d 355 (8th Cir. 1934), Beers v. Comm’r, 78 F.2d 447 (4th Cir. 1935).
Revenue Acts since 1921, and that in using the word "property," Congress did not expand on its colloquial use to include inchoate rights such as a contingent remainder. Because, as a general rule of statutory construction, Congress is presumed to employ words in the common and ordinary sense, the dissent argued Congress never intended the word "property" in the Revenue Acts to include contingent interests. Moreover, in view of the consistent judicial and administrative interpretation of the term, Congress indicated its approval by its failure to amend the statute to overrule that interpretation.

Yet, in spite of compelling Three Branch Authority discussed by the dissent, Douglas's opinion demonstrated how his desire to achieve a pro-Commissioner result distorted his judicial integrity. As to the significance of Congress's failure to act, Douglas discounted congressional silence as signifying its approval since Congress had not made any statements overtly approving the consistent judicial and administrative interpretation of the statute over the past fifteen years. Moreover, without any analysis and contrary to the record, Douglas dismissed the relevant case law and administrative pronouncements as not having the "consistency and uniformity" such that Congress's reenactment of the same language on multiple occasions was indicative of congressional approval. Finally, having dispensed with the contrary weight of the Three Branch Authority, Douglas approved the Commissioner's interpretation of the statute based upon the "exercise by the administrative agency of its continuing rule-making power."

3. Douglas Invoked Public Policy Considerations to Justify a Per Se Rule Denying the Deductibility of Lobbying Type Expenses

In Douglas's majority opinion in Textile Mills Securities Corp. v. Commissioner, Douglas took Judicial Interpretation to an extreme by approving a Treasury Regulation that established a per se ban on the deductibility of all lobbying type expenditures even

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118. Id. at 435-436. The one exception was § 113(5) of the Revenue Act of 1928, in which Congress enacted a general date of death basis rule and another more limited basis rule (value of the property at the time of distribution to the taxpayer). Id.
119. Id. at 436.
120. Id. at 438.
121. See id. at 432 (majority opinion).
122. Reynolds, 313 U.S. at 432.
123. Id.
124. Id. (citing Comm'r v. Wilshire Oil Co., 308 U.S. 90, 100-01 (1939)).
though there was no language in the predecessor of § 162(a) allowing a deduction for ordinary and necessary expenses to indicate all such expenditures were nondeductible. Although Douglas's rationale was based upon his perception of a public policy aversion towards contracts related to influencing legislation, the scope of the disallowance went well beyond inappropriate influence on legislators to include other legitimate lobbying activities.

Specifically, the case involved the scope and validity of a Treasury Regulation stating, "Sums of money expended for lobbying purposes, the promotion or defeat of legislation ... are not deductible from gross income" as ordinary and necessary expenses under section 162(a) (Lobbying Expenditure Regulation). Because Douglas's very brief majority opinion failed to address relevant prior case law and his holding was essentially a de facto affirmation of the Ninth Circuit's opinion in Sunset Scavenger Co. v. Commissioner, the following detailed discussion, beginning with the Board of Tax Appeals decision, is in order.

In Sunset Scavenger Co. v. Commissioner, the taxpayer, a garbage collector, contributed monies to an organization opposing the passage of a municipal ordinance that would have negatively affected the organization's business. The activities of the organization involved printing and distributing pamphlets, newspaper advertisements, and the employment of speakers advocating the position of the organization. The taxpayer sought to deduct those expenditures as "ordinary and necessary" expenses pursuant to § 162(a). With no discussion or reference to the Lobbying Expenditure Regulation, the Board of Tax Appeals determined those expenditures were deductible "ordinary and necessary" expenses as part of a legitimate effort to protect business and property. The Board found as significant the means used were all directed to making the organization's case to the public and not "buying votes or influencing acts of public officials."

On appeal, the Ninth Circuit considered whether the Lobbying Expenditure Regulation, not cited in the Board of Tax Appeals case, trumped the Board's factual finding that the expenditures

126. Id. at 338.
127. Id. at 337. (quotation omitted).
128. See Sunset Scavenger Co. v. Comm'r, 84 F.2d 453 (9th Cir. 1936).
130. Id.
131. Id. at 763.
132. Id.
were deductible as ordinary and necessary business expenses.\textsuperscript{133} In reversing the Board, the Ninth Circuit approved the Lobbying Expenditure Regulation as establishing a valid per se rule barring the deductibility of lobbying type expenditures as “ordinary and necessary” expenses within the meaning of § 162(a).\textsuperscript{134} As to the Board’s determination that the expenses were legitimate, the Ninth Circuit viewed that distinction irrelevant as the regulation did not differentiate between legitimate and illegitimate lobbying type expenditures.\textsuperscript{135}

Subsequently, in \textit{Textile Mills Securities Corp. v. Commissioner},\textsuperscript{136} the Board of Tax Appeals was compelled to directly address the validity of the Lobbying Expenditure Regulation. In that case, the taxpayer, a Delaware corporation, was hired by certain German textile interests whose properties in the United States had been seized by the government during World War I pursuant to the Trading with the Enemy Act.\textsuperscript{137} The role of the taxpayer was to launch an extensive publicity campaign advocating the procurement of congressional legislation that would lead to the recovery of the lost properties by its clients. The engagement contract set the taxpayer’s compensation for its services as a percentage of the value of property recovered with the expenses of the campaign to be borne by the taxpayer.\textsuperscript{138} In 1929 and 1930, the taxpayer claimed business deductions for amounts paid for expenses related to carrying out the campaign.\textsuperscript{139}

Relying upon the Ninth Circuit’s holding in \textit{Sunset Scavenger}, the Commissioner challenged the deductibility of the taxpayer’s expenditures based upon the per se disallowance rule of the Lobbying Expenditure Regulation.\textsuperscript{140} In its consideration of the issue, the Board engaged in an in-depth analysis of the \textit{Sunset Scavenger} case and acknowledged the similarity of the taxpayer’s expenditures in \textit{Textile Mills} brought their deductibility within the purview of the regulation.\textsuperscript{141} The Board rejected, however, the Lobbying Expen-

\begin{footnotes}
\item \textsuperscript{133} \textit{Sunset Scavenger}, 84 F.2d at 456-57.
\item \textsuperscript{134} \textit{Id.} at 457. There was some question as to whether the deductibility of lobbying type expenses turned upon the legality of the underlying activity. In its holding, the Ninth Circuit made it clear that the per se disallowance of a business deduction applied without regard to the presence or absence of an illegal purpose. \textit{Id.}
\item \textsuperscript{135} \textit{Sunset Scavenger}, 84 F.2d at 456-57.
\item \textsuperscript{136} \textit{Textile Mills Sec. Corp. v. Comm’r}, 38 B.T.A. 623 (1938).
\item \textsuperscript{137} \textit{Id.} at 624.
\item \textsuperscript{138} \textit{Id.} at 625.
\item \textsuperscript{139} \textit{Textile Mills}, 38 B.T.A. at 626-27.
\item \textsuperscript{140} \textit{Id.} at 627-28.
\item \textsuperscript{141} \textit{Id.} at 629.
\end{footnotes}
diture Regulation as a per se rule of disallowance that would fore-close a case by case analysis of whether a particular expenditure was “ordinary and necessary” within the meaning of §162(a). Based upon its own factual analysis, the Board concluded the expenditures were deductible as ordinary and necessary expenses.\textsuperscript{142}

On appeal, the Third Circuit appeared to sidestep the issue of whether the Lobbying Expenditure Regulation was a pro se denial of a business deduction for lobbying type expenses.\textsuperscript{143} Similar to the Board’s approach, the Third Circuit launched into its own analysis of whether the taxpayer’s expenditures were ordinary and necessary within the meaning of §162(a).\textsuperscript{144} In doing so, however, the Third Circuit reached a different conclusion. First, the court noted that similar contracts providing a contingent fee for procuring remedial legislation pursuant to the Trading with the Enemy Act had been declared void as against public policy.\textsuperscript{145} For that reason, the court determined expenditures related to such null and void contracts could not be considered as ordinary because they were “outside the norm of ordinary business conduct.”\textsuperscript{146} Second, the Third Circuit determined the expenditures were not necessary because there was nothing in the record to indicate proximate causation between the taxpayer’s efforts and the ultimate passage of the remedial legislation the taxpayer’s clients were seeking.\textsuperscript{147}

Only after the foregoing analysis did the Third Circuit make reference to the Lobbying Expenditure Regulation.\textsuperscript{148} Although the court discussed the regulation with approval, its decision was based on the narrower grounds that the taxpayer’s expenditures were not ordinary and necessary.\textsuperscript{149} Therefore, it appeared that the Third Circuit viewed the Lobbying Expenditure Regulation simply as an acknowledgement of their non-deductibility when related to null

\textsuperscript{142} Id. at 631. In support of its holding, the Board noted that the Trading with the Enemy Act specifically authorized Congress to settle claims for the recovery of seized property once the war had ended. From that perspective, because the taxpayer’s activities were consistent with the legislative mandate of presenting the claims of its clients before Congress for approval, they differed from more typical lobbying activities in which the proponents were without any legislative mandate. Id. at 630 (citing Trading with the Enemy Act, Pub. L. No. 65-91, § 12, 40 Stat. 411, 424 (1917)).

\textsuperscript{143} Comm'r v. Textile Mills Sec. Corp., 117 F.2d 62 (3d Cir. 1940).

\textsuperscript{144} Id. at 66-67.

\textsuperscript{145} Id. at 64.

\textsuperscript{146} Id. at 65.

\textsuperscript{147} Id.

\textsuperscript{148} Id. at 66.

\textsuperscript{149} Textile Mills, 117 F.2d at 67.
and void contracts, leaving open the possibility of the deductibility of legitimate lobbying type expenditures.

Thus, on the eve of the appeal of the Ninth Circuit's decision in *Textile Mills*, it was at least arguable that the Supreme Court could distinguish the holdings of the Third Circuit and the Ninth Circuit based upon the legality of the underlying contract. Accordingly, Douglas's majority opinion could have implemented one of the two alternative rationales for disallowing the taxpayer's deduction of its lobbying type expenditures. Although the difference between the two interpretations might have appeared to be largely semantic as applied to the facts of *Textile Mills*, the Third Circuit's interpretation would not have required the Court to read conditions or elements into the implementation of a tax statute that were not literally set forth in the statutory language. Therefore, if Douglas had adopted the Third Circuit's interpretation of the Lobbying Expenditure Regulation, it would have allowed subsequent courts to consider the deductibility of legitimate lobbying type expenditures.

Yet, making no reference to the *Sunset Scavenger* case, Douglas's majority opinion effectively adopted the Ninth Circuit's interpretation of the Lobbying Expenditure Regulation. Ironically, in justifying his holding, Douglas noted the consistency of successive promulgations of the Lobbying Expenditure Regulation without change—a factor he often discounted in other opinions. Also, as a further justification of the broad scope of the regulation, Douglas found it to be in accord with the public policy of not spreading "insidious influences through legislative halls . . . ." Obviously, Douglas was not troubled, by the expansiveness of the Lobbying Expenditure Regulation in barring deductions even in those cases in which public policy was not violated. To this point, Douglas stated:

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150. See id at 66. In further support of this conclusion, the Third Circuit noted Congress's enactment of a statute allowing charitable contribution deductions excluding amounts expended for the purpose of attempting to influence legislation. If such expenditures were in any event deductible as ordinary and necessary expenses pursuant to §162(a), the court determined there would be no reason for Congress to state that such expenditures were nondeductible for purposes of another provision. Also, because §162(a) required an expense to be both ordinary and necessary, the failure of the ordinary prong of the test would be sufficient to deny its deductibility. Id. at 66.

151. For example, advertising and/or speaking in public venues without direct contact with legislatures may be construed as legitimate lobbying type expenditures. See *Sunset Scavenger Co. v. Commr*, 31 B.T.A. 758, 761-763 (1934).


153. Id. at 338.
The point is that the general policy indicated by those cases need not be disregarded by the rule-making authority in the segregation of non-deductible expenses. There is no reason why, in absence of clear Congressional action to the contrary, the rule-making authority cannot employ that general policy in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction. The exclusion of the latter from "ordinary and necessary" expenses certainly does no violence to the statutory language. The general policy being clear it is not for us to say that the line was too strictly drawn.154

B. Douglas's Literal Interpretation of the Word "Allowed" in the Predecessor of § 1016(a)(2) Intended to Prevent Taxpayer Abuse of Depreciation Deduction Resulted in Unduly Punitive Tax Consequences For the Taxpayer.

Virginian Hotel Corp. of Lynchburg v. Commissioner was Douglas's last blatantly pro-commissioner majority opinion during the Pro-Commissioner Period.155 Unlike his earlier opinions in which Douglas relied upon strained Judicial Interpretation to achieve a Pro-Commissioner result, in this case Douglas achieved that result with a Literal Interpretation that was unduly punitive to the taxpayer. Ironically, if Douglas had rendered a Judicial Interpretation based upon congressional intent as he did in the Maguire case, the result would have been equitable to the Commissioner and the taxpayer.

Specifically, Virginian Hotel involved the interpretation of the word "allowed" with respect to the mandatory basis reduction of claimed depreciation deductions under the predecessor of § 1016(a)(2). In that case, for a number of tax years, the taxpayer had taken straight line depreciation deductions based upon a recovery period the taxpayer believed tracked the underlying property's useful life.156 Subsequently, the Commissioner determined the property's useful life was longer than the recovery period used by the taxpayer. Additionally, the aggregate amount of the depreciation deductions claimed by the taxpayer over the understated recovery period exceeded the aggregate amount of allowable depreciation deductions computed over the Commissioner's longer recovery period (Allowable Depreciation Deductions).157 Because the taxpayer realized large losses during those tax years even with-

154. Id. at 339.
156. Id. at 524.
157. See id. at 524-25.
out considering the excessive depreciation deductions, the excessive deductions had produced no additional tax benefits. Although the Commissioner extended the property’s recovery period, he never challenged the propriety of the excessive depreciation.\textsuperscript{158}

The issue was whether the taxpayer’s adjusted basis for the remainder of the recovery period should be the original cost of the property reduced by the entire amount of depreciation deductions taken by the taxpayer or by the lesser amount of the allowable deductions. The predecessor of § 1016(a)(2) required a basis to be reduced by depreciation deductions “to the extent allowed (but not less than the amount allowable) . . . .”\textsuperscript{159} The term “allowed” included excessive depreciation claimed by the taxpayer that was unchallenged by the Commissioner during the applicable limitations period.\textsuperscript{160} Thus, applying a Literal Interpretation of the word “allowed,” the Commissioner reduced the taxpayer’s basis by the amount of depreciation deductions actually claimed by the taxpayer.\textsuperscript{161} Consequently, because the taxpayer’s basis for the remaining recovery period was lower than it would have been had it been reduced only by the Allowable Depreciation Deductions, the taxpayer lost the benefit of a similar amount of depreciation deductions over the balance of the extended recovery period.\textsuperscript{162}

In challenging the Commissioner’s basis adjustment, the taxpayer contended the word “allowed” in the predecessor of §1016(a)(2) connoted the receipt of a tax benefit by a taxpayer who claimed excessive depreciation deductions. Conversely, in this case, the excessive depreciation deductions produced no tax benefits for the taxpayer. Therefore, the taxpayer argued the basis reduction should have been limited to the recomputed amount of the Allowable Depreciation Deductions with no reduction of the useless excessive depreciation deductions.\textsuperscript{163}

Although the wording of the statute did not condition the basis reduction of an allowed deduction upon the receipt of a tax benefit, such a condition could have been implied from the legislative history. As even Douglas acknowledged in his majority opinion, prior to the amendment of the predecessor of §1016(a)(2), the basis reduction was limited to the amount of allowable depreciation deduc-

\textsuperscript{158} Id.
\textsuperscript{159} Id. at 525.
\textsuperscript{160} Id. at 526.
\textsuperscript{161} See id. at 524.
\textsuperscript{162} See Virginian Hotel Corp., 319 U.S. at 524.
\textsuperscript{163} Id. at 525-26.
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The purpose for requiring a basis reduction of an allowed depreciation deduction, however, was to prevent the taxpayer from receiving unwarranted tax benefits by claiming excessive depreciation deductions but reducing basis only by the lesser allowable amount of depreciation. In other words, if within the applicable limitations period, the Commissioner did not challenge the excessive depreciation deductions that had actually produced commensurate tax benefits, and the taxpayer was not required to reduce basis by those excessive depreciation deductions, then the taxpayer could potentially receive an unwarranted tax benefit windfall of being able to "over depreciate" the property to the extent the aggregate amount of depreciation deductions claimed over the recovery period exceeded its cost.

