

# Income Tax--Consolidated Corporation's Liability for Tax Incurred by Constituent Corporation

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“The provision in the Fourteenth Amendment that no State shall deny to any person within its jurisdiction the equal protection of the laws, was not intended to prevent a State from adjusting its system of taxation in all proper and reasonable ways. \* \* \* It may impose different specific taxes upon different trades and professions and may vary the rates of excise upon various products; it may tax real estate and personal property in a different manner. \* \* \* All such regulations and those of like character, so long as they proceed within reasonable limits and general usage are within the discretion of the State Legislature. \* \* \* We think we are safe in saying that the Fourteenth Amendment was not intended to compel the State to adopt an iron rule of equal taxation.”

It is therefore submitted that the dissenting opinion is logically correct and practical in operation for the following reasons:

1. The nature of the tax in question is one on the receipts of a business, and is not a tax on property, regardless of the name assigned to it. A tax statute is not to be condemned because of the name. If a tax of the net receipts of one form of business is invalid because a similar tax is not levied on other kinds of business it would mean that the business receipts of one form of business could not be taxed unless a tax was imposed on every kind of business. Certainly, this was not within the contemplation of the statute in question.

2. The tax levied against the casualty receipts of foreign fire insurance companies in Illinois was reasonable, since their casualty business formed only a small part of their operations. Foreign fire insurance companies in that state were in a class different from those companies that did a casualty business only. If this tax measure is held invalid the ultimate result would be that few businesses would escape taxation although justified in being exempted.

3. The Fourteenth Amendment does not compel a state to adopt an “iron rule of taxation.” There was no abuse of discretion in the tax on receipts of casualty business done by foreign fire insurance companies in Illinois, and the tax should have been declared valid.

IRVING WEINSTEIN.

INCOME TAX—CONSOLIDATED CORPORATION’S LIABILITY FOR TAX INCURRED BY CONSTITUENT CORPORATION.—The Oswego Falls Pulp & Paper Company was a constituent corporation to a consolidation of the taxpayer (Oswego Falls Corporation) with itself on

January 30, 1922, pursuant to Section 7 of the Business Corporation Law of New York. In 1925 the constituent corporation, through its president and under its corporate seal, executed waivers of the Statute of Limitations for the years 1917-1920. The taxpayer executed a waiver for the year 1921 as successor by consolidation; and for the year 1919 as transferee of the constituent corporation. Notices of assessment for the years 1917-1921 were sent to the taxpayer (consolidated corporation) advising it of its liability as *transferee* of the Oswego Falls Pulp & Paper Company. The Commissioner seeks to hold the defendant taxpayer liable as transferee, alleging that the notice of assessment is valid. *Held*, the constituent corporation could not execute a waiver, the taxpayer is not a transferee, the notice of assessment is valid; and therefore the taxpayer is liable only for the year 1921. *Commissioner of Internal Revenue v. Oswego Falls Corporation*, 71 F. (2d) 673 (C. C. A. 9th, 1934).

- The taxpayer was consolidated under the authority of New York State<sup>1</sup> and therefore the legislature of that state fixes the effect of such consolidation.<sup>2</sup> The constituent corporation, after consolidation, is for all purposes extinguished.<sup>3</sup> But the termination of a corporation may not impair a creditor's rights;<sup>4</sup> and where the dissolved corporation has distributed its assets to the stockholders, the Commissioner may proceed against the stockholders as transferees<sup>5</sup> under the statute.<sup>6</sup> Under such circumstances the president of the dissolved corporation may execute a waiver of the Statute of Limitations.<sup>7</sup>

A consolidated corporation is vested with the rights of the con-

<sup>1</sup> N. Y. STOCK CORP. LAW §86 (Cons. Laws, c. 59), formerly N. Y. BUSINESS CORP. LAW §7 (Cons. Laws, c. 4).

<sup>2</sup> *Matter of Bergdorf*, 206 N. Y. 309, 99 N. E. 714 (1912). In speaking of the statutory merger provisions which were similar to the consolidation provisions, the court said, "It would not have taken place without statutory authority and the legislature fixed the indisputable and exclusive effect of it."

<sup>3</sup> *Miner v. New York, C. & H. R. R. Co.*, 123 N. Y. 242, 25 N. E. 339 (1890) (The corporate life came to an end at the time of the consolidation); *Irvine v. New York Edison Co.*, 207 N. Y. 425, 101 N. E. 358 (1913) (The constituent corporation became rightless, powerless, and propertyless).

