

# Taxable Income (Revised edition)(Book Review)

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"Public" as contrasted with "Private" Law would seem to indicate that the allocation is fortuitous rather than planned.

Too great a burden has been placed on some individuals. A notable example is Professor Laurence P. Simpson, who has been called upon for far too many articles, five in all, necessarily affecting the comprehensiveness of some of his surveys. This illustrates the necessity of a wider originating body of writers than is available in any single institution.

The volume abounds with typographical errors and omissions. Illustrations are the misprint of a date at page 18, where the United Nations charter is stated to have been ratified by the United States in 1944; an unintelligible sentence beginning at line 26 on page 169; the two incomplete sentences, already referred to, at page 154; a misprint at line 12 of note 1 on page 598; the use of the word "litigative" at page 624; an ungrammatical expression at line 20 on the same page; absence of reference to the state where a federal case arose, in the citation at page 697 of 149 F. (2d) 558; an error in the use of "or" for "on" at line 8 on page 978; a typographical error in "of" for "or" at line 24 on page 1146; "charge" for "charged" at line 17 on page 1188; and reference by one writer to the "U. N. O." (at p. 57) after the author of the preceding article had pointed out that the proper reference is "U. N." (p. 19).

Legal research has become much too cumbersome for adequate handling perhaps even by the law teacher, certainly by the practitioner. For this reason the idea of an annual survey of American law is a constructive step forward in legal education. The project is of sufficient importance to warrant the enlisting of the best effort of our best legal talent. The quest for assistance from broader fields should be, in view of the importance of the purpose, one of easy fulfillment.

The Survey is on the whole a striking achievement for a single law faculty. Its usefulness could be greatly increased by entrusting the function to an all-American team of experts.

RALPH A. NEWMAN.

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TAXABLE INCOME. (Revised edition.) By Roswell Magill. New York: Ronald Press Co., 1946. Pp. viii, 491, table of cases, index. \$6.

The Income Tax has now been an integrated part of the fiscal policy of our government for more than thirty-three years. The imposition of a tax on income from its very inception raised numerous fundamental questions on the nature of income. "What is income" was and still is a perplexing question. Is it what the economist means by income? Or the accountant who is so intimately concerned with financial statements and the income concept? What does the average man conceive as income?

When the first of the current series of income tax laws was passed in 1913, Congress probably had in mind the average man's concept of the term. To the extent that the legislators were familiar with the economist's concept they probably found it too broad, while the accountant's concept with which

they were undoubtedly even less familiar was too specialized. It would appear then that the problem confronting Congress was not what is income in any theoretic sense but rather what income, no matter what it might be conceived to be, should be subjected to a tax.

Congress therefore was seeking a pragmatic concept of taxable income. Even after thirty-three years it cannot be said that the issue has been settled with any finality, although much progress has been made. The economist and much more so the accountant have made important contributions to this fundamental problem, but in the last analysis the courts and the lawyers have evolved what is today recognized as a concept of taxable income.

In 1936 Professor Magill submitted a critical analysis of the concept of taxable income as it had been developed by the courts in the decided cases and by Congress in the various tax laws and tax regulations. The results of this scholarly analysis were made available to the tax fraternity in what was probably the most important contribution in the field of income taxation. After an interval of nine years, a revised edition of this noteworthy book has now been published. This edition brings down to date the further developments in the courts and in the legislature towards a concept of taxable income.

To this reviewer it was again an intellectual treat to read the illuminating comments of the author on the leading cases that had contributed to the development of the concept of taxable income. The first five chapters of the book deal with the principle that income must be realized to become taxable. It was this principle that was the basis of the courts decisions in the earlier reorganization cases, taxing distributions representing exchanges in connection with customary business reorganizations. Following these decisions, therefore, it was necessary to change the law in order to make such exchanges non-taxable. This section of the law is still one of the most technical provisions of the Internal Revenue Code. Since the principle of realization is so well illustrated by the reorganization cases, the author starts his discussion with the subject of corporate distributions.

In the first part of the book there is also a discussion of sales, exchanges and purchases as these affect taxable income. This subject necessarily includes a discussion of the capital gain and loss provisions of the law. It is difficult for the layman to accept the principle that one can realize taxable income upon mere purchase of property, since it would seem that no profit or loss can be determined until the property had been disposed of. And yet there are situations involving bargain purchases and options, for example, where the element of taxable income has been found both by the courts and Congress. In the case of *Commissioner v. Smith*,<sup>1</sup> the Supreme Court in 1945 held that an option to purchase stock at prices less than the value of the stock when the option was exercised, represented income in the nature of compensation to the extent that such value exceeded the option price. Unfortunately this decision was promulgated after the publication of the revised edition and the reader does not have the benefit of any comments the author might make on this decision. There is a reference in the book to the decision in the lower court which, it so happens, was reversed by the Supreme Court.