As explained above, however, the potential abuse Congress sought to prevent did not exist on the facts of Virginian Hotel. Therefore, the Commissioner suffered no harm as a result of the taxpayer's excessive but useless depreciation deductions. As Justice Jackson stated in his dissenting opinion, it was not likely Congress intended to punish the taxpayer or allow the Commissioner to make inconsistent corrections of a taxpayer mistake under such circumstances. In his view, adjusting the property's basis by the recomputed amount of the prior years' Allowable Depreciation Deductions to be depreciated over the remaining extended recovery period would have rectified the situation. By reducing the basis by the useless depreciation deductions in addition to extending the recovery period, however, the taxpayer was unduly deprived of claiming otherwise Allowable Depreciation Deductions.

In the final analysis, the contrast between Douglas's majority opinions in Maguire and Virginian Hotel demonstrated Douglas's bias towards the Commissioner. In the former case, Douglas prof-

164. Id. at 526.
165. Id.
166. For example, assume a taxpayer acquired a depreciable asset at a cost of $1,000. In the first year of the recovery period, the taxpayer claimed a $300 depreciation deduction even though the allowable amount was $200. If the taxpayer were required to reduce the property's basis by the $200 allowable deduction, the adjusted basis would be $800. This would allow the taxpayer to claim additional depreciation of $800, or $1,100 in total. If the Commissioner failed to challenge the excessive depreciation deduction within the applicable limitation period, the aggregate depreciation deductions ($1,100) would exceed the property's cost ($1,000). To prevent such a taxpayer windfall, the predecessor of § 1016(a)(2) required the taxpayer to reduce the property's basis by amount of the "allowed" depreciation deduction, or $300. This way the remaining basis of $700 plus the $300 depreciation deduction already taken would equal the property's cost.
167. Virginian Hotel, 319 U.S. at 531-32 (Jackson, J. dissenting).
168. Id. at 531.
ffered a pro-commissioner Judicial Interpretation based upon his perception of congressional intent. Conversely, in *Virginian Hotel*, Douglas ignored congressional intent and rendered a pro-commissioner Literal Interpretation that was inequitable to the taxpayer. It is hard to conceive that in preventing taxpayer abuse Congress would have intended to swing the pendulum the other way and punish taxpayers who made harmless mistakes.\(^{169}\)

### III. The Pro-Taxpayer Period – 1944-1958

**A. Douglas’s Willingness to Consider the Merits of the Taxpayer’s Position in His Final Majority Opinion of the Pro-Commissioner Period Was a Precursor to Future Pro-Taxpayer Opinions.**

Approximately one year after Douglas’s unduly harsh Pro-commissioner majority opinion in *Virginian Hotel*, the Pro-Taxpayer Period began. Shortly after that decision, Douglas inexplicably shifted his allegiance from the Commissioner to the taxpayer, albeit not to the extreme he exhibited during the Taxpayer Advocate Period. Prior to this shift, Douglas’s last pro-commissioner opinion, *Equitable Life Assurance Society v. Commissioner*,\(^ {170}\) lacked the zealous spin characteristic of his Pro-Commissioner Period opinions. In sharp contrast to *Virginian Hotel*, Douglas reached a decision favorable to the Commissioner while giving fair and balanced consideration to the merits of the taxpayer’s position.

*Equitable Life* presented the relatively simple issue of whether the “excess interest dividend” payments that a life insurance company paid to persons entitled to receive a lump sum distribution of insurance proceeds as an inducement to keeping those proceeds on deposit with the company were deductible as “interest.”\(^ {171}\) At the beginning of the tax year in issue, the taxpayer declared it would pay out excess interest dividends at a certain rate to depositors; they did in fact pay a total amount of $534,000 in that tax year.\(^ {172}\)

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\(^{169}\) Moreover, the result of the case was absurd because the Commissioner would never have the incentive to challenge excessive but useless depreciation deductions. This is because a successful challenge would not result in any additional tax assessment against the taxpayer. It would, however, mean that the depreciation deductions would not be “allowed” unallowable. Consequently, there would be no corresponding basis reduction. Thus, the Commissioner could achieve a tax windfall by simply not challenging the propriety of excessive but useless depreciation deductions so as to compel a basis reduction that would limit the taxpayer’s otherwise allowable depreciation deductions in subsequent tax years.


\(^{171}\) *Id.* at 561-62.

\(^{172}\) *Id.* at 562.
The taxpayer contended it was entitled to an interest deduction for those payments because its declaration of a promise to pay excess dividend payments was in effect an offer to pay interest to those who kept the insurance proceeds on deposit with the taxpayer. Accordingly, those depositors who agreed to do so had accepted that offer.

In a short, well-reasoned majority opinion, Douglas determined that the excess dividend payments did not fit the conventional definition of "interest" as "the amount which one has contracted to pay for the use of borrowed money." Following a fair and objective analysis of the merits of the taxpayer's argument, Douglas concluded the contingent nature of the excess dividends payable at the pleasure of the insurance company was not the equivalent of an absolute obligation to pay interest. Moreover, Douglas noted that if the Court were to extend deductibility to this type of payment, it would erode the strict rule of construction of the meaning of "interest" as it appeared in the various reenacted tax statutes that had allowed it as a deduction.

Thus, even though Douglas decided the case in favor of the Commissioner, the softer and more rational tone that flowed in Douglas's opinion was a significant moderation of his heavy handed, pro-commissioner spin that was prevalent in his Pro-Commissioner Period opinions.

B. Douglas's Dissenting Opinions Advocated the Consistent Application of Judicially Created Doctrines to Achieve Fair Results for the Taxpayer.

Douglas's shift of allegiance and spin towards the taxpayer became evident in three cases decided between 1944 and 1952 in which Douglas wrote dissenting opinions advocating the consistent application of judicially created doctrines in a manner favorable to the taxpayer's position. Although at times his opinions lacked coherent analysis, the recurring theme was a fair result that did not prejudice the taxpayer.

173. Id. at 561-62.
174. Id. at 563.
175. Id. at 564 (quoting Old Colony R. Co. v. Comm'r, 284 U.S. 552, 560 (1932)).
176. Equitable Life, 321 U.S. at 564.
177. Id.

In Commissioner v. Harmon, the Court had to decide which of two conflicting judicially created doctrines it would apply. In that case, Oklahoma, a separate property state, had adopted an optional community property statute allowing a married couple to irrevocably elect to have all their collective earnings and receipts be treated prospectively as community income. In October 1939, the taxpayers, husband and wife, made such an election; and, in filing separate 1939 income tax returns, each spouse reported one half of their collective November and December income. The Commissioner challenged the separate reporting, asserting each taxpayer was responsible to report his or her own income.

Thus, the issue was whether the cross-assignment of income from one spouse to the other would be recognized for federal income tax purposes. In two previous cases involving income splitting between spouses, the Court had reached opposite holdings. In Commissioner v. Earl, the genesis of the “assignment of income doctrine,” the Court held that a husband who contractually assigned his future wage income to his wife could not shift its taxability from himself to his wife in spite of the contract’s enforceability under state contract law. Conversely, in Poe v. Seaborn, a husband and wife who were residents of Washington, a community property state, each reported half of their community income even though it was earned entirely by the husband. In approving the couple’s income splitting, the Court distinguished the case from. Earl because in the latter case the assignment of income by husband to wife was consensual whereas in Seaborn “the earnings [were] never the property of the husband, but that of the community.” Effectively, the Court’s holding in Seaborn was a judicially created community property state exception to the judicially created assignment of income doctrine.

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179. Id. at 44-45.
180. Id. at 45.
181. Id.
185. Id. at 117.
Thus, in *Harmon*, the Court had to decide whether to apply the assignment of income doctrine or the community property state exception to the doctrine. In choosing to apply the latter doctrine, the Court determined the consensual nature of the arrangement was more analogous to *Earl* than to *Seaborn*.\(^{186}\) Despite the fact that post-election, the taxpayers’ spousal rights were equivalent to the spousal rights in traditional community property states.\(^{187}\) Additionally, the Court distinguished *Harmon* from *Seaborn* because in the latter case, the married couple resided in a mandatory state law community property system that pre-dated the enactment of the Sixteenth Amendment authorizing the establishment of a federal income tax system.\(^{188}\) In contrast, in *Harmon*, the Oklahoma community property statute was optional and post-dated the enactment of the Sixteenth Amendment.\(^{189}\)

In his dissenting opinion, Douglas disagreed with the majority’s premise that *Seaborn* was distinguishable from *Earl*. In fact, he believed the former case was in direct conflict not only with *Earl* but also with his majority opinion in *Clifford*.\(^{190}\) Yet, in spite of his approval of the holdings in the latter two cases, Douglas acknowledged the significance of *Seaborn* as a judicially created community property state exception to the Court’s holding in those cases.\(^{191}\) For that reason, Douglas contended that unless the Court was inclined to overrule *Seaborn*, it was bound to follow it.\(^{192}\)

Having concluded that *Seaborn* was the appropriate doctrine, Douglas argued it was on point with *Harmon*. As a matter of fairness, Douglas rejected the majority’s distinction between a couple who resided in a state with a long standing community property system and a couple who resided in a state with an elective community property system.\(^{193}\) Because in both states each spouse had a vested one-half interest in the couple’s collective earnings, Douglas reasoned that each spouse should be entitled to report one half of

\(^{186}\) Comm'r v. Harmon, 328 U.S. 44, 46 (1944).

\(^{187}\) Id. at 52. (Douglas, J. dissenting). In his dissent, Douglas also noted the written election once filed was irrevocable. Id.

\(^{188}\) Id. at 46 (majority opinion).

\(^{189}\) Id. at 47.

\(^{190}\) Harmon, 323 U.S. at 56 (Douglas, J., dissenting) (discussing Comm'r v. Clifford, 309 U.S. 331 (1940)).

\(^{191}\) Id. at 50-51.

\(^{192}\) Id. at 56-57.

\(^{193}\) Id. at 51-52.
their collective income for Federal income tax purposes. In summary of his position, Douglas stated that

“If by law, the earnings are never the property of the husband, but that of the community,” the husband should fare no better in Washington or Texas or California than in Oklahoma. The source of the “law” which determines whether or not that result obtains is the same in each case — the legislature and the judiciary of the particular state.

To this point in his judicial career, Douglas’s dissenting opinion in Harmon was the most even handed and devoid of any spin. The essence of Douglas’s dissenting opinion was his quest for consistency in two regards. First, Douglas contended that the Court should have followed Seaborn, a case he believed to be directly on point with Harmon. Second, he believed that taxpayers residing in community property states should be subject to the same rules of taxation regardless of when or how the separate states enacted those laws.

2. Douglas Rejected the Application of the Judicially Created Annual Accounting Period Doctrine When It Prejudiced the Taxpayer.

In United States v. Lewis, the taxpayer reported a $22,000 bonus he received on his income tax return in 1944. In 1946, as a result of losing a legal action brought against him by his employer, the taxpayer was compelled to return $11,000 of the bonus. The issue was whether the proper way to correct the taxpayer’s “over” reporting of the subsequently returned bonus was to amend his 1944 income tax return to claim a refund or to take a deduction in 1946, the year of repayment.

Applying two complimentary judicially created doctrines, the Court held the taxpayer’s remedy was to claim a deduction in the year of repayment. First, pursuant to the “claim of right doctrine” enunciated by the Court in North American Oil Consolidated v. Commissioner, the total amount of the bonus was taxable to the taxpayer in the tax year of receipt because he “had at all times

194. Id.
195. Id. at 52 (citation omitted).
197. Id. at 590-91.
198. Id. at 591.
199. Id. at 592.
claimed and used the full $22,000 unconditionally as his own,”

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even though in a subsequent tax year, the taxpayer was required to return $11,000 of the bonus based upon a “mistake of fact.” 202

Second, that result also tied into the “annual accounting period” doctrine. Under the latter doctrine, because each tax year stands on its own, all income the taxpayer received under a claim of right in a given tax year must be reported in that tax year. 203 So the correlative return of the erroneously received income was properly deductible in the year of its repayment to the employer. 204

With even more zeal than he had expressed in his pro-taxpayer dissenting opinion in Harmon, Douglas again sided with the taxpayer in a short dissent. Although Douglas agreed with the majority that the entire bonus was reportable in the year of receipt under the claim of right doctrine, 205 for the first time in his career, Douglas advocated an equitable remedy for the taxpayer. In this quest, unlike his dissenting opinion in Harmon in which he criticized the majority for not following the Court’s decision in Seaborn, Douglas had no problem endorsing an equity driven exception to the annual accounting period doctrine. This was reminiscent of Douglas’s many pro-commissioner opinions in which he ignored or disregarded authority that did not suit his desired outcome. In this case, the spin was definitely for the taxpayer who Douglas believed should have the right to claim a refund to “get back the tax which he paid on the money.”

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In language that was to become a recurring theme in subsequent pro-taxpayer opinions, Douglas expressed his desire to achieve equity for the taxpayer as follows:

Many inequities are inherent in the income tax. We multiply them needlessly by nice distinctions which have no place in the practical administration of the law. If the refund were allowed, the integrity of the taxable year would not be violated. The tax would be paid when due; but the Government would not be permitted to maintain the unconscionable position that it can keep the tax after it is shown that payment was made on money which was not income to the taxpayer.

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201. Lewis, 340 U.S. at 591.
202. Id. (quoting Greenwald v. United States, 57 F. Supp. 1017 (Ct. Cl. 1944)).
203. See id. at 592.
204. See id.
205. Id. at 592 (Douglas, J., dissenting).
206. Id.
207. Lewis, 340 U.S. at 592.
3. Douglas Opposed the Newly Created Relation Back Doctrine

In *Arrowsmith v. Commissioner*, over Douglas's dissent, the Court introduced the judicially created "relation back doctrine." In that case, beginning in 1937, two equal shareholders began to liquidate their corporation and divide the proceeds between them. Liquidation distributions spanned four taxable years 1937-1940. Treating the liquidation as the sale of their stock to the corporation in exchange for the proceeds, each shareholder reported a capital gain. Subsequently, in 1944, after the liquidation was formally completed, a judgment was entered against the corporation and one of the shareholders individually. By virtue of transferee liability, each shareholder reported their payments to satisfy the judgment as an ordinary rather than a capital loss.

