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Income Tax--Constitutionality of Tax on Profits Derived from Sale of County Bonds (Willcuts v. Bunn, 51 S. Ct. 125 (1931))

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counting.¹⁰ Beginning with *U. S. v. Anderson*,¹¹ progress in the development of the law was rapid, and the archaic rule of the *Lumber Mutual Fire Ins.* case was disregarded for scientific principles of accounting.¹² The instant case serves notice that hybrid returns, consisting of mixed items determined on both the "accrual" and the "receipts and disbursements" basis will no longer be tolerated, and that the law in this respect will henceforth be narrowly construed.

T. S. W.

INCOME TAX—CONSTITUTIONALITY OF TAX ON PROFITS DERIVED FROM SALE OF COUNTY BONDS.—Plaintiff purchased as an investment certain bonds issued by counties and municipalities of Minnesota in 1919. In January, 1924, he realized a profit of \$736.26, through their sale, paid an income tax on such, under protest, and claimed a refund, which he seeks to recover charging the Revenue Act of 1924,¹ as void since it taxes a government instrumentality. The claim was rejected, demurrer to the complaint was overruled, judgment entered for the plaintiff, and affirmed by the Circuit Court.² On appeal, judgment reversed, *Held*, tax is not upon obligations of a state, or any political subdivision; but is upon profits realized upon the sale of such obligations. As a practical consequence there is no basis for the conclusion that the borrowing power of the states are adversely affected, nor can sale by private individuals in any way be

¹⁰ Montgomery, *Income Tax Procedure* (1925) p. 497: "Nothing can be more obvious than the proposition that true net income cannot be determined by looking over one's cash account." See also Holmes, *Federal Income Tax* (1917) pp. 299-301. Of interest is the Report of the Committee on Ways and Means (House Report No. 992, 64th Cong., 1st Sess., p. 4) with reference to the income tax provisions of the Revenue Act of 1916: "As two systems of bookkeeping are in use in the United States, one based on the cash or receipt basis and the other on the accrual basis, it was deemed advisable to provide in the proposed measure that an individual or corporation may make return of income on either the cash or accrued basis, if the basis selected clearly reflects the income."

¹¹ *U. S. v. Anderson*, 269 U. S. 442, 443, 46 Sup. Ct. 131, 70 L. ed. 347 (1925). Justice Stone turns our attention to "a consideration of the difficulties involved in the preparation of an income account on a strict basis of receipts and disbursements for a business of any complexity." In this case we have recognized for the first time the principle that while the first problem in income taxation is to define income, the second and equally important problem is to allocate income in respect to time; and furthermore, that income is said to be accrued when it is definitely receivable, although its payment may not be due. (See also note 10.)

¹² *W. S. Barstow & Co. v. Bowers*, 15 F. (2nd) 75 (D. C., N. Y.) (1926); *Becker v. U. S.*, 21 F. (2nd) 1003 (C. C. A., Ga.) (1927); *R. P. Hyams Coal Co. v. U. S.*, 26 F. (2nd) 805 (D. C., La.) (1928); *Weed & Bros. v. U. S.*, 38 F. (2nd) 935, 51 Sup. Ct. 25 (1930).

¹ 43 Stat. 253 (1924). U. S. C. A. Tit. 26, Sec. 954 (1926).

² 35 F. (2d) 29 (C. C. A., 8th, 1929).

termed a government instrumentality. *Willcuts v. Bunn*, 51 Sup. Ct. 125 (1931).

The lower courts while holding the tax as one on a government instrumentality, attempted to bring the present case within the constitutional prohibition as exempt from taxation since affecting the borrowing power of the state.³ Taxation is as essential to the existence of government as is the borrowing of money. State bonds are exempt from Federal taxation since they constitute a contract of the state, and a tax upon the amount payable bears directly on the borrowing power of the state.⁴ But the sale of bonds by purchasers after issuance by the state, is a transaction distinct from the contract of the government,⁵ and the exemption on the obligation of the state does not extend to profits realized by a private sale.

There has been much discussion regarding "government instrumentalities." The courts have held that the states may not tax directly incomes from patents and copyrights,⁶ though they may utilize incomes from such instrumentalities as an element in ascertaining the value of the privilege of doing business.⁷ Thus while patent royalties may not be taxed the income derived from the manufacture and sale of a patented article is not exempt.⁸ The problems presented in the *Macallen* case,⁹ where the Court refused to distinguish between direct and excise taxes when levied on government instrumentalities, are not involved here. The tax is not levied directly or indirectly on an *instrumentality*, for obviously this is a private business transaction. The question presented is a practical one. The states or their subdivisions will suffer no additional burden; the individual is bearing his share of the cost of government by paying a tax upon the profits arising from the sale of government bonds as he would were industrial securities the subject of the sale.

C. A. B.

INCOME TAX—TAXABILITY OF INCOME LEFT WIDOW IN LIEU OF DOWER.—The relator, a widow, accepted in lieu of dower the income from a trust estate created by the last will and testament of her

³ *Supra* note 2; *Pollock v. Farmers Loan & Trust Co.*, 157 U. S. 429, 15 Sup. Ct. 675 (1894); *National Life Ins. Co. v. U. S.*, 227 U. S. 508, 48 Sup. Ct. 59 (1928).

⁴ *Weston v. Charleston*, 2 Pet. 449, 468 (U. S. 1829).

⁵ *Trefry v. Putnam*, 227 Mass. 522, 529, 116 N. E. 904, 907 (1917).

⁶ *Long v. Rockwood*, 277 U. S. 142, 48 Sup. Ct. 463 (1928); see (1930) 4 St. John's L. Rev. 311, 313.

⁷ *Educational Films Inc. v. Ward*, 51 Sup. Ct. 170 (1931); See also *Powell, Indirect Incroachment on Federal Authority* (1918) 31 Harv. L. Rev. 321.

⁸ *Patterson v. Kentucky*, 97 U. S. 501, 24 L. ed. 1115 (1878); *Webber v. Virginia*, 103 U. S. 344 (1880).

⁹ *Macallen v. Mass.*, 279 U. S. 620, 49 Sup. Ct. 432 (1929).