Vanderbilt Law Review

Volume 21
Issue 2 *Issue 2 - March 1968*

Article 3

3-1968

Recent Cases

Law Review Staff

RECENT CASES

Conflict of Laws—Torts—Law of Jurisdiction with Predominant Interest in Resolution of Issue Applied

En route to California two members of plaintiff's family were killed in a Missouri automobile collision with defendant, a California resident. Although the decedents' estates were being administered in Ohio, which was their domicile at the time of the accident, plaintiffs moved from Ohio to California and brought a wrongful death action in the state court. The California Court of Appeals applied the traditional rule that the measure of damages recoverable in a wrongful death action is determined by the place of the wrong; plaintiffs were awarded the 25,000 dollar maximum allowed under Missouri law. On appeal, the plaintiffs contended that since Ohio and California had more substantial contacts with the parties and greater interest in the outcome of the litigation, the laws of either of these states, which place no limitation on wrongful death recoveries, should determine the measure of damages. The California Supreme Court, *held*, reversed. The forum court should weigh the interests and policies of each state, and the law of the jurisdiction having the predominant interest in the resolution of each specific issue should be applied. *Reich v. Purcell*, 432 P.2d 727, 63 Cal. Rptr. 31 (Sup. Ct. 1967).

The traditional choice-of-law rule in tort cases has been that the law of the place of the wrong determines the substantive rights of the parties.[1] Because this rule derived from the "vested rights" doctrine[2] that the right to recover for a foreign tort owes its creation to the law of the place where the injury occurred, it was assumed that the laws of that same jurisdiction necessarily determined the extent of liability. The "vested rights" theory and the view that the law of

1. RESTATEMENT OF CONFLICTS § 384 (1929). On the issue of measure of damages, "[t]he law of the place of the wrong governs the amount of recovery for wrongful death as well as the right to recover. Thus, any limitation upon the amount imposed by the law of the place of the wrong will be applicable to determine the maximum amount recoverable elsewhere." *Id.* § 391, comment *d*.

2. "The theory . . . is that although the act complained of was subject to no law having force in the forum, it gave rise to an obligation . . . which, like other obligations, follows the person, and may be enforced wherever the person may be found . . . . But as the only source of this obligation is the law of the place of the act, it follows that the law determines not merely the existence of the obligation, . . . but equally determines its extent." Slater v. Mexican Nat'l R.R., 194 U.S. 120, 126 (1904). The erosion of this doctrine has been recognized in subsequent decisions. Richards v. United States, 369 U.S. 1 (1962), noted with approval the departures by state courts discussed later in this comment.

one jurisdiction controls all issues have been discredited by many writers[3] who argue that choice of law problems should be resolved by the law of the state having the most significant contacts with the parties and the greatest interest in the outcome of a specific legal issue. However, the courts have been slow to deviate from the traditional rule, which has the weight of precedent coupled with the comforts of familiarity, predictability and ease of mechanical application. In the last two decades a few courts, with a variety of rationalizations, have refused to apply the law of the place of the tort when to do so would have frustrated the policies of the state which had the paramount interest in the resolution of the particular issue. Although the concepts of "substantial contacts" and "predominant interest" were implicit in these early decisions, such ideas were not articulated. Instead courts employed language more familiar to choice of law problems, such as "substantive" and "procedural."[4] *Grant v. McAuliffe*[5] involved an Arizona car accident in which all parties were California residents, and the tortfeasor's estate was being administered in California. To have applied Arizona (place of the tort) law would have denied the action because Arizona allowed no survival of the cause of action. Rather than defeat the interest of her citizens while advancing no interest of Arizona, the California Supreme Court characterized the issue as procedural and applied forum law, noting that "[b]asically the question is one of the administration of the decedent's estate, which is a purely local proceeding."[6] In *Emery v. Emery*[7] members of a California family were injured while traveling in Idaho when another member of the family lost control of the car. Idaho law provided immunity from intrafamily tort liability; California law did not. Because the incidents of the family relationships were established and regulated by the law of the family's domicile (California), the California court applied California law rather than the law of the place of the tort (Idaho) to determine

3. Cavers, *A Critique of the Choice-of-Law Problem*, 47 HARV. L. REV. 173, 178 (1933); Cheatham, *American Theories of Conflict of Laws: Their Role and Utility*, 58 HARV. L. REV. 361, 379-85 (1945); Cheatham and Reese, *Choice of the Applicable Law*, 52 COLUM. L. REV. 959 (1952); Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. REV. 267 (1966).

4. Traynor, *Is This Conflict Really Necessary?* 37 TEXAS L. REV. 657, 669-70 (1959).

5. 41 Cal. 2d 859, 264 P.2d 944 (1953).