Relating the payments in satisfaction of the judgment back to the liquidation, the Commissioner recharacterized the ordinary loss as a capital loss. In his majority opinion, Justice Black agreed with the Commissioner's recharacterization because he viewed the liquidation distributions and the judgment satisfaction payment as integral parts of the same transaction. The Court reasoned that a contemporaneous payment of the judgment during the liquidation process would have simply reduced the amount of capital gain. Accordingly, the Court held the loss realized in a later tax year must be recognized as a capital loss — in essence creating the relation back doctrine. The Court also addressed the argument that the relation back doctrine was contrary to the annual accounting period doctrine because a loss realized in a later tax year should stand alone in that tax year and, thus, be treated as an ordinary loss. In response, the Court explained the relation back doctrine did not compromise the annual accounting period doctrine because the look back was only for purposes of characterizing the loss and not an attempt to reopen the prior tax year for readjustment.

208. See Arrowsmith v. Comm'r, 344 U.S. 6 (1952)
209. *Id.* at 7.
210. *Id.*
211. *Id.*
212. *Id.*
213. *Id.* at 7-8.
215. *Id.*
216. *Id.* at 9.
217. See *id.* at 8.
218. See *id.* at 8-9.
As a further indication of Douglas's shift of allegiance to the taxpayer, Douglas disapproved of the relation back doctrine created by the majority. Expressing the same desire for consistency expressed in his dissenting opinion in *Harmon*, Douglas disagreed with the Court's explanation that the relation back doctrine was not inconsistent with the annual accounting period doctrine in a one paragraph dissent. Although not clearly articulated, he viewed the relation back doctrine as an unwarranted exception to that doctrine. Accordingly, Douglas criticized the Court's lack of consistency in applying the annual accounting period doctrine to the detriment of the taxpayer in *Lewis* but not in *Arrowsmith* when it would have benefitted the taxpayer.

**C. Poorly Reasoned, No Spin Douglas Majority Opinions Resulted in Inequitable Tax Consequences to the Taxpayer and to the Commissioner, Respectively.**

Not all of Douglas's opinions contained spin. Ironically, several of his no spin opinions were poorly reasoned and led to indefensible outcomes. Douglas's majority opinions in the companion cases, *United States v. Olympic Radio & Television, Inc.* and *Lewyt Corp. v. Commissioner* were prime examples of this type of opinion. Both cases involved accrual method corporate taxpayers who were subject to regular income tax as well as the excess profits tax (EPT). In *Lewyt*, the EPT was imposed on income generated from war contracts with the Government. Considering the substantial amount of tax liability taxpayers subject to both taxes could potentially incur, it was not surprising that Congress provided those taxpayers with a measure of mitigating tax relief. Congress granted this tax relief by virtue of allowing the taxpayer to enhance the tax benefit of a net operating loss (NOL) with the inclusion of some or all of its EPT liability in its computation. In *Lewyt*, Douglas's literal interpretation of accrual accounting Code sections resulted in an absurd and inequitable outcome in favor of the taxpayer; in *Olympic Radio* Douglas's interpretation resulted in an equally absurd and inequitable outcome in favor of the Commissioner.

219. See id. at 9-10 (Douglas, J., dissenting).
1. The Accrual Method Taxpayer Takes a Big Hit

In Olympic Radio pursuant to the predecessor of §172, an accrual method corporate taxpayer took advantage of the tax benefit of deducting its EPT liability “paid or accrued within the taxable year” in the computation of an NOL so as to provide a greater carry back amount to offset taxable income in a previous tax year.\(^{225}\) In that case, in 1946, the taxpayer sustained an NOL of approximately $311,000 it was entitled to carry back to 1944.\(^{226}\) Also in 1946, the taxpayer paid EPT of approximately $263,000 for the 1945 tax year.\(^{227}\) Because the taxpayer was on the accrual method of accounting, the question was whether it was entitled to deduct the accrued 1945 EPT paid in 1946 in the computation of its 1946 NOL.\(^{228}\)

A negative answer would have been devastating because most corporations subject to EPT were accrual method taxpayers; thus, the majority of taxpayers eligible for the tax benefit would be unable to take advantage of it. Moreover, as the Court of Claims noted, it was unlikely that an accrual method taxpayer would incur EPT in a year in which it also sustained an NOL.\(^{229}\) Therefore, in order for the EPT tax benefit to have any viability, the Court of Claims rendered a Judicial Interpretation of the relevant accounting related Code sections consistent with its view that Congress intended all taxpayers including accrual method taxpayers to deduct the EPT in the tax year it was paid.\(^{230}\)

In writing for the majority, however, Douglas reversed the Court of Claims' holding. Based upon an illogical analysis of the interrelationship between the accrual accounting sections of the Code and the allowance of deductions in general, Douglas concluded the taxpayer could not deduct the accrued 1945 EPT paid in 1946 in the computation of the 1946 NOL. In explaining his rationale, Douglas stated as follows:

We can only take the [Internal Revenue] Code as we find it and give it as great an internal symmetry and consistency as its words permit. We would not be faithful to the statutory scheme, as revealed by the

\(^{225}\) Olympic Radio, 349 U.S. at 234.

\(^{226}\) Id. at 233.

\(^{227}\) Id.

\(^{228}\) Id. at 234.


\(^{230}\) Id.
words employed, if we gave "paid or accrued" a different meaning for the purposes of [the predecessor of § 172] than it has in the other parts of the same chapter.\textsuperscript{231}

So in essence, Douglas implemented a Literal Interpretation of the procedural accrual accounting Code sections that were designed to determine only how and when to take a deduction to virtually eliminate a substantive deduction for a whole class of taxpayers. Considering the harshness of the EPT liability in addition to the regular income tax, it is hard to conceive Congress would have provided significant tax relief that would not be available to most taxpayers who could use it.

2. \textit{Turnabout Was Fair Play as the Commissioner Takes a Hit.}

Ironically, in \textit{Lewyt Corp.},\textsuperscript{232} the companion case to \textit{Olympic Radio}, Douglas's Literal Interpretation of accounting method sections of the Code also led to an absurd outcome, this time to the detriment of the Commissioner. The issue involved another tax benefit derived from the inclusion of EPT in the computation of the NOL that could potentially result in the taxpayer use of all or part of the same NOL twice. Pursuant to the predecessor of § 172, the NOL was first carried back to the second preceding tax year. If after the application of the NOL to the second preceding year, there was any remaining NOL, it would be carried forward to the first preceding tax year. The EPT imposed in the tax year the NOL was generated was integrated into the general formula as follows: the NOL to be carried forward from the second preceding tax year to the first preceding tax year was the excess of the unreduced NOL (meaning it did not take into account the amount by which it reduced taxable income for the first preceding year) over the excess of the second preceding tax year net income over the amount of the EPT (the EPT NOL Formula).\textsuperscript{233} So, in application, if the EPT imposed in the NOL tax year was greater than the net income from the second preceding tax year, the entire NOL would remain intact to be carried forward to the first preceding tax year.\textsuperscript{234}

Applying the EPT NOL Formula to the facts of the case was problematic. In 1946, the corporation, an accrual method taxpayer, sustained a NOL of approximately $164,000 that it was able to carry

\begin{itemize}
\item \textsuperscript{231} \textit{Olympic Radio}, 349 U.S. at 236.
\item \textsuperscript{232} \textit{Lewyt Corp. v. Comm'r}, 349 U.S. 237 (1955).
\item \textsuperscript{233} Unreduced NOL > (Second Preceding Tax Year Net Income > NOL Tax Year EPT).
\item \textsuperscript{234} \textit{See Lewyt Corp.}, 349 U.S. at 238-39; \textit{see also id.} at 248 (Frankfurter, J., dissenting).\
\end{itemize}
back to 1944 and completely use to offset a like amount of its income for that year. On its original 1944 income tax return, the taxpayer reported EPT of approximately $625,000. Due to subsequent adjustments made after the close of the 1944 tax year, however, the EPT was reduced to approximately $280,000. The taxpayer’s 1944 net income including the NOL was approximately $585,000. The precise issue was whether the amount of EPT to be used in the EPT NOL Formula was $625,000, the amount of EPT accrued as of the end of tax year 1944, or $280,000, the amount of EPT ultimately determined to be owed by the taxpayer. If the larger accrued amount was used, the entire NOL of $164,000 would be carried forward to 1945. On the other hand, if the lower amount as actually determined to be owed was used, there would be no NOL to be carried forward to 1945.

The Commissioner argued that using the larger accrued EPT in the formula would enable the taxpayer to receive the tax benefit of the NOL i.e., carry forward to 1945 for EPT it ultimately did not owe and did not pay. Conversely, the taxpayer contended that as an accrual method taxpayer, it was entitled to use the amount of the EPT that had accrued as of the end of the 1944 tax year. Intuitively, it was not likely Congress would have intended to grant such a substantial tax benefit based upon an accrued tax that in the end was not owed.

Notwithstanding a resulting phantom deduction, Douglas applied a Literal Interpretation of the relevant sections and adopted the taxpayer’s position. In an apparent comparison to his holding in Olympic Radio, Douglas observed that “the rule that general equitable considerations do not control the measure of deductions or tax benefits cuts both ways” sometimes to the benefit of the govern-

235. Id. at 239 (majority opinion).
236. Id.
237. Id.
238. Id.
239. Lewyt Corp., 349 U.S. at 238.
240. $164,000 (unreduced NOL) > ($585,000 (1944 net income) > $625,000 (accrued EPT)). Because the net income would not have been greater than the accrued EPT, there was no excess in the second part of the formula, and, thus nothing to subtract from the unreduced NOL. So the entire unreduced NOL would be carried forward to 1945.
241. $164,000 (unreduced NOL) > ($585,000 (1944 net income) > $280,000 (amount of EPT actually owed)), or $164,000 (unreduced NOL) > $304,000 (difference between the 1944 net income and amount of EPT actually owed). Because the unreduced NOL ($164,000) did not exceed $304,000, there would be no NOL to carry forward to 1945.
243. Id. at 239.
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ment and sometimes to the benefit of the taxpayer.\textsuperscript{244} Moreover, he attributed the differing results to Congress's legislative authority to "be strict or lavish in its allowance of deductions or tax benefits."\textsuperscript{245}

In the final analysis, Douglas's explanation of the outcome in both cases as being attributable to Congress's prerogative in granting strict or lavish tax benefits made no practical sense in either case. It seems inconceivable that in providing tax benefits to relieve taxpayers subject to the EPT Congress would in one instance deny the benefits to an entire class of taxpayers, and in another instance provide an unwarranted tax benefit windfall to the same class of taxpayers based entirely on the class's accounting method. To the contrary, it is more likely Congress intended to provide the tax benefit to those taxpayers who actually suffered the hardship of the EPT liability and not to provide it to those taxpayers who did not regardless of their accounting method. Thus, in this instance, a Judicial Interpretation of the applicable statutes allowing the taxpayer in \textit{Olympic Radio} the deduction for the 1945 EPT liability paid in 1946 and limiting the amount of EPT included in the NOL EPT Formula to the amount of EPT actually owed in \textit{Lewyt Corp.} would have been consistent with that intent.

IV. THE TAXPAYER ADVOCATE PERIOD—1958-1975

From 1958 through the end of Douglas's tenure on the Court in 1975, Douglas became the de facto taxpayer advocate on the bench. During this period, Douglas dissented on the side of the taxpayer in a number of the most famous landmark tax cases ever decided by the Court. Many aspects of Douglas's mostly dissenting opinions were devoid of any reasoned analysis and were brazenly Pro-Taxpayer.

\textsuperscript{244} Id. at 240.
\textsuperscript{245} Id.
A. Cases Exemplifying Douglas’s Repudiation of Judicial Interpretations as His Allegiance Became Unashamedly More Pro-Taxpayer.


Decided eleven years into the Taxpayer Advocate Period, Douglas’s dissenting opinion in United States v. Skelly Oil Co. best exemplified his repudiation of Judicial Interpretations that dominated his opinions during the Pro-Commissioner Period. Perhaps Douglas’s radical shift in allegiance from the Commissioner to the taxpayer explains this phenomenon. In any event, as discussed below, in his advocacy of the taxpayer’s position, it was clear that Douglas had become a proponent of Literal Interpretation of tax statutes preferring to leave it to Congress, not the Court, to cure any inequities that were perceived to be unfair to the Commissioner.

In addition to its significance to the Douglas tax legacy, Skelly Oil was unique in that Justice Marshall’s majority opinion reached a Pro-Commissioner result with a hybrid Literal/Judicial Interpretation of I.R.C. § 1341(a)(2). Section 1341(a)(2) provides that “a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item . . . .” As it applied to the instant case, in 1958, the taxpayer, a producer of natural gas, was compelled to refund over $500,000 of overcharged fees it had received from its customers and had included in its gross income over the six preceding tax years. In the computation of the depletion deduction for those tax years, however, the same $500,000 was included in gross income from the property from which the taxpayer had deducted 27 $\frac{1}{2}\%$ of that amount, or approximately $140,000. So, after taking into account the depletion deductions, of the $500,000 included in gross income, only approximately $360,000 was actually taxable.

Relying upon a Literal Interpretation of § 1341(a)(2), the taxpayer claimed a deduction of the entire $500,000 refunded amount.

247. Id. at 681 n.1.
248. Id. at 679.
249. Id. at 679-80.
250. Id.
it had previously included in gross income.\textsuperscript{251} If the deduction was allowed to stand, the taxpayer would have received the windfall of a partial double deduction by virtue of a full $500,000 deduction even though only $360,000 of those fees was actually taxed.\textsuperscript{252}

In holding in favor of the Commissioner (i.e., matching the bottom line $360,000 of taxable income with an equivalent deduction), Marshall applied a strained hybrid Literal Interpretation/Judicial Interpretation of § 1341(a)(2). In doing so, Marshall contended that the word “item” referring to the amount previously included in gross income was not in all cases necessarily equivalent in amount to the “deduction” allowed.\textsuperscript{253} As additional support, Marshall noted that the placement of § 1341 in the subchapter of the Code dealing with annual accounting system adjustments implied that the determination of the amount of the deduction was to be made “by reference to the applicable [substantive] sections of the Code and the case law developed under those sections.”\textsuperscript{254} Then, citing case law authority barring interpretations of the Code that would allow the equivalent of a double deduction in the absence of clear congressional intent, the Court could not believe that “Congress intended to give taxpayers a deduction for refunding money that was not taxed when received.”\textsuperscript{255}

Ironically, unlike his Pro-Taxpayer opinions in which he advocated equitable interpretations of tax statutes favorable to the taxpayer, in his dissenting opinion, Douglas rejected such an interpretation of the statute to achieve an equitable result for the Commissioner. Applying a strictly Literal Interpretation of § 1341(a)(2), Douglas concluded the taxpayer was entitled to the full $500,000 deduction and stated as follows: “[T]he taxpayer followed the words of the tax law literally, using no new or strained construction of words to find a tax advantage; there is no conflict between this case and any other decision.”\textsuperscript{256}

Finally, possibly due at least in part to his shift in allegiance to the taxpayer, Douglas unequivocally expressed his dissatisfaction with Judicial Interpretations designed to cure perceived inequities in tax statutes. In lieu of the Court’s intervention, Douglas became an advocate of statutory correction through the collaborative ef-

\begin{itemize}
\item \textsuperscript{251} Id. at 680.
\item \textsuperscript{252} Skelly Oil, 394 U.S. at 680.
\item \textsuperscript{253} Id. at 683.
\item \textsuperscript{254} Id.
\item \textsuperscript{255} Id. at 685.
\item \textsuperscript{256} Id. at 691 (Douglas, J., dissenting).
\end{itemize}
forts of the Joint Committee on Internal Revenue Taxation and Congress. Significantly, Douglas also expressed regret for voting with the majority in Commissioner v. Hallock, a classic Judicial Interpretation case that laid the foundation for many of his Pro-Commissioner opinions.