<sup>4</sup> *Guarantee Trust Co. of New York v. New York & Queens County Ry. Co.*, 253 N. Y. 190, 170 N. E. 887 (1930) (It continues to exist in so far as its existence is necessary for the protection of its creditors).

<sup>5</sup> *Phillips v. Commissioner of Internal Revenue*, 283 U. S. 589, 51 Sup. Ct. 608 (1930).

<sup>6</sup> REV. ACT OF 1926 §280, 44 Stat. 9, 61, 26 U. S. C. A. §1069.

<sup>7</sup> *Wonder Bakeries Co., Inc. v. United States*, 6 F. Supp. 228 (Ct. Cl. 1934).

stituent corporation,<sup>8</sup> and assumes its contract and tort liability<sup>9</sup> as though it had itself incurred it,<sup>10</sup> but *not* as transferee or assignee.<sup>11</sup> The consolidated corporation must be substituted for the constituent corporation if the action had not been commenced prior to consolidation.<sup>12</sup> The creditor's rights are unimpaired and preserved.<sup>13</sup> Where the statute does not provide for an assumption of liabilities, as in the case of a transfer, the funds of the debtor corporation constitute a trust in the hands of the transferee which the creditor may reach.<sup>14</sup> But the creditor may proceed equitably against the transferee only when he has exhausted his remedies against the transferor,<sup>15</sup> unless otherwise provided by statute,<sup>16</sup> or where such action would be futile.<sup>17</sup> The federal courts will enforce the remedy existing in the state courts when the facts which confer federal jurisdic-

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<sup>8</sup> N. Y. STOCK CORP. LAW §89 (Cons. Laws, c. 59), formerly N. Y. BUSINESS CORP. LAW §11 (Cons. Laws, c. 4). "Upon the filing of such certificate of consolidation \* \* \* all the rights, privileges, franchises and interests of each of the constituent corporations, and all the property, real, personal and mixed, and all the debts due on whatever account to either of them, \* \* \* shall be taken and deemed to be transferred to and vested in such new corporation, without further act or deed, \* \* \*." *Miner v. New York, C. & H. R. R. Co.*, *supra* note 3; *cf. Matter of Bergdorf*, *supra* note 2; *Citizens Savings & Trust Co. v. Cincinnati D. Traction Co.*, 106 Ohio 577, 140 N. E. 380 (1922) (under statute similar to that of New York).

<sup>9</sup> *Polhemus v. Fitchberg R. R. Co.*, 123 N. Y. 502, 26 N. E. 31 (1890); *Lee v. Stillwater & Mechanicville Street Ry. Co.*, 140 App. Div. 779, 125 N. Y. Supp. 840 (3d Dept. 1910); *American Railway Express Co. v. Commonwealth*, 190 Ky. 636, 228 S. W. 433 (1921) (under statute providing regulations similar to those of New York).

<sup>10</sup> N. Y. STOCK CORP. LAW §90 (Cons. Laws, c. 59), formerly N. Y. BUSINESS CORP. LAW §§11 and 12 (Cons. Laws, c. 4) (context is materially unaltered). "The rights of creditors of any corporation that shall be consolidated shall not in any manner be impaired, \* \* \* but such new corporation shall be deemed to have assumed and shall be liable for all liabilities and obligations of each of the corporations consolidated in the same manner as if such new corporation had itself incurred such liabilities or obligations. \* \* \*"  
*Western Maryland Ry. Co. v. Commissioner of Internal Revenue*, 33 F. (2d) 695 (C. C. A. 4th, 1929); *West Texas Refining & Developing Co. v. Commissioner of Internal Revenue*, 68 F. (2d) 77 (C. C. A. 10th, 1933).

<sup>11</sup> *Seaboard Air Line R. R. v. United States*, 256 U. S. 655, 41 Sup. Ct. 611 (1921). The court held that the statute prohibiting a transferee or assignee from prosecuting a claim against the United States did not apply to a consolidated corporation which was enforcing a claim of its constituent corporation.

<sup>12</sup> *Lee v. Stillwater & Mechanicville Street Ry. Co.*, *supra* note 9.

<sup>13</sup> In the *Matter of The Utica National Brewing Co.*, 154 N. Y. 268, 48 N. E. 521 (1897); *Wilson v. Mechanical Organette Co.*, 170 N. Y. 542, 63 N. E. 550 (1902).

<sup>14</sup> *Campbell v. Dick*, 71 Okla. 186, 176 Pac. 520 (1918).