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<sup>1</sup> 324 U. S. 177.

In addition to the problem of what is taxable income there is the further basic problem of when is such income taxable. A rather complete chapter in the first division of the book is devoted to this important problem and the reader will find here a full discussion of the cash and accrual basis for reporting income. The realization of income to a cash basis taxpayer includes the cognate problem of the constructive receipt of income as well as the problem of the realization of income which, though not in the form of cash, is nevertheless deemed to be equivalent of cash. In recent years there have been two important developments in determining when realized income is to be taxed. One principle now known as the tax benefit rule, deals with a deduction as, for example, of a bad debt properly taken in one year and recovered in a later year. Ordinarily the recovery is considered taxable income, but under the tax benefit rule, such recovery is non-taxable income to the extent that there was no benefit to the taxpayer resulting from the deduction taken in the earlier year. The other development attempts to deal more equitably with a cash basis taxpayer who in one year receives income earned over a long period of time. Section 107 today provides a method for taxing such income as if it were spread over the period during which the income was earned. This prevents a distortion of income which necessarily must be taken on the basis of annual periods.

The second part of the book is devoted to the subject of characteristics of income, the most important of which is the element of control over property. This characteristic has been developed essentially by the courts and finds its application principally in the fields of the taxation of trusts, the family partnership and in cases concerned with assignments of income. It is a simple matter for a taxpayer to create a trust which under the Code may be a separate taxable entity, and through such an entity to avoid the payment of surtaxes at high rates by shifting income from himself to the created entity. To meet such an easy avoidance of tax, the courts were compelled to seek a principle of taxation that would not do serious violence to long established principles of property law. Hence we find courts ruling that control of property carries with it the burden of taxation or that benefits obtained through the discharge of family obligations make income apparently out of the reach of the taxpayer nevertheless taxable to him. And it has even been held that the procuring of a satisfaction may be characteristic of taxable income.

One of the most significant decisions in recent years is *Helvering v. Clifford*.<sup>2</sup> The court in this case used the broad language of Section 22(a), which defines income, to tax to the grantor the income of a short term irrevocable trust. Since this book was written before the Treasury issued T. D. 5488, the author does not, of course, discuss the attempt of the Treasury Department to give some definiteness to the Clifford doctrine. As a matter of fact, the Commissioner in this regulation extends the doctrine beyond the limitations set by the Supreme Court and it will be of interest to see how far the court will go along with the Commissioner when cases affected by the regulation reach the court for adjudication.

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<sup>2</sup> 309 U. S. 331 (1940).

Unfortunately also the *Tower*<sup>3</sup> and *Lusthaus*<sup>4</sup> cases invalidating many of the family partnerships that sprang up in recent years were decided after this revised edition was published. The author's comments on these cases would be worth reading. The family partnership attempts to split income, usually between husband and wife, pretty much as the law permits them to do in community property states. It has recently been suggested that Congress tax the income of all married persons virtually on a community property basis. This would have the virtue, at least, of overcoming the decided advantage from a tax standpoint enjoyed today by residents of community property states. There is a rather full discussion by the author of the problem of short term trusts as well as of community property.

In his discussion of the characteristics of income the author devotes an interesting chapter to the subject of gross income, gross receipts and net income, and comes to the conclusion that under the tax law and under the Sixteenth Amendment, Congress might levy an income tax on gross income.

In Part 3 of the book, the author discusses miscellaneous types of income, insurance, annuities, gifts and bequests. The final chapter is a fine summary under the title "Toward a Concept of Taxable Income."

The book is definitely required reading for any student of the subject of income taxation.

BENJAMIN HARROW.\*

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AMERICAN LABOR. By Herbert Harris. New Haven: Yale University Press, 1945. Pp. 459.

In a sense, *American Labor*, first published in 1938, is outdated. The last eight years have been rich, even luxuriant, in labor history as a result of the acceleration in labor organization, the operations of the National Labor Relations Act, the creation of the C. I. O. and, finally, the war. It is this last period that requires study, analysis and indeed, another book.

That a book is outdated in this sense can hardly derogate from the useful function it serves: a vivid picture of labor history in this country from its beginnings until the late 1930's. The method is an interesting one: two extended chapters on labor history, a final chapter containing many debatable assumptions and some questionable conclusions; and, sandwiched in between are seven monographs, each upon an important labor organization: The United Mine Workers, The United Brotherhood of Carpenters and Joiners, The American Newspaper Guild, The International Ladies' Garment Workers' Union, The Railroad Unions, The United Automobile Workers and The Textile Workers' Union.

The chapter on the United Mine Workers is of particular significance in the light of recent events. One is awed by the firmness of the historical pat-

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<sup>3</sup> 326 U. S. — (1946).

<sup>4</sup> 327 U. S. — (1946).

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