2. *Douglas Refused to Implement a Judicial Interpretation Expanding the Scope of the Tax Benefit Rule.*

In *Nash v. United States*, the Commissioner sought a Judicial Interpretation expanding the scope of the tax benefit rule with regard to bad debts. In that case, the taxpayers were partners in eight partnerships reporting income on the accrual method of accounting. Accordingly, the full face amount of accounts receivable were included in the partnerships’ gross income. Pursuant to § 166(c), the partnerships used the reserve method to deduct bad debts by which a certain portion of the current tax year’s accounts receivable, estimated to become worthless in subsequent tax years, was currently deductible and added to a bad debt reserve. When an account receivable actually became worthless during a given tax year, no deduction was allowed and the bad debt reserve would be reduced by the amount of the bad debt.

Subsequently, pursuant to a § 351 tax-free transaction, the assets of the eight partnerships including the accounts receivable were transferred to eight new corporations in exchange for the stock of the new corporations. The issue was whether the partnerships were required to include the outstanding balance of the bad debt reserve in gross income because after the transfer of the accounts receivable, the reserve was no longer necessary to the partnerships.

Pursuant to the tax benefit rule codified in the predecessor of § 111(a), “gross income does not include income attributable to the recovery during the taxable year of a bad debt . . . to the extent . . . of the recovery exclusion with respect to such debt . . . .” Under § 111(b)(1), the “recovery exclusion” was the amount of the bad debt which did not result in the reduction of tax (i.e., a tax benefit). By implication, the amount of a bad debt recovery that had previ-

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258. *Skelly Oil*, 394 U.S. at 690 n.2.
260. *Id.* at 2.
261. *Id.* at 2-3.
262. *Id.* at 2-4.
ously generated a tax deduction would be included in gross income. In this case, it appeared that the full amount of the partnerships' bad debt reserve had generated deductions.263

The Commissioner contended that the outstanding balance of a bad debt reserve no longer necessary to the partnerships should be treated as a "recovery" for purposes of the tax benefit rule, thus, includible in the partnerships' gross income.264 In Douglas's majority opinion, he refused to adopt a Judicial Interpretation that would extend the meaning of the word "recovery" as advocated by the Commissioner. According to Douglas, such a Judicial Interpretation would require the recasting of § 111 as follows: a "bad debt reserve that has produced an income tax benefit in a prior year is to be added to income in the year when it was recovered or when its need is ended."265

In the final analysis, because the literal language of § 111 did not contain the language necessary to achieve the Commissioner's desired result as well as the tax-free transfer of the accounts receivables from the partnerships to the corporations, Douglas was unwilling to depart from the Literal Interpretation of the statute.266 Thus, Douglas once again demonstrated his allegiance to the taxpayer.

3. Douglas Refused to Implement a Judicial Interpretation Narrowing the Scope of the Research or Experimental Expenditures Deduction.

In Snow v. Commissioner,267 at issue was the scope of the deduction for research and experimental expenditures pursuant to I.R.C. § 174(a)(1). Under that section, a taxpayer was entitled to deduct research or "experimental expenditures which are paid or incurred ... during the taxable year in connection with his trade or business ..."268 In that case, the taxpayer had invested $10,000 in a limited partnership "formed to develop a special purpose inciner-
ator for the consumer and industrial markets." During the tax year in issue, the partnership "reported no sales of the incinerator . . . ." The taxpayer, however, reported his distributive share of the partnership loss attributable to the partnership's experimental expenditures.

Prior to reaching the Court, the two lower courts held that the taxpayer was not entitled to the § 174 deduction because the partnership was not engaged in a trade or business in the tax year in which the experimental expenditures were incurred. In those decisions, despite differences in the wording, the lower courts apparently interpreted the phrase "in connection with [a] trade or business" set forth in § 174(a) to have the same meaning as the phrase "carrying on a trade or business" set forth in § 162(a) (relating to the deduction for ordinary and necessary business expenses). Consequently, based upon the lower courts' Judicial Interpretation, a taxpayer would not be entitled to a deduction for experimental expenses unless he was engaged in a trade or business.

In his majority opinion, Douglas reversed the lower court decisions. Although not clearly articulated, Douglas apparently perceived the language in § 162(a) ("carrying on a trade or business") more narrowly than the language of § 174(a) ("in connection with a trade or business"). Therefore, Douglas interpreted the § 174(a) language to require a lesser degree of business activity. The outcome of the case was to allow a taxpayer a deduction for experimental expenditures during the developmental stages of an invention even though the taxpayer was not engaged in a trade or business at the time the expenditures were incurred. Thus, Douglas's pro-taxpayer opinion in Snow was an example of Douglas's unwillingness to render Judicial Interpretations of tax statutes that were favorable to the Commissioner.

269. Id. at 502.
270. Id.
271. Id. at 501.
273. See Snow, 482 F.2d at 1031-32.
274. See Snow, 416 U.S. at 502-03.
275. Id. at 503-04. Douglas also found the legislative history of § 174 supportive of his Literal Interpretation. Of significance was a statement by the Chairman of the House Committee on Ways and Means describing the enactment of § 174 as being "particularly valuable to small and growing businesses." Id. (emphasis added).
4. **Douglas Rejected a Judicial Interpretation to a Treasury Regulation as a Means of Correcting an Inequitable Result to the Commissioner.**

In *United States v. Generes*, the Commissioner sought the equivalent of a Judicial Interpretation to cure an inequity in its own Treasury Regulation. The issue was whether a taxpayer who advanced over $300,000 to and on behalf of a defunct corporation wholly owned by him and other members of his family was entitled to the tax benefit of a business bad debt deduction. Pursuant to the applicable regulations, the characterization of the debt as a business bad debt was to be determined by the relationship between the debt and the taxpayer’s trade or business. A debt is a business bad debt “if that relation is a *proximate* one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless . . . .”

The resolution of the issue turned upon whether the word “proximate” meant that the business purpose for the taxpayer advancing funds to the corporation had to be the “dominant motivation” or only a lesser “significant motivation.” In this case, the taxpayer asserted the business purpose for advancing the funds to the corporation was to protect his job as a salaried employee. Yet, the underlying facts suggested that the taxpayer’s dominant motivation in advancing over $300,000 to the corporation was to protect his substantial $38,900 investment and desire to maintain the integrity of the corporation as an ongoing entity in contrast to maintaining his annual employee compensation of $12,000.

So, if the word “proximate” meant “dominant” as the Commissioner contended, the debt would be properly characterized as a nonbusiness bad debt. Such a reading of the regulatory language, however, would have been a stretch. First, the words “dominant motivation” implied a much higher degree of motivation than the word “proximate.” Second, the wording “a proximate one” sug-

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277. *Id.* at 97. The taxpayer owned 44% of the stock, his son-in-law, Kelly, also owned 44% of the stock with the remaining 12% of the stock owned by the taxpayer’s son and another son-in-law. *Id.*
278. *Id.* at 113 (Douglas, J., dissenting) (quoting Treas. Reg. § 1.166-5(b)(2) (1972) (emphasis added)).
279. *Id.* at 96 (majority opinion).
280. *Id.* at 106.
281. *Generes*, 405 U.S. at 97. In fact, as president of the corporation, the taxpayer worked only six to eight hours a week. It was his son-in-law, Kelly, who ran the day-to-day operations on a full time basis. *Id.*
gested the possibility of more than one motivation. Assuming there were two motivations, the words "a proximate one" could be interpreted to mean that even a significant motivation of a lesser degree than a dominant motivation, would be sufficient to qualify as business bad debt.

Effectively conceding the regulation was poorly worded, the majority opinion in favor of the Commissioner made no effort to read "dominant motivation" into the word "proximate." Instead, the Court focused on the Code's distinction between business and nonbusiness items as a matter of tax policy. Noting the much more significant tax benefits Congress had provided in the form of business deductions as compared to nonbusiness deductions, the Court reasoned there should be a similar distinction between a business bad debt and a nonbusiness bad debt. Therefore, to allow a business bad debt deduction when the taxpayer's dominant motivation was to protect his investment would have compromised congressional intent.

Another justification for requiring a dominant motivation advanced by the Court was to provide a workable standard for the trier of fact to implement in assessing whether the taxpayer's loss was business or investment related. In other words, the looser standard of significant motivation could lead to taxpayer manipulation because the "mere presence of a business motive, however small and however insignificant, [would control] the tax result at the taxpayer's convenience." Discounting the majority's arguments and the possibility of taxpayer abuse, in his dissenting opinion, Douglas refused to deviate from a Literal Interpretation of the Treasury Regulation to cure a perceived inequitable result for the Commissioner. This was evident from the first paragraph of his dissent in which Douglas held the Commissioner accountable for his own Treasury Regulation's

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282. See id. at 105. To this point, the majority opinion stated: The Regulations' use of the word "proximate" perhaps is not the most fortunate . . . . It has little place in tax law where plural aspects are not usual, where an item either is or is not a deduction, or either is or is not a business bad debt, and where certainty is desirable.

283. Id. at 103-04.

284. Id. The Court also found such an allowance would be contrary to its holding in Whipple v. Comm'r, 373 U.S. 193 (1963), in which it determined that an 80% shareholder of a corporation who provided organizational, promotional, and managerial services was not in a "trade or business." On that basis, the shareholder was denied a business bad debt deduction for unpaid advances he made to the corporation. Id. at 102.

use of the words “a proximate one” and not “primary and domi-
nant” in characterizing a taxpayer’s motivation for advancing funds
as it related to the taxpayer’s trade or business. Douglas then
applied a Literal Interpretation of the word “proximate” and con-
cluded the taxpayer had adequately demonstrated that the advance
of funds on behalf of the corporation had a “‘proximate’ relation to
his business as a salaried officer . . . .”

Similar to his repudiation of Judicial Interpretations to cure in-
equities in tax statutes on behalf of the Commissioner he had ex-
pressed in his dissenting opinion in Skelly Oil, Douglas stated as
follows:

I protest now what I have repeatedly protested, and that is the use
of this Court to iron out ambiguities in the Regulations or in the Act,
when the responsible remedy is either a recasting of the Regulations
by Treasury or presentation of the problem to the Joint Committee on
Internal Revenue Taxation . . . that regularly rewrites the Act and is
much abler than are we to forecast revenue needs and spot loopholes
where abuses thrive.

Thus, Douglas’s dissent in Generes was yet another indication of a
double standard he developed during the Taxpayer Advocate Pe-
riod of endorsing equitable remedies for the taxpayer but leaving it
to Congress to do the same for the Commissioner.

B. The Spin in Douglas’s Opinions Stopped in Favor of the
Taxpayer Who He Was Definitely Looking Out for.

In the Taxpayer Advocate Period, a common theme in Doug-
las’s opinions was a pro-taxpayer spin regardless of the underlying
issue. This section of the article focuses on the various important
areas of tax law addressed by the Court in which Douglas was truly
the taxpayer’s advocate on the bench.

1. Deductibility of Traveling Expenses

The deductibility of traveling expenses was one area of tax law
in which Douglas made his mark as a Pro-Taxpayer advocate in
three strongly worded dissenting opinions. The deductibility of
traveling expenses, including the cost of meals and lodging, had
long been a contentious issue between the Commissioner and tax-

286. See id. at 113-14 (Douglas, J., dissenting).
287. Id. at 114. Moreover, Douglas was willing to accept the taxpayer’s motivation at
face value as evident by his refusal to consider whether it was prudent to advance such a
large sum of money to the corporation to save his job. Id.
288. Id. at 114-15.
payers. In general, the allowance of a deduction for meals and lodging incident to a taxpayer's employment or business pitted the non-deductibility of personal living expenses against the "exigencies of business." Section 162(a)(2) bridged that gap by allowing a deduction for "traveling expenses (including amounts expended for meals and lodging . . . ) while away from home in the pursuit of a trade or business." Yet, in spite of a specific provision allowing the deduction, there had been an ongoing debate as to the meaning of the word "home" and more broadly the meaning of the term "away from home." Neither term was defined in the Code.

Since 1921, however, the Commissioner had defined the word "home" to mean the taxpayer's principal place of business or employment even if it did not coincide with the location of the taxpayer's residence. In 1940, the Commissioner added the additional requirement that the term away from home implied an overnight stay.

The Commissioner's definition of "home," however, was inconsistent with the Literal Interpretation of home as being the taxpayer's residence. Moreover, the requirement that the taxpayer be away from home overnight was not included in the statutory language. Thus, the implementation of the statute in the manner advocated by the Commissioner would have required a Judicial Interpretation. On both counts, Douglas disagreed with the Commissioner. First, as to the meaning of the word "home," Douglas defined it literally as the taxpayer's residence. He also vehemently opposed the Commissioner's insistence that the taxpayer be away from home overnight as a condition of deductibility not expressly set forth in the statute.

a. Definition of the Word "Home"

During Douglas's tenure on the Court, despite having three opportunities to define the word "home," the Court failed to do so. In each case, the Court denied the taxpayer's deduction for traveling expenses on other grounds. The first case, Commissioner v. Flowers (Douglas voting with the majority), decided during the Pro-Taxpayer Period, was the seminal decision regarding the deductibility of traveling expenses. The case involved a taxpayer who resided in

290. Id. at 474 (quotation omitted).
291. Id. at 472 n.5 (citing O.D. 864, 4 C.B. 211 (1921); O.D. 1021, 5 C.B. 174 (1921)).
Jackson, Mississippi, but worked in Mobile, Alabama. The issue was whether the taxpayer's cost for food and board during the time he spent in Mobile was deductible. In a decision in favor of the Commissioner, the Tax Court defined "home" as "the post, station or place of business where the taxpayer was employed . . . ." Since the taxpayer's place of employment was in Mobile rather than Jackson, the Commissioner contended the taxpayer's traveling expenses in Mobile were not incurred away from his "home" in the pursuit of business.

Although the Court affirmed the Tax Court's decision, it declined to decide whether the definition of home was the taxpayer's residence, or place of business or employment. Instead, the Court created the following three-part test (the Flowers Test) to determine whether traveling expenses were deductible:

1. The expense had to be ordinary and necessary;
2. The expense had to be incurred "while away from home"; and
3. There had to be a "direct connection between the expenditure and carrying on the trade or business of the taxpayer or of his employer."

Applying the third prong of the test, the Court determined that there was no business connection between the taxpayer travel and his employment. Since the taxpayer's decision to live in Jackson was purely personal, his traveling expenses incurred in Mobile were not deductible whether the taxpayer's home was his residence or place of employment. For that reason, the Court denied the taxpayer's deduction without providing any clarification to the definition of "home."