<sup>15</sup> *Ozan Lumber Co. v. Davis Sewing Machine Co.*, 284 Fed. 161 (D. Del. 1922); *Irvine v. New York Edison Co.*, *supra* note 3. A creditor seeking the equitable assets of a debtor must produce an unsatisfied judgment.

<sup>16</sup> *Baumgartner v. Commissioner of Internal Revenue*, 51 F. (2d) 472 (C. C. A. 9th, 1931).

<sup>17</sup> *Hatch v. Morosco Holding Co., Inc.*, 50 F. (2d) 138 (C. C. A. 2d, 1931).

tion exist.<sup>18</sup> It is obvious that a taxpayer and transferee cannot co-exist, as such status would presuppose two juristic persons, one being primarily liable and the latter secondarily liable.<sup>19</sup>

Generally where a waiver purports to be executed for a dissolved corporation it is ineffective,<sup>20</sup> unless such power is given by statute of the state of incorporation.<sup>21</sup> But the court will look at the substance rather than the form of the transaction,<sup>22</sup> and it has held that a waiver signed by the *transferee* acting for the dissolved transferrer was valid,<sup>23</sup> although the Statute of Limitations had expired;<sup>24</sup> though in the instant case the court strictly construed the waiver.<sup>25</sup> And so the court has held that a notice of assessment naming the party as "taxpayer" instead of "transferee" was valid<sup>26</sup> and that such notice need not be signed by the Commissioner<sup>27</sup> nor have any definite or special form.<sup>28</sup>

### I. D.

TAXATION—GAIN OR LOSS ON SECURITIES HELD IN MARGIN ACCOUNT.—Early in 1926, petitioner purchased on marginal account a block of United Gas Improvement Company stock. In 1928, he purchased additional stock of the same company and in subsequent transactions he sold an amount equal to the number of shares he

<sup>18</sup> *Union Pacific Ry. Co. v. Board of Commissioners of Weld County, Colorado*, 222 Fed. 651 (C. C. A. 8th, 1915).

<sup>19</sup> *Western Union Telegraph Co. v. Commissioner of Internal Revenue*, 68 F. (2d) 16 (C. C. A. 2d, 1933).

<sup>20</sup> *Commissioner of Internal Revenue v. Newport Co.*, 65 F. (2d) 925 (C. C. A. 7th, 1933), *rev'd on other grounds*, 291 U. S. —, 54 Sup. Ct. 481 (1934); *cf. Wonder Bakeries Co., Inc. v. United States*, *supra* note 7. "There is a conflict in the decisions as to whether an officer and stockholders of a dissolved corporation can file a waiver for it under any circumstances," but such a party can file a waiver for the dissolved corporation that would be binding on himself. Instant case.

<sup>21</sup> *Helvering v. South Penn Oil Co.*, 68 F. (2d) 420 (App. D. C. 1933).

<sup>22</sup> *Chicago, Milwaukee & St. Paul Ry. Co. v. Minneapolis Civic & Commerce Ass'n*, 247 U. S. 490, 38 Sup. Ct. 553 (1918).

<sup>23</sup> *Helvering v. Newport Co.*, 291 U. S. —, 54 Sup. Ct. 481 (1934). The court, without discussion, dismisses the *contra* proposition as without merit.

<sup>24</sup> *Commissioner of Internal Revenue v. Wolf Co.*, 69 F. (2d) 1001 (C. C. A. 3d, 1934).

<sup>25</sup> The court ruled that all waivers, except the one for the year 1921, were ineffective, and thus, it of necessity included the waiver executed by the taxpayer as "transferee."

<sup>26</sup> *Burnet v. San Joaquin Fruit & Investment Co.*, 52 F. (2d) 123 (C. C. A. 9th, 1931). But in this case the liability of the transferee was that of a taxpayer.

<sup>27</sup> *Riggs v. Commissioner of Internal Revenue*, 50 F. (2d) 1082 (C. C. A. 3d, 1931); *Helvering v. Continental Oil Co.*, 68 F. (2d) 750 (App. D. C. 1933).

<sup>28</sup> *Tameling v. Commissioner of Internal Revenue*, 43 F. (2d) 814 (C. C. A. 2d, 1930); *Noyes v. United States*, 55 F. (2d) 870 (C. C. A. 9th, 1932); *Ventura Consolidated Oil Fields v. Welch*, 6 F. Supp. 327 (S. D. Cal. 1934).