Significantly, in the aftermath of the Flowers decision, the definition of "home" remained a contentious issue. Moreover, even though the Tax Court adopted the Commissioner's definition in the Flowers case, through subsequent case law, the Tax Court expanded the scope of its meaning. For example, in Schurer v. Commissioner, the taxpayer, a registered plumber residing in Pittsburgh, traveled...

294. Flowers, 326 U.S. at 471 (quoting 3 T.C.M. (CCH) 803 (1944)).
295. Id.
296. Id. at 472.
297. Id. at 470.
298. Id. at 473.
299. Id. at 472-73.
to various remote temporary work sites.  As a starting point, the Tax Court defined “home” as the place in which the taxpayer was regularly employed or carried on a trade or business regardless of his place of residence. Since the taxpayer did not regularly work in any of those locations, however, no one location could be considered to be his home. Consequently, although not clearly articulated in the opinion, it appeared the Tax Court recognized Pittsburgh as the taxpayer’s home since in the past he regularly practiced his trade as a registered plumber in that location. As a result, the Tax Court recognized the taxpayer’s travel to those temporary work sites as being away from home and allowed him to deduct his traveling expenses to and from Pittsburgh.

Subsequently, in *Leach v. Commissioner*, the Tax Court extended its holding in *Schurer* in a way that was favorable to the taxpayer. In that case, in 1945, the taxpayer apparently had no regular employment in the place he resided and during that entire year worked at various remote locations. Consistent with the *Schurer* case, the Tax Court determined that none of those locations could be considered the taxpayer’s home. Yet, despite having no regular employment in the location where he maintained his personal residence, the Tax Court recognized it as his home for purposes of allowing him a deduction for traveling expenses to work sites away from home finding “[t]he expenses (lodging only) were unavoidable, reasonable, and necessary expenses while away from his ‘home’ in pursuit of his trade.”

Thus, from the *Schurer* and *Leach* cases, it appeared that the Tax Court construed the taxpayer’s place of employment or business, as his “home” only if it is was or had been his regular place of employment or business. If the taxpayer did not currently have regular employment in the place where he resided or never had regular employment there, traveling expenses for work performed in locations away from the taxpayer’s residence were considered “away from home,” and, thus, deductible. In subsequent cases, the Tax Court tempered its expanded definition of home by holding a taxpayer’s home would be treated as being shifted from his place of

301. *Id.* at 547.
302. *Id.* at 547.
304. *Id.* at 21.
305. *Id.*
306. *Id.*
residence to a work location, unless it was unreasonable for the taxpayer to reestablish his personal residence in that work location. In other words, if the employment was "temporary," it would be unreasonable for the taxpayer to relocate his residence at the employment site. On the other hand, if the employment was indefinite, the taxpayer's decision not to relocate his residence would be considered to be personal. Thus, traveling expenses incident to temporary employment were deductible, but not so for indefinite employment.

In Peurifoy v. Commissioner, the first traveling expense case decided by the Court since Flowers, the Tax Court's refined definition of "home" was put to the test. Factually similar to the Schurer case, three blue-collar taxpayers were often sent by their union to work at sites located far away from their personal residences. During the tax years in issue, the taxpayers worked at the various locations for extended periods of times (20 1/2 months, 12 1/2 months, and 8 1/2 months). The taxpayers deducted their food and board expenses as well as the cost of transportation to and from their residences. The Commissioner disallowed those deductions because in his view the taxpayers' employment was indefinite rather than temporary. The Tax Court disagreed and decided the case as a question of fact (i.e., the employment was temporary, found in favor of the taxpayer).

On appeal, the Fourth Circuit reversed the Tax Court holding as being "clearly erroneous" on the facts. On final appeal to the Supreme Court of the United States, without any analysis, the Court deferred to the judgment of the Fourth Circuit and affirmed its reversal of the Tax Court decision. In doing so, the Court merely restated the Tax Court's temporary versus indefinite employment distinction but offered no clarification to the definition of "home."

Conversely, in his dissenting opinion, Douglas asserted that the proper application of the Flowers Test would have resulted in a favorable decision for the taxpayer. Because the expenses were

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307. See Jones v. Comm'r, 13 T.C. 880 (1949); see also, Albert v. Comm'r, 13 T.C. 129 (1949).
309. Id. at 150.
310. Id. at 156.
311. Id. at 153-54.
312. Id. at 157.
315. Id. at 62 (Douglas, J., dissenting).
reasonable and directly connected with the taxpayers’ trade or business, Douglas reasoned that the determinative factor was whether the taxpayers incurred those expenses while “away from home.” Defining the word “home” literally, Douglas concluded it meant the place where the taxpayer maintained his family abode and rejected “the Commissioner’s contention that ‘home’ is synonymous with the situs of the employer’s business.” Moreover, uncharacteristic of his Pro-Commissioner Period opinions, Douglas expressed his belief that Congress did not intend the harsh result of denying a deduction to taxpayers who were compelled to work at locations away from their place of residence. So, in applying the three prong Flowers test, Douglas would have allowed a deduction for traveling expenses required by the exigencies of the employer’s business in order to carry out the taxpayer’s chosen trade.

Finally, nine years after the Peurifoy decision, the Court was presented with another opportunity to define the word “home,” but again declined to do so. In Commissioner v. Stidger, the issue was whether a Marine captain permanently stationed and residing with his family in California could deduct the cost of his meals incurred on a fifteen-month tour of duty in Japan. By Marine Corps rule, the taxpayer’s family was prohibited from accompanying him on this tour. For military purposes, based upon the length of the tour, the taxpayer’s “permanent duty station” during the fifteen-month period was Japan. The Commissioner disallowed the deduction based upon his view that the taxpayer’s “home” had shifted from California to Japan; thus, none of his expenses were incurred while away from home. The Tax Court agreed with the Commissioner and held in his favor. On appeal, the Ninth Circuit rejected the Tax Court’s definition of “home” interpreting it to mean the taxpayer’s residence.

In the first part of the Court’s majority opinion, Chief Justice Warren reviewed the origins of the Commissioner’s definition of “home” as being the taxpayer’s place of employment or business and noted his consistency in applying that definition. Yet, in

316. *Id.*
317. *Id.* at 63 n.6.
319. *Id.*
320. *Id.* at 289.
321. *Id.*
323. Stidger v. Comm’r, 355 F.2d. 294, 298 (9th Cir. 1965).
spite of the Commissioner urging the Court to adopt his definition of home based upon congressional review and re-enactment of "the [statutory] language with an awareness of the administrative interpretation [as constituting] a legislative endorsement," the Court declined to do so. Incomprehensibly, applying the same underlying rationale (i.e., the consistency of the Commissioner’s position and the apparent congressional approval of it), Warren opted to adopt the Commissioner’s much narrower longstanding position “that a military taxpayer’s permanent duty station [was] also his home for purposes of determining deductibility of travel expenses.”

In a critical dissenting opinion closely resembling his dissent in Peurifoy, Douglas rejected the majority’s narrow holding and focused on the broader issue of the meaning of the term “away from home.” Similar to Peurifoy, Douglas determined that the taxpayer’s home was his family residence in California, and because he had satisfied the Flowers Test, his traveling expenses were deductible. In directly addressing the Commissioner’s urging that defining “home” as the taxpayer’s place of employment would provide the certainty of a fixed rule, Douglas was not persuaded that the benefit of such a rule outweighed what he viewed as an unambiguous literal definition of the word “home” as the taxpayer’s residence. In summarizing his position, Douglas stated, “While equity is seldom an ingredient of the tax laws, while they are indeed inherently discriminatory in many ways . . . we need not increase their harshness by giving simple words unusual or strained meanings — unless of course Congress has plainly made an arbitrary choice.”

b. The Overnight Requirement

As discussed above, § 162(a)(2) allowed a deduction for “traveling expenses (including amounts expended for meals and lodging . . .) while away from home in the pursuit of a trade or business.” Similar to Skelly Oil, United States v. Correll was a clash between the majority who advocated a pro-Commissioner Judicial Interpretation that would insert the word “overnight” following the words “away from home” as a limitation on the deductibility of traveling

325. Id. at 292 (citing Comm’r v. Winmill, 305 U.S. 79 (1938)).
326. Id.
327. Id. at 297-299 (Douglas, J., dissenting).
328. Id.
329. Id. at 298 (footnote omitted).
expenses,\textsuperscript{330} and the dissent, led by Douglas, who countered with a pro-taxpayer Literal Interpretation that did not insert “overnight.”\textsuperscript{331} In \textit{Correll}, a traveling salesman covering an expansive geographic territory on a daily basis sought a deduction for the cost of breakfast and lunch on the road even though he returned home each day for dinner.\textsuperscript{332} The Commissioner disallowed the deduction because the taxpayer’s daily work activities did not include an overnight stay.\textsuperscript{333} The Sixth Circuit affirmed a district court decision in favor of the taxpayer.\textsuperscript{334} In rejecting the overnight requirement, the Sixth Circuit asserted it “[did not] bear [any] rational relation to the business necessity of the meal expense.”\textsuperscript{335}

In reversing the Sixth Circuit, the majority opinion found merit in the Commissioner’s overnight requirement. The Court lauded it as a means of avoiding “wasteful litigation and continuing uncertainty that would inevitably accompany any purely case-by-case approach to the question of whether a particular taxpayer was ‘away from home’ on a particular day.”\textsuperscript{336} Moreover, by requiring an overnight stay, the Court noted the requirement eliminated the unfair discrimination of allowing meal deductions for one-day travelers but denying similar treatment for commuters who clearly could not deduct the cost of their meals.\textsuperscript{337} Finally, in an attempt to reconcile the Court’s Judicial Interpretation with the literal language of the statute, the Court noted the pairing of the words “meals and lodging” as a unit suggested that the deductibility of meals was intended only where the travel also involved lodging.\textsuperscript{338}

The merits of the Court’s Judicial Interpretation were at least arguable. Although there was ample contrary case law maligning the Commissioner’s overnight requirement as going far beyond the literal meaning of the words of the statute,\textsuperscript{339} with the exception of Treasury Regulations in which there was no direct reference to the

\textsuperscript{331} \textit{Id.} at 307 (Douglas, J., dissenting).
\textsuperscript{332} \textit{Id.} at 300 (majority opinion).
\textsuperscript{333} \textit{Id.}
\textsuperscript{334} Correll v. United States, 369 F.2d 87 (6th Cir. 1966).
\textsuperscript{335} \textit{Id.} at 89.
\textsuperscript{336} \textit{Correll}, 389 U.S. at 302.
\textsuperscript{337} \textit{Id.} at 303.
\textsuperscript{338} \textit{Id.} at 304.
\textsuperscript{339} See Waters v. Comm’r, 12 T.C. 414 (1949); Chandler v. Comm’r, 226 F.2d 467 (1st Cir. 1955); Williams v. Patterson, 286 F.2d 333 (5th Cir. 1961); Hanson v. Comm’r, 298 F.2d 391 (8th Cir. 1962); Bagley v. Comm’r, 46 T.C. 176 (1966).
overnight requirement,\textsuperscript{340} since 1940 administrative pronouncements had consistently applied the overnight requirement to the deductibility of travel expenses.\textsuperscript{341} Moreover, legislative history with regard to a related Code section also appeared to be supportive of the overnight requirement.\textsuperscript{342} Pursuant to the Internal Revenue Code of 1954, under certain circumstances, § 62(2)(C) allowed an employee to take a § 162(a) deduction for the “expenses of travel, meals, and lodging while away from home” as an above the line deduction. According to the legislative history, § 62(2)(C) corresponded to § 22(n)(2) of the Internal Revenue Code of 1939.\textsuperscript{343} In an apparent reference to the latter section, the Senate Committee Report stated, “[a]t present, business transportation expenses can be deducted by an employee . . . only . . . if they are incurred while he was away from home overnight.”\textsuperscript{344} Thus, in Correll, the majority concluded that statement was indicative of congressional approval of the overnight requirement as a prerequisite for the deduction.\textsuperscript{345}

Conversely, in a two-paragraph dissent, with no discussion or analysis of any of the authority discussed in the majority opinion (other than a quote from the Sixth Circuit decision), Douglas objected to the Commissioner’s interjection of the word “overnight” following the words “while away from home.” Based upon a Literal Interpretation of the statutory language, Douglas contended “away from home” suggested a geographical separation between

\textsuperscript{340} Ironically, Treas. Reg. § 1.162-2, the regulation specifically addressing the deductibility of traveling expenses, made no reference to the overnight requirement. Although Treas. Reg. § 1.162-17(b)(3)(ii) (deductibility of employee business expenses in excess of employer reimbursements), Treas. Reg. § 1.162-17(b)(4) (relating to the proper way for an employee to account for employee business expenses when required to do so by his employer in order to receive reimbursement), and Treas. Reg. § 1.162-17(c)(2) (relating to the proper way for an employee to substantiate reimbursed employee business expenses in a statement attached to his income tax return) all refer to “overnight” lodging, it is in the context of record keeping.

\textsuperscript{341} See I.T. 3395, 1940-2 C.B. 64; Rev. Rul. 54-497, 1954-2 C.B. 75; Rev. Rul. 61-221, 1961-2 C.B. 34 (reaffirming the overnight rule with a slight modification to allow a deduction for meals and lodging expenses necessitated by the exigencies of employment over a period substantially longer than an ordinary workday even if the taxpayer did not stay away overnight); Rev. Rul. 63-239, 1963-2 C.B. 87.


\textsuperscript{344} See supra note 342 (emphasis added); see also Correll, 389 U.S. at 305, n.20 (discussing the legislative history).

\textsuperscript{345} United States v. Correll, 389 U.S. 299, 305-06 (1967) (observing that the Commissioner agreed with inclusion of “overnight” as discussed in the legislative history). On the other hand, it could be argued that the reference to “overnight” in the Senate Report was loose language and if Congress intended to allow the deduction only if it involved an overnight stay, it could have clarified any confusion by amending § 162(a)(2) by simply adding the word “overnight” after the words “away from home.”
the taxpayer and “home” rather than the time element implied by the word “overnight” not present in the statute. For that reason, Douglas disapproved of what he viewed as an inappropriate interjection of an overnight requirement “by administrative construction or regulations.” Thus, Douglas would have allowed the taxpayer’s deduction for the cost of breakfast and lunch on the road.

2. *Douglas Championed Taxpayer Rights Against Intrusive IRS Investigations*

In the Taxpayer Advocate Period, there were two cases in which the Court considered the taxpayer’s rights against intrusive IRS investigations. In one case, the taxpayer’s statutory rights were at issue. The other case involved the taxpayer’s constitutional privilege against self-incrimination. In both cases decided in favor of the Commissioner, Douglas’s dissenting opinions advocated what he viewed as the taxpayer’s right to privacy.

a. *The Commissioner’s Standard of Proof Necessary to Compel an Examination of the Taxpayer’s Books and Records From Closed Tax Years*

In *United States v. Powell*, the issue was the sufficiency of an IRS summons to compel the taxpayer’s production of records with regard to tax years that were closed due to the expiration of the normal three-year statute of limitations. Relevant to the resolution of the issue was § 7605(b) stating that “[n]o taxpayer shall be subjected to unnecessary examination . . . and only one inspection of a taxpayer’s books . . . shall be made . . . unless the . . . Secretary . . . after investigation, notifies the taxpayer in writing that an additional inspection is necessary.” Although the statute itself imposed no standard of proof on the Commissioner as a condition for production of documents, lower courts had imposed varying judicially created standards of proof.

More specifically, prior to the expiration of the three-year statute of limitations, the Commissioner had examined the tax returns of the corporate taxpayer. After the three-year statute of limitations had expired, on suspicion of possible fraud, the Commissioner’s agent sent the taxpayer a letter notifying him “that the

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346. *Id.* at 307 (Douglas, J., dissenting).
347. *Id.*
349. *Id.* at 52-53 (quoting I.R.C. § 7605(b) (1954)).
350. *Id.* at 49.
agent had reason to suspect that the taxpayer had fraudulently falsified its 1958 and 1959 [tax] returns by overstating expenses; thus, the agent desired to reexamine the taxpayer’s books for those years. Subsequently, because the taxpayer failed to cooperate, the agent issued a summons to the taxpayer for the production of the requested records. Because the taxpayer refused to comply with the summons, the Commissioner petitioned the district court to enforce it. The agent’s affidavit in support of his petition merely reiterated his belief that the taxpayer had committed fraud. As a result of the hearing, the district court granted the agent one hour to review the taxpayer’s records. On appeal, the Third Circuit reversed the district court’s finding that the affidavit was not sufficient to satisfy what it perceived to be the standard of showing probable cause in order to compel the taxpayer’s production of the requested documents with respect to closed tax years.

Thus, on appeal, the question of the requisite standard of proof was posed to the Court. In addition to the Third Circuit, numerous lower courts had adopted a “reasonable basis probable cause” standard. Disagreeing with the standards promulgated by case law, the Court based its holding in favor of the Commissioner on an analysis of the relevant legislative history of § 7605(b). According to the majority, the legislative history indicated the statute was enacted to protect taxpayers from “unnecessary annoyance” and overzealous “tax examiners” with no mention of a required standard of proof to be imposed on the Commissioner. Consequently, the Court determined Congress’s limited purpose of preventing agency abuse did not mean it intended to give courts the authority “to oversee the Commissioner’s determinations to investigate.”

For those reasons, the Court rejected the probable cause standard finding the primary purpose of the statute “was no more than

351. Id. at 50.
352. Id. at 49. Per § 6501(c)(1), in the case of a fraudulent tax return, there is no statute of limitations to restrict the Service’s authority to examine the return. Id. at 49 n.2.
353. Id. at 49.
355. Id. at 50.
356. Id.
357. See id. at 53.
358. See In re Andrews’ Tax Liability, 18 F. Supp. 804 (D. Md. 1937); Zimmerman v. Wilson, 105 F.2d 583 (3d Cir. 1939); In re Brooklyn Pawnbrokers, 39 F. Supp. 304 (E.D.N.Y. 1941); Martin v. Chandis Sec. Co., 128 F.2d 731 (9th Cir. 1942); O’Connor v. O’Connell, 253 F.2d 365 (1st Cir. 1958); De Masters v. Arend, 313 F.2d 79 (9th Cir. 1963).
359. Powell, 379 U.S. at 54 (quoting 61 Cong. Rec. 5855 (1921)).
360. Id. at 56.
to emphasize the responsibility of agents to exercise prudent judgment in wielding the extensive powers granted to them by the Internal Revenue Code.”361 The standard it did create, however, was amorphous and seemingly would not have required any more substantiation than the agent had presented in his district court affidavit. According to the Court, the standard was as follows: “[The Commissioner] must show that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner’s possession, and that the administrative steps required by the Code have been followed . . . .”362

Conversely, emphasizing the importance of peace of mind provided to taxpayers by virtue of the three-year statute of limitations, Douglas’s pro-taxpayer dissenting opinion clearly indicated he was looking out for the taxpayer’s rights against intrusive IRS investigations.363 In Douglas’s view, once the three-year statute of limitations had expired, any examination of an otherwise closed tax year was “presumptively ‘unnecessary’ within the meaning of § 7605(b) — a presumption the [Commissioner] must overcome.”364 The actual standard endorsed by Douglas appeared to be a “reasonable basis” standard — somewhere in between a “probable cause” standard and the “legitimate purpose” standard created by the majority. In stating that he would require the district court “to be satisfied that the Service is not acting capriciously in reopening the closed tax period . . . [and] insist[ing] the District Court act in a judicial capacity, free to disagree with the administrative decision unless that minimum standard is met,”365 Douglas cited several cases in which the courts had applied a “reasonable basis” standard.366 In the absence of some minimum guidelines, Douglas believed the “statute of repose” (i.e., the statute of limitations) would be rendered meaningless as a protection of the taxpayer’s right against intrusive IRS examinations.367

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361. Id.
362. Id. at 57-58.
363. Id. at 59 (Douglas, J., dissenting) (referring to the statute of limitations as a “statute of repose”).
364. Id. at 60.
366. Id. at 59 n.2.
367. Id. at 60.
b. **Constitutional Privilege Against Compulsory Self-Incrimination Inherent in Taxpayer’s Right Not to Produce Her Self-Prepared Documents**

In contrast to the *Powell* case, in *Couch v. United States*, the issue was whether the taxpayer could assert her Fifth Amendment privilege against compulsory self-incrimination to squash the enforcement of a summons issued to her accountant demanding the delivery of her business and tax records she had turned over to him. The Commissioner’s reason for seeking the taxpayer’s records was to investigate her for potential criminal or civil tax fraud.

Simply stated, the Court held the taxpayer had no right to assert her Fifth Amendment privilege with respect to documents she owned that were not in her possession. In the majority’s view, the Fifth Amendment privilege belonged to the possessor of documents containing potentially self-incriminating information. In this case, that information was in the possession of her accountant who was not the subject of the Commissioner’s investigation.

In addition to the Court’s ultimate holding, there were a number of other significant points discussed in the majority opinion. For one, the majority discounted any expectation of privacy by the taxpayer because the information contained in the records provided to the accountant was potentially subject to mandatory disclosure in the income tax returns he was hired to prepare. Moreover, if the return the accountant prepared was found to be false, he would be compelled to disclose the information he relied on in his own defense. Thus, under these circumstances, there could be no expectation of privacy “in the very situation where obligations of disclosure

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369. *Id.* at 327. In *Powell*, there was no constitutional challenge to the Service’s summons of the corporate taxpayer’s books and records. Although not discussed in the case, a likely reason is the Fifth Amendment privilege against compulsory self-incrimination does not apply to corporations. *See United States v. White*, 322 U.S. 694, 698-701 (1944); First Nat’l Bank v. Bellotti, 435 U.S. 765, 778 (1978).


371. *Id.* at 329. In holding that an owner not in possession of her own documents was not entitled to assert her Fifth Amendment privilege, the Court distinguished its decision in *Boyd v. United States*, 116 U.S. 616 (1886). In that case, the production order was sent to the owner of the documents who was also in possession of them. *Couch*, 409 U.S. at 330 (citing *Boyd*, 116 U.S. at 630).

372. *Id.* at 329. Since the Court determined the taxpayer did not have a Fifth Amendment privilege to prevent the accountant’s delivery of her documents to the Service, it did not specifically address which of her documents she could have withheld from delivery if they had been in her possession. The documents in the possession of the accountant included bank statements, payroll records, and reports of sales and expenditures. *Id.* at 323-24.
exist and under a system largely dependent upon honest self-reporting even to survive.”

Another significant point was the distinction made by the majority opinion between a transfer of the possession of taxpayer's records to her accountant rather than to her own employees. By transferring her records out of her possession to an independent party who maintained possession of those records for many years, she relinquished her right to assert a Fifth Amendment privilege to prevent their delivery to the Commissioner.

In arguably Douglas's most passionately worded pro-taxpayer dissenting opinion, Douglas vehemently disagreed with the majority's contention that the taxpayer's transfer of possession of her documents to her accountant had nullified her privilege against self-incrimination to prevent their delivery to the Commissioner. In doing so, Douglas admonished the majority for missing the way the Fourth and Fifth Amendments worked in lockstep to protect an individual’s privilege against compulsory self-incrimination. Douglas's quotation of the following excerpt from the Boyd case succinctly reflected his position: “[We have been unable] to perceive that the seizure of a man's private books and papers to be used in evidence against him is substantially different from compelling him to be a witness against himself. We think it is within the clear intent and meaning of those terms.”

In addition, Douglas objected to the majority's assertion that by turning over her documents to the accountant, she had also relinquished any expectation of confidentiality and privacy. In taking the opposite position, Douglas noted that as the taxpayer's return preparer, the accountant had a fiduciary duty not to use the records provided to him for any other purpose. Thus, with that limitation of use, Douglas contended the taxpayer had a valid expectation the documents would remain confidential and private.

Finally, Douglas noted the chilling effect the majority's decision would have on the recording of thoughts by individuals who did not want to risk an invasion of privacy. Douglas was concerned that

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373. Id. at 335.
374. Id. at 334-36.
375. Id. at 338 (Douglas, J., dissenting). To this point, in the first paragraph of his dissent, Douglas lamented, “The decision today sanctions yet another tool of the ever-widening governmental invasion and oversight of our private lives.” Couch, 409 U.S. at 338.
376. Id. at 338-39.
377. Id. at 340, n. 2 (quoting Boyd, 116 U.S. 616, 633 (1886)).
378. Id. at 340.
cautious individuals would refrain from recording their thoughts or sharing their private documentation with anyone, even for a relatively short period of time, for fear of potential seizure by the Government.\textsuperscript{379} Also, a taxpayer required to file a tax return would face the daunting choice of hiring a competent accountant at the risk of potential disclosure of her personal documents or self-preparing a tax return she might not be competent to prepare.\textsuperscript{380} In other words, with these two examples of potentially stifled self-protective behavior, Douglas accused the majority opinion of punishing individuals by depriving them of their privilege against self-incrimination should the transfer of private documents to third parties be necessary. Taking the majority to task for encroaching upon a taxpayer’s constitutional privileges, Douglas was definitely looking out for the rights of the taxpayer against invasive IRS investigations.

C. Form Over Substance or Substance Over Form — One Pro-Commissioner Majority Opinion and One Pro-Taxpayer Dissenting Opinion

In the realm of tax law, the form and substance of a transaction are often at odds. The underlying question is whether a transaction structured in a tax favorable form should be respected when it lacked the substance of that form. During the Taxpayer Advocate Period, there were two significant cases in which Douglas wrote opinions regarding this issue. The comparative tones of Douglas’s majority opinion in \textit{Commissioner v. P.G. Lake, Inc.},\textsuperscript{381} and his dissenting opinion in \textit{Knetsch v. United States},\textsuperscript{382} were diametrically opposite in reflection of Douglas’s obvious bias to the party whose position he advocated in the respective opinions.

1. A Pro-Commissioner Majority Opinion.

Douglas’s majority opinion in favor of the Commissioner in \textit{P.G. Lake} was an anomaly in the Taxpayer Advocate Period. In that case, the taxpayer, a corporation located in Texas, assigned an oil payment right to its president in satisfaction of a debt it owed to him.\textsuperscript{383} The taxpayer treated the transaction as a sale of an interest in land (i.e., a capital asset), in exchange for the cancellation of in-

\textsuperscript{379} Id. at 341-42.
\textsuperscript{380} Id. at 342.
\textsuperscript{383} P.G. Lake. 356 U.S. at 262.
debtedness. Accordingly, the taxpayer reported the resulting profit as long-term capital gain. In support of its reporting position, the taxpayer relied on *Tennant v. Dunn*, a Texas Supreme Court holding that payments issuing out of oil and gas leases were interests in land and the legal equivalent of real estate. Conversely, the Commissioner maintained that regardless of its state law label as an interest in land, the oil payment right was in substance an assignment of future income so that the gain generated to pay off the taxpayer’s debt was taxable as ordinary income.

In his majority opinion, Douglas agreed with Commissioner and held that the substance of oil property interest as the right to future income was determinative of its taxability as ordinary income. Without any analysis of the Texas Supreme Court case, and dismissing the significance of pre-1946 administrative pronouncements by the Commissioner treating oil payment rights as capital assets, Douglas based his decision on the historically narrow construction the Court had implemented in evaluating whether transactions purported to be the conversion of capital investments were worthy of capital gain treatment.

Elevating substance over form, Douglas characterized his decision as follows: “These arrangements seem to us transparent devices. Their forms do not control. Their essence is determined not by subtleties of draftsmanship but by their total effect.”

2. A Pro-Taxpayer Dissenting Opinion.

Decided only two-and-a-half-years after *P.G. Lake*, Douglas’s elevation of form over substance in his dissenting opinion in *Knetsch* was the extreme opposite of his pro-Commissioner majority opinion in the former case. In *Knetsch*, on December 11, 1953, a sixty-year-old taxpayer purchased ten single premium thirty-year maturity deferred annuity savings bonds in the aggregate amount of $4,004,000 bearing interest at the rate of 2½% compounding annually.

In payment for the bonds, the taxpayer tendered $4,000 in cash plus nonrecourse notes of $4,000,000 secured by the bonds.

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384. Id.
386. Id. at 57.
388. See id. at 265, n. 5.
389. Id. at 265.
390. Id. at 266-67 (citations omitted).
bearing interest at the rate of $3\frac{1}{2}\%$ per annum to the insurance company.\textsuperscript{392}

According to the annuity contract, the taxpayer was required to pay each year's interest on the notes in advance. So, on the same day as the purchase, the taxpayer paid the first year's interest of $140,000.\textsuperscript{393} The contract also allowed the taxpayer to immediately borrow the excess of the cash and loan value of the annuity bonds over the outstanding indebtedness as determined at the end of the contract year. The Table of Cash and Loan Values of the bonds determined as of December 11, 1954, (the end of the first contract year) was $4,100,000. Five days after the purchase, the taxpayer borrowed $99,000 of the $100,000 spread between the cash and loan value and his outstanding indebtedness. The interest rate on this borrowing was $3\frac{1}{2}\%$ per annum, or $3,465, also payable in advance. So, in the first year, the taxpayer paid the aggregate amount of $143,465 in interest and received $99,000 in borrowed funds from the insurance company.\textsuperscript{394}

Similarly, in the beginning of the second year, the taxpayer prepaid the interest of $143,465 on the then outstanding loan balance of $4,099,000. As of December 11, 1955, the cash and loan value of the bonds was $4,204,000. Thus, the difference between the cash and loan value of the bonds and the outstanding balance of his loan was $105,000, of which he borrowed $104,000. As in the prior year, the taxpayer prepaid the interest on the new borrowing of $3,640. So in the second year, the taxpayer paid out the aggregate amount of $147,105 in interest and received $104,000 in borrowed funds from the insurance company.\textsuperscript{395}

For tax years 1953 and 1954, the Commissioner disallowed the taxpayer interest deductions of $143,465 and $147,105 respectively, because he did not view the "loan" between the taxpayer and the insurance company as being a valid indebtedness.\textsuperscript{396} In holding against the taxpayer, the trial judge in the lower court agreed with the Commissioner and concluded no indebtedness was created and; thus, "(n)o [sic] economic gain could be achieved from the purchase of these bonds without regard to the tax consequences."\textsuperscript{397}

\textsuperscript{392} Id. at 362-63.
\textsuperscript{393} Id. at 363.
\textsuperscript{394} Id.
\textsuperscript{395} Id.
\textsuperscript{396} Id. at 362.
\textsuperscript{397} Knetsch, 364 U.S. at 365 (quoting the trial court's findings of fact).
On appeal, in determining the validity of indebtedness, the Court considered the economic realities of the arrangement. Over the two years of the loan, the taxpayer had received the aggregate amount of $203,000 in borrowed funds as compared to paying $294,570 in interest. The Court questioned the essence of the economic benefit the taxpayer had actually received for the net out-of-pocket difference of $91,570.\textsuperscript{398} Although upon the maturity of the annuity at age 90, the taxpayer would have received monthly annuity payments of over $90,000 or substantial insurance benefits had he died prior to the maturity. Based on his borrowing patterns, however, he would have received only $43 per month upon maturity.\textsuperscript{399} Thus, the only real economic benefit the taxpayer received from the transaction was a reduction of tax in the aggregate amount of over $233,000 for tax years 1954 and 1955.\textsuperscript{400}

Thus, similar to Douglas's majority opinion in \textit{P. G. Lake}, in the instant case, the Court elevated substance over form and denied the taxpayer's interest deductions. Conversely, despite acknowledging the lack of any economic substance in the transaction apart from the substantial income tax deduction, Douglas's dissenting opinion in \textit{Knetsch} sided with the taxpayer.\textsuperscript{401} Incomprehensibly, Douglas asserted that "as long as the transaction itself is not hocus-pocus, the interest charges incident to completing it would seem to be deductible . . . ."\textsuperscript{402} Moreover, contrary to his majority opinion in \textit{P. G. Lake}, in which Douglas gave no credence to the characterization of an oil payment right as an interest in property under Texas law, in the instant case, Douglas recognized the validity of the interest payments based on the authority of the insurance company to operate, issue the annuity bonds, and make those loans under Texas law.\textsuperscript{403}

In an obvious spin for the benefit of all taxpayers, the main impetus for Douglas's opinion was his concern that denying interest deductions based upon a negative return on an investment would establish a dangerous precedent in other common situations. As an example, Douglas noted that many taxpayers routinely borrow funds to purchase securities at interest rates that far exceed the rate of return of the underlying securities. On this point, Douglas

\textsuperscript{398} Id.
\textsuperscript{399} Id. at 364-65.
\textsuperscript{400} Id. at 366.
\textsuperscript{401} Id. at 370 (Douglas, J., dissenting).
\textsuperscript{402} Id.
\textsuperscript{403} \textit{Knetsch}, 364 U.S. at 370.
stated: “To disallow the ‘interest’ deduction because the annuity de-
vice was devoid of commercial substance is to draw a line which will
affect a host of situations not now before us and which, with all
dereference, I do not think we can maintain when other cases reach
here.” In any event, Douglas’s spin of the obvious sham interest
transaction was more indicative of his pro-taxpayer stance he
demonstrated throughout the Taxpayer Advocate Period.

D. Douglas’s Dissenting Opinions in Three Vocabulary Cases

Towards the end of Douglas’s tenure on the Court, Douglas
wrote three dissenting opinions in three landmark “vocabulary” cases involving important tax issues. Each opinion was decidedly
Pro-Taxpayer.


Taxpayers engage in transactions that have federal income and
estate tax significance. In many instances, the tax consequences
turn on either the status of or change in a taxpayer’s property rights
as established pursuant to applicable state law. In Commissioner
v. Estate of Bosch, the issue was whether for federal estate tax
purposes, a federal court could substitute its own determination of a
taxpayer’s property rights under state law when a state court (other
than the highest court of the state) had already made a
determination.

Estate of Bosch involved an appeal of two cases from the Sec-
ond Circuit with very different results. In the first case, the issue
was whether the Commissioner was bound by a decision of the Su-
preme Court of New York holding that a wife’s previously executed
release of a general power of appointment with respect to trust
corpus prior to her husband’s death was a nullity. Accepting the
determination of the state court in the affirmative with the conse-

404. Id. at 371.
405. Loosely defined, a “vocabulary” case is one that is immediately identifiable simply
by reference to its name. Although the author does not know the origin of the term, the first
time the author heard it was when Professor Steven J. Willis, who teaches at the University of
Florida Levin College of Law, used it in reference to Crane v. Commissioner, 331 U.S. 1
(1947).
406. As an example, whether a taxpayer with legal title to property must personally rec-
ognize the gain triggered by its sale or exchange depends on whether she is holding it in trust
for another.
408. Comm’r v. Estate of Bosch, 363 F.2d 1009 (2d Cir. 1966). The Supreme Court re-
ferred to this case as “No. 673.” Estate of Bosch, 387 U.S. at 457.
quence of the wife holding a general power of appointment at the
time of her husband's death, the Tax Court held the trust corpus
qualified for the marital deduction for purposes of federal estate
tax. On appeal, the Second Circuit affirmed the Tax Court
decision.

In sharp contrast, in the second case, a Connecticut probate
court had determined that a certain provision in a decedent's will
did not negate the application of the state's proration statute.
Although in considering the federal estate tax consequences of the
decision, the district court agreed with the finding of the state pro-
bate court, it held that the "decrees of the Connecticut Probate Court . . . under no circumstances can be construed as binding and
conclusive upon a federal court in construing and applying the fed-
eral revenue laws." On appeal, the Second Circuit agreed with
the district court that the judgment of the state probate court was
not binding on a federal court and ultimately reversed its decision
on the merits of the case.

Simply stated, in holding federal courts were not bound by
lower state court determinations, the Court laid down a judicially
created doctrine providing wide discretion for federal courts to re-
view state court decisions. To this effect the Court stated, "If there
be no decision by [a state court of last resort] then federal authori-
ties must apply what they find to be the state law after giving
'proper regard' to relevant rulings of other courts of the State." Thus, for purposes of resolving a federal tax issue, a federal court
could essentially overrule a lower state court determination of a
taxpayer's property rights.

In his dissenting opinion, Douglas adamantly objected to what
he viewed as an unwarranted exercise of jurisdiction by federal
courts on matters of state law better resolved by competent lower
state courts. Beyond the arrogance of a federal court second-

410. Id. at 459.
411. Id.
412. Second Nat'l Bank of New Haven v. United States, 351 F.2d 489 (2d Cir. 1965). The
Supreme Court referred to this case as "No. 240." Estate of Bosch, 387 U.S. at 457.
413. Estate of Bosch, 367 U.S. at 459-61.
414. Id. at 461 (citing Second Nat'l Bank of New Haven v. United States, 222 F. Supp.
446, 457 (D. Conn. 1963)).
415. Id.
416. Id. at 466. The Court reversed and remanded No. 673 for further proceedings not
inconsistent with its opinion and affirmed No. 240.
417. Id. at 465.
418. See id. at 469 (Douglas, J., dissenting).
guessing a finding of a state court, Douglas noted the anomaly of taxing the taxpayer or her estate for property rights not recognized by state law. In making this point, Douglas used the example of a state court determination that a decedent did not own a certain property at her death. Based on that determination, the executor did not include the property on the decedent’s federal estate tax return. Subsequently, the Commissioner challenged the non-inclusion of the property and ultimately re-litigated the state court determination in a federal court. If the Commissioner were to prevail, the property would then be subject to federal estate tax. The federal court’s determination, however, would have no legal effect on the ownership of the property as established by the state court. So, the decedent’s estate would be compelled to pay estate tax on property that the decedent did not own and would not pass to her heirs. Thus, Douglas’s sensitivity to state law determinations of property rights was indicative of respect to state tribunals and fairness to taxpayer’s who relied on those determinations.

2. United States v. Davis.

In United States v. Davis, from the tone of Douglas’s short dissenting opinion, it was clear he believed the taxpayer had fallen into a form over substance tax trap sanctioned by the Court. In that case, the taxpayer, his wife, and his children collectively owned 100% of the common stock of a closely held corporation. In order to qualify for a corporate loan, the taxpayer purchased 1,000 shares of non-voting preferred stock for the total amount of $25,000 to increase the corporation’s working capital. As previously planned, after satisfying the loan, the corporation redeemed the taxpayer’s stock for $25,000. Treating the redemption as a sale of the preferred stock under I.R.C. § 302(a), the taxpayer reported no gain since the amount realized ($25,000) was equal to his cost basis ($25,000). The Commissioner disagreed and treated the redemption as an ordinary income dividend pursuant to §§ 301 and 316.

419. Estate of Bosch, 387 U.S. at 470-71.
421. Id. at 302 (stating that the taxpayer, his wife, and two children each owned 250 of the 1,000 outstanding shares of common stock).
422. Id. at 303.
423. Id.
424. Id. at 303-05; see also I.R.C. § 1001(a) (2006) (stating the gain computation formula with regard to the sale or exchange of property).
because in his view the transaction was essentially equivalent to a dividend.\textsuperscript{425}

As was relevant to the instant case, the tax treatment of the redemption as a sale or a dividend turned on whether the transaction met any of the tests set forth in § 302(b).\textsuperscript{426} Sections 302(b)(2) and (b)(3) provided safe harbor tests for sale treatment based upon a significant reduction in a shareholder's ownership and voting interests pursuant to a statutory formula or in the complete termination of a shareholder's entire interest in the corporation, respectively. Neither of those safe harbors would have applied in this case, however, because none of the taxpayer's voting stock was redeemed by the corporation.

The other way to qualify a redemption as a sale was to meet the rather amorphous requirement of "not essentially equivalent to a dividend" under § 302(b)(1). Beyond those words, the statute provided no indication as to its meaning. In determining whether the taxpayer met the § 302(b)(1) requirement, the Commissioner advocated the application of the "strict net effect" test.\textsuperscript{427} Pursuant to this test, the redeeming distribution was treated as a dividend if after the distribution, the taxpayer was in the same relative stock ownership and voting position as he would have been had a conventional dividend been declared.\textsuperscript{428} In addition to the stock actually owned by the redeeming shareholder, pursuant to § 318(a) via § 302(c), a shareholder was deemed to constructively own the stock owned by certain family members including a spouse or children. Thus, because the taxpayer was deemed to own 100\% of the corporate stock before and after the redemption,\textsuperscript{429} the net effect of the redeeming distribution was a pro rata dividend distribution with no change in shareholder relationships.\textsuperscript{430}

In lieu of the strict net effect test, the Sixth Circuit preferred the "flexible net effect" test employed by the district court.\textsuperscript{431} Pursuant to the flexible net effect test, a valid business purpose for the re-

\textsuperscript{425} Id. at 303.
\textsuperscript{426} Davis, 397 U.S. at 304.
\textsuperscript{427} See Davis v. United States., 408 F.2d.1139, 1142 (6th Cir. 1969) (discussing the decision appealed by the Government from the Sixth Circuit to the Court in which the former court discussed the strict net effect test).
\textsuperscript{428} Id. at 1142-43.
\textsuperscript{429} The taxpayer actually owned 250 shares of common stock and constructively owned the 250 shares of common stock held by his wife and the 250 shares of common stock owned by each of his children. Thus, through actual and constructive ownership, the taxpayer owned 100\% of the common stock of the corporation. See I.R.C. § 318(a)(1)(A)(i)-(ii).
\textsuperscript{430} Davis, 408 F.2d at 1143.
\textsuperscript{431} Id. (discussing Davis v. United States, 274 F. Supp. 466 (M.D. Tenn. 1967).
Redemption with no tax avoidance motives would nullify the conclusiveness of the strict net effect test so as to establish the redemption was not essentially equivalent to a dividend.\textsuperscript{432} Accordingly, the Sixth Circuit accepted the validity of the taxpayer’s business purpose and affirmed the District Court’s decision that the taxpayer’s redemption of the 1,000 shares of preferred stock was to be treated as a sale.\textsuperscript{433}

On appeal to the Supreme Court, based upon an analysis of relevant legislative history,\textsuperscript{434} Justice Marshall’s majority opinion essentially rejected the flexible net effect test applied by the Sixth Circuit.\textsuperscript{435} Section 302(b)(1) was the successor of § 201(g) of the Revenue Act of 1926,\textsuperscript{436} which provided a redemption of stock was to be treated as a dividend “at such time and in such manner as to [be] . . . essentially equivalent to the distribution of a taxable dividend . . . .”\textsuperscript{437} Over the years that followed the statute’s enactment, some courts determined dividend treatment based upon whether the redemption was part of a tax avoidance scheme and other courts simply applied the “strict net effect” test. Thus, if not part of a tax avoidance scheme, the former courts treated a redemption that did not otherwise meet the strict net effect test as a sale.\textsuperscript{438} Yet, despite the inconsistency of the case law, Marshall believed that in enacting § 302(b)(1), Congress intended it to be applied without regard to a valid business purpose or the lack of a tax avoidance motive.\textsuperscript{439} So, without specifically referring to the strict net effect test, Marshall adopted a Judicial Interpretation of § 302(b)(1) that read the test into its application. On this point, Marshall stated as follows:

\begin{itemize}
  \item \textsuperscript{432} See id. at 1143.
  \item \textsuperscript{433} Id. at 1144.
  \item \textsuperscript{434} Davis, 397 US. at 310-11.
  \item \textsuperscript{435} In addition to relying on the flexible net effect test, the taxpayer argued that the attribution rules should not be applied in considering whether a redemption was essentially equivalent to a dividend because § 302(b)(1) made no explicit reference to stock ownership. Assuming those rules did not apply, as a 25% owner of the common stock, the redemption would not be essentially equivalent to a dividend because it would not have been pro rata or proportionate to his stock ownership interest. Marshall rejected that argument because § 302(c) specifically made the attribution rules applicable to the determination of stock ownership under § 302 so as to include § 302(b)(1). Moreover, in his view, the legislative history of § 302(b)(1) gave no indication of a congressional intent not to apply the attribution rules to that section. Id. at 305-07.
  \item \textsuperscript{436} Id. at 308-09. Actually, § 115(g)(1) of the Internal Revenue Code of 1939 succeeded § 201(g) followed by § 302(b)(1) of the Internal Revenue Code of 1954.
  \item \textsuperscript{437} Davis. 397 U.S. at 308 (citations omitted).
  \item \textsuperscript{438} See id. at 309.
  \item \textsuperscript{439} Id. at 311-12.
\end{itemize}
We conclude that that is what Congress did when enacting § 302(b)(1). If a corporation distributes property as a simple dividend, the effect is to transfer the property from the company to its shareholders without a change in the relative economic interests or rights of the stockholders. Where a redemption has that same effect, it cannot be said to have satisfied the “not essentially equivalent to a dividend” requirement of § 302(b)(1).\footnote{Davis, 397 U.S. at 313. Earlier in his opinion, Marshall acknowledged that the Court’s holding meant that a stock redemption of a sole shareholder would always be treated as a dividend. \textit{Id.} at 307 n. 8.}

In a short three paragraph dissent, Douglas expressed his own pragmatic pro-taxpayer Judicial Interpretation of the § 302(b)(1). Embracing the factual findings and rationale of the district court and the Third Circuit, Douglas viewed the transaction in its entirety as having a bona fide business purpose.\footnote{See \textit{id.} at 314 (Douglas, J., dissenting).} First, the taxpayer’s purchase of 1,000 shares of preferred stock was a temporary infusion of capital for the sole purpose of satisfying a condition of the lender to secure a corporate loan. Subsequently, once the loan was repaid and the temporary infusion of capital was no longer necessary, the corporation redeemed the taxpayer’s preferred stock. In that context, Douglas agreed with the two lower courts that the redemption did not have the characteristics of a dividend; thus, it should have passed the “not essentially equivalent to a dividend” test.\footnote{\textit{Id.}} In a final criticism of the majority’s myopic view, Douglas admonished the Court for a Judicial Interpretation of § 302(b)(1) by which a redemption of the stock of a sole shareholder would always be considered a dividend as effectively writing that section out of the Code. Characteristic of many of his Taxpayer Advocate Period opinions, Douglas believed such a Pro-Commissioner interpretation should be made by Congress rather than the Court.\footnote{\textit{Id.}}

3. \textit{Commissioner v. Idaho Power Co.}

In \textit{Commissioner v. Idaho Power Co.},\footnote{Comm’r v. Idaho Power Co., 418 U.S. 1 (1974).} the Court implemented a Judicial Interpretation regarding the interplay of §§ 167(a)(1) and 263(a)(1). In that case, the taxpayer, a public utility corporation, used its own equipment in the construction of its own improvements and additions (Capital Improvements).\footnote{\textit{Id.} at 4.} Taking the position that the equipment was used in its trade or business, the
taxpayer claimed depreciation deductions under § 167(a)(1) over its relatively short recovery period. Conversely, on the authority of § 263(a)(1), the Commissioner disallowed the depreciation deduction because that section barred a deduction for “[a]ny amount paid out for new buildings or for permanent improvements . . . .” Thus, the Commissioner considered the cost of the equipment to be an amount paid out for the Capital Improvements and added it to its adjusted basis to be depreciated over its longer recovery period. Simply stated, the issue was not whether the taxpayer was allowed to take the depreciation deductions on the equipment, but whether its cost had to be capitalized and depreciated over the recovery period of the Capital Improvements.

The Tax Court’s decision in favor of the Commissioner was reversed by the Ninth Circuit. Prior to the case reaching the Supreme Court, the case law had been split on whether the capitalization requirement of § 263(a) trumped the depreciation deduction for construction-related equipment under § 167(a)(1). For example, the Eighth Circuit held that the depreciation of a train used to transport workers and equipment to a construction site was not currently deductible, but had to be capitalized. Subsequently, on virtually identical facts, the Board of Tax Appeals reached the opposite conclusion and allowed the depreciation deduction on the equipment used in construction of branch lines of the railroad because it deemed it to be used in the taxpayer’s trade or business. Finally, in a case analogous to Idaho Power Co., the Court of Claims reached the same conclusion as the Eighth Circuit.

In the lower court Idaho Power Co. decisions, however, the Tax Court and the Ninth Circuit considered a Literal Interpretation of I.R.C. § 263(a)(1) never before advanced in any prior construction related depreciation case. In the Tax Court decision, the taxpayer argued the capitalization requirement of § 263(a)(1) only applied to amounts paid out for new buildings or for permanent improve-

446. Id. at 5. Section 167(a)(1) “allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear . . . of property used in a trade or business . . . .” Id. at 3 n.1.
447. Id. at 3 n.2 (emphasis added).
448. Id. at 4, 6.
450. Great N. Ry. Co. v. Comm’r, 40 F.2d 372 (8th Cir. 1930).
Consequently, the taxpayer reasoned that depreciation was not an amount paid; thus, the cost of the equipment should not be added to the basis of the Capital Improvements.\(^\text{454}\)

In taking this position, the taxpayer relied on *Gordon v. Commissioner*, a Tax Court case in which the taxpayer claimed a depreciation deduction on an automobile used to take his dependent son to the doctor as a "medical expense."\(^\text{455}\) Section 213(a) allowed a deduction for "expenses paid during the taxable year . . . for medical care of the taxpayer . . . or dependent . . ." The predecessor of § 213(d)(1)(B) further provided a deduction for "transportation primarily for and essential to medical care." Based upon the payment requirement of § 213(a), however, the Tax Court disallowed the taxpayer's depreciation deduction on the automobile because "[a]ny allowance for depreciation was not an 'expense paid' or 'amount paid.'"\(^\text{456}\)

In *Idaho Power Co.*, however, the Tax Court refused to extend its rationale in *Gordon* to construction related depreciation of equipment.\(^\text{457}\) For purposes of § 263(a), the Tax Court equated the cost of tools with a useful life of less than a year and labor used in the construction of Capital Improvements (clearly capitalized expenditures) with the cost of equipment used for the same purpose as a capital expenditure.\(^\text{458}\) Consistent with the Court of Claim's holding on the issue,\(^\text{459}\) the Tax Court required the capitalization of the cost of the equipment to the depreciable basis of the Capital Improvements.\(^\text{460}\)

On appeal, in an analytical opinion, the Ninth Circuit reversed the Tax Court.\(^\text{461}\) First, the Ninth Circuit explained the function of the depreciation deduction as a means for the taxpayer to recover the cost of an asset over its useful life.\(^\text{462}\) Second, based upon a review of the legislative history of the depreciation deduction, the court concluded that Congress intended a liberal and expansive means of depreciation deduction cost recovery.\(^\text{463}\) Third, the Ninth

\(^{453}\) \(\text{Idaho Power Co. v. Comm'r, 29 T.C.M. (CCH) 383 (1970).}\)

\(^{454}\) \(\text{Id.}\)

\(^{455}\) \(\text{Gordon v. Comm'r, 37 T.C. 986 (1962).}\)

\(^{456}\) \(\text{Id. at 987.}\)

\(^{457}\) \(\text{Idaho Power Co., 29 T.C.M. (CCH) 383 (1970).}\)

\(^{458}\) \(\text{Id.}\)

\(^{459}\) \(\text{S. Natural Gas Co. v. United States, 412 F.2d 1222 (Ct. Cl. 1969).}\)

\(^{460}\) \(\text{Idaho Power Co., 29 T.C.M. (CCH) 383 (1970).}\)

\(^{461}\) \(\text{Id.}\) at 690-92.

\(^{462}\) \(\text{Id.}\) at 692-93.
Circuit recognized the distinction between the general § 162 deduction for ordinary and necessary business expenses and the § 167 depreciation deduction. The former deduction specifically required the capitalization of otherwise deductible business expenditures with a useful life of more than one year. Conversely, the § 167 depreciation deduction had no such requirement. Fourth, in disagreeing with the Tax Court, the Ninth Circuit determined the allowance for depreciation was not an amount paid out within the meaning of § 263(a). Finally, the Ninth Circuit found the taxpayer's use of its equipment with continuity and regularity in its construction activities was in furtherance of the taxpayer's principal trade or business in the selling and production of electrical energy; thus, the taxpayer was entitled to claim depreciation deductions on the equipment over its own recovery period.

Thus, the Ninth Circuit implemented a Literal Interpretation of §§ 167(a)(1) and 263(a) that was consistent with legislative history, analogous case law, and the statutory distinction between the deductibility of general business expenses under § 162(a) and the deductibility of depreciation under § 167(a). Notwithstanding the merit of the Ninth Circuit's decision, however, the Supreme Court rejected its rationale and reversed its decision. In lieu of the Ninth Circuit's Literal Interpretation, the Court interjected its own Judicial Interpretation of the two sections.

In doing so, the majority opinion stressed the need for consistency of tax law and accepted accounting practice. To achieve this result, the capitalization of equipment used in construction into the cost of the Capital Improvements was essential. Similar to the Tax Court, the Court believed that the cost of equipment used in construction should be treated in the same way as labor, tool, and material costs. In addition, the Court adopted the Tax Court's

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464. Id. at 693.
465. Id. (citing §§ 163 (interest) and 164 (taxes) as other examples of deductions that did not require capitalization).
466. Id. at 694. In addition to relying on Gordon v. Comm'r, 37 T.C. 986 (1962), which explained that an allowance for depreciation not an amount paid for purposes of the medical expense deduction, the court cited Orr v. United States, 343 F.2d 553 (5th Cir. 1965) in which the Fifth Circuit denied the taxpayer a depreciation deduction on an automobile and airplane the taxpayer used in connection with his charitable work. Similar to §§ 213(a) and 263(a), § 170(a)(1) allowed a charitable deduction for “any charitable contribution . . . payment of which is made within the taxable year.” I.R.C. § 170(a)(1) (1970) (emphasis added).
467. Idaho Power Co., 477 F.2d at 696.
469. See id. at 10.
470. Id. at 13. The Court also noted the unfairness a decision to allow the taxpayer to depreciate the cost of the equipment over its useful life would be to taxpayers who hire an
characterization of the depreciation allowance as an amount paid for purposes of § 263(a).\textsuperscript{471}

Finally, in an attempt to provide literal support for Judicial Interpretation, the Court cited the priority-ordering directive of § 161.\textsuperscript{472} According to § 161, “there shall be allowed as deductions the items specified in this part [including § 167(a)], subject to the exceptions provided in part IX [including § 263(a)].” From that statutory language, the Court concluded that the § 167(a)(1) allowance for depreciation deductions was trumped by the § 263(a) requirement for capitalization.\textsuperscript{473}

In Douglas’s dissenting opinion, as in many of his pro-taxpayer opinions, Douglas again expressed disdain of Judicial Interpretations of tax statutes stating as follows: “This Court has, to many, seemed particularly ill-equipped to resolve income tax disputes between the Commissioner and the taxpayers. . . . Indeed, we are called upon mostly to resolve conflicts between the circuits which more providently should go to the standing committee of Congress for resolution.”\textsuperscript{474}

With an obvious bias in the taxpayer’s favor, Douglas advocated the Literal Interpretation of the underlying statutes advanced in the Ninth Circuit opinion. Specifically, Douglas agreed with the Ninth Circuit’s determination that the allowance for depreciation was not an amount paid out within the meaning of § 263(a).\textsuperscript{475} To that point, Douglas implied that the majority’s Judicial Interpretation of amount paid as including the cost of construction related equipment crossed the line into judicial legislation.\textsuperscript{476}

As further support for his pro-taxpayer position, Douglas cited relevant legislative history in which Congress had adopted taxpayer favorable estimates of useful life of depreciable property as well as generous deductions of its cost over its useful life.\textsuperscript{477} For those additional reasons, Douglas disagreed with the majority’s decision to independent contractor to do their construction work. In the latter case, the cost of the job would include the depreciation expense of the equipment used by the independent contractor. Yet, those taxpayers would be required to capitalize that cost over the useful life of the Capital Improvement.

\textsuperscript{471.} Id. at 16-17.
\textsuperscript{472.} Id. at 17.
\textsuperscript{473.} Id.
\textsuperscript{474.} Idaho Power Co., 418 U.S. at 19 (Douglas, J., dissenting).
\textsuperscript{475.} Id. at 21.
\textsuperscript{476.} See id.
\textsuperscript{477.} Id. at 20.
require the taxpayer to capitalize the cost of equipment otherwise depreciable over a relatively short recovery period. 478

Finally, perhaps as an exclamation mark of his pro-taxpayer bias, Douglas expressed his cynicism of the Commissioner's litigation position. In doing so, Douglas speculated that the Commissioner would have likely advocated a Literal Interpretation of the words amount paid out if the useful life of the equipment had been forty years and the useful life of the Capital Improvements had been only ten years. 479 So in addition to spinning his analysis of relevant tax law in favor of the taxpayer, Douglas spun the Commissioner's motives in challenging taxpayer positions as being self-serving.

V. CONCLUSION

Although much better known for his opinions regarding constitutional law and individual rights, Justice William O. Douglas also left an indelible mark in tax law. Throughout his thirty-six year tenure on the Court, Douglas wrote a significant number of majority and dissenting opinions that were full of spin slanted to the party he favored. In addition to their obvious bias, Douglas's opinions often lacked well-reasoned analysis, ignored compelling counter-arguments to his position made by his brethren in dissenting or majority opinions, misconstrued, minimalized, or completely ignored contrary judicial and legislative authority. In addition to Douglas's dubious legacy as a "spin" Justice in tax controversies, Douglas also wrote poorly reasoned majority opinions that were difficult to comprehend and provided little guidance for the taxpayer and the Commissioner.

During the Pro-Commissioner Period, Douglas's Judicial Interpretations of tax statutes often crossed the line into judicial legislation, leading to absurd outcomes with punitive consequences to the taxpayer. Then, approximately one-year after delivering one of his harshest pro-Commissioner majority opinions, Douglas's allegiance inexplicably shifted to the taxpayer. Throughout the approximately fourteen-year Pro-Taxpayer Period that would follow, the tone of Douglas's opinions moderated. Although favoring the taxpayer, his opinions were less extreme and more reasoned as he sought the consistent application of judicially created doctrines that were fairly applied to the taxpayer. Finally, during the Taxpayer Advocate Pe-

478. Id. at 20-21.
479. Id. at 21.
period spanning over his last years on the bench, Douglas's zealous advocacy of the taxpayer's position intensified. Throughout this period, mostly in the role of a dissenter, Douglas championed the taxpayer's cause in significant areas of tax law including the deductibility of traveling expenses and privacy rights against intrusive IRS investigations. Also of note were his scathing pro-taxpayer dissenting opinions in three of the most famous vocabulary tax cases ever decided by the Court.

So in answering the question raised by the title of this article, the spin stopped for the party Douglas favored who he was definitely looking out for. Although in the beginning of his tenure on the Court, the spin was definitely in favor of the Commissioner, by the end of his career, Douglas had become an unashamed zealous taxpayer advocate.
ABSTRACT
THE WILLIAM O. DOUGLAS TAX FACTOR:
WHERE DID THE SPIN STOP AND WHO
WAS HE LOOKING OUT FOR?

Although much better known for his opinions regarding constitutional law and individual rights, Justice William O. Douglas also left an indelible mark in tax law. Throughout his thirty-six year tenure on the Supreme Court, Douglas wrote a significant number of majority and dissenting opinions in some of the most famous tax law cases of his day. As the title of the article suggests, most of Douglas’s opinions were full of spin from the bias of the party he favored and read more like a brief than an objective Court opinion. In addition to their obvious spin, Douglas’s opinions often lacked well-reasoned analysis, ignored compelling counter-arguments made by his brethren in dissenting and majority opinions, misconstrued, minimalized, or completely ignored contrary judicial and legislative authority. In many instances, Douglas’s majority opinions frequently crossed the line of judicial interpretation into judicial legislation with absurd outcomes and punitive consequences to the taxpayer or the government. In addition to Douglas’s dubious legacy as a “spin” Justice in tax controversies, Douglas also wrote poorly reasoned majority opinions that were difficult to comprehend and provided little guidance to the taxpayer and the government.

The purpose of this Article is to critique the judicial evolution of Douglas as a “rogue” Justice in tax controversies through a comprehensive analysis of a cross section of Douglas’s prominent majority and dissenting opinions in the three distinct periods of his judicial tenure. Those periods were (1) the Pro-Commissioner Period (1939-1944) in which Douglas’s opinions were decidedly spun for the Commissioner regardless of the inequitable consequences to the taxpayer; (2) the Pro-Taxpayer Period (1944-1958) in which Douglas’s allegiance shifted from the Commissioner to the taxpayer as reflected in his opinions delivered throughout that period; and (3) the Taxpayer Advocate Period (1958-1975) in which Douglas’s Pro-Taxpayer opinions were as extremely slanted in favor of the taxpayer as they were in favor of the Commissioner during the Pro-Commissioner Period.