6. *Id.*

7. 45 Cal. 2d 421, 428, 289 P.2d 218, 223 (1955). "That state has the primary responsibility for establishing and regulating the incidents of the family relationship and it is the only state in which the parties can, by participation in the legislative processes, effect a change in those incidents. Moreover, it is undesirable that the rights, duties, disabilities, and immunities conferred or imposed by the family relationship should constantly change as members of the family cross state boundaries during temporary absences from their home." The same reasoning was applied in Haumschild v. Continental Cas. Co., 7 Wis. 2d 130, 95 N.W.2d 814 (1959).

intrafamily immunity. In *Kilberg v. Northeast Airlines, Inc.*[8] a New York domiciliary sued a Massachusetts corporation when a flight originating in New York crashed in Massachusetts. The New York court noted the place of the air crash was "entirely fortuitous," and while it applied that portion of the Massachusetts wrongful death statute which created the right of action, it refused to apply that part of the statute which limited damages, on the ground that such limitations were contrary to New York public policy.[9] The landmark case of *Babcock v. Jackson*[10] abandoned the subterfuge and concluded that "[t]here is no reason why all issues arising out of a tort claim must be resolved by reference to the law of the same jurisdiction. Where the issue involves standards of conduct, it is more than likely that it is the law of the place of the tort which will be controlling, but the disposition of other issues must turn, as does the issue of the standard of conduct itself, on the law of the jurisdiction which has the strongest interest in the resolution of the particular issue presented."[11] The initial clarity of *Babcock* was clouded by subsequent New York decisions. As in *Babcock*, all parties in *Dym v. Gordon*[12] were New York residents, and the car and insurance were based in New York. However, the court, purporting to apply *Babcock*, chose Colorado law (place of the auto accident) because the parties were temporarily residing in Colorado and the guest-passenger relationship originated there. Judge Fuld, who wrote the majority opinion in *Babcock*, dissented in *Dym*,[13] arguing that while Colorado's contacts

8. 9 N.Y.2d 34, 172 N.E.2d 526, 211 N.Y.S.2d 133 (1961).

9. Pearson v. Northeast Airlines, Inc., 309 F.2d 553 (2d Cir. 1962), *cert. denied*, 372 U.S. 912 (1963), held New York could constitutionally apply Massachusetts wrongful death statute while disregarding the limitation of damages provision. The court's language in *Kilberg* that the measure of damages was procedural rather than substantive was subsequently repudiated. "It is open to us, therefore, particularly in view of our own strong public policy as to death action damages, to treat the measure of damages in this case as being a procedural or remedial question controlled by our own State policies." *Id.* at 41-42, 172 N.E.2d at 529, 211 N.Y.S.2d at 137. However, Davenport v. Webb, 11 N.Y.2d 392, 395, 183 N.E.2d 902, 904, 230 N.Y.S.2d 17, 20 (1962), said *Kilberg* "must be held merely to express this State's strong policy with respect to *limitations* in wrongful death actions."

10. 12 N.Y.2d 473, 191 N.E.2d 279, 240 N.Y.S.2d 743 (1963).

11. 12 N.Y.2d at 484, 191 N.E.2d at 285, 240 N.Y.S.2d at 752. Marshalling contacts for New York, the court noted the "injuries sustained by a New York guest as the result of the negligence of a New York host in the operation of an automobile garaged, licensed and undoubtedly insured in New York, in the course of a week-end journey which began and was to end there. In sharp contrast, Ontario's sole relationship with the occurrence is the purely adventitious circumstances that the accident occurred there." 12 N.Y.2d at 482, 191 N.E.2d at 284, 240 N.Y.S.2d at 750. Although Ontario law would control issues of conduct, the court reasoned Ontario had little interest in the specific issue of guest statutes whose purpose was to prevent fraudulent collusive actions by passengers against Ontario insurance companies.

12. 16 N.Y.2d 120, 209 N.E.2d 792, 262 N.Y.S.2d 463 (1965).

13. Chief Judge Desmond dissented separately on the "strong public policy" ground of his *Kilberg* decision and *Babcock*. He explicitly rejected the concepts of "significant

were "quantitatively greater" they were not "significant" in relation to the particular issue and underlying policy involved.[14] The *Babcock* approach of isolating issues and weighing contacts to determine which jurisdiction has the strongest interest in the resolution of the particular issue clearly calls for more discretion and analysis on the part of the court. For this reason, although many courts have abandoned the traditional rule,[15] many other jurisdictions have continued to consider the place of the wrong controlling, regardless of the issue before the court.[16] *The Tentative Draft of Restatement Second* has adopted the newer position, and sets forth guidelines or considerations to assist in determining which state has the most significant contacts.[17]

contacts," "center of gravity," and "interests of the respective states" as "catchwords" representing at best not methods or bases of decision but considerations to be employed in setting up new rules of law required by the changing times" which lacked the necessary guidance to aid lawyers in advising clients or courts in deciding cases. *Id.* at 135, 209 N.E.2d at 801, 262 N.Y.S.2d at 475.

14. The purpose of Colorado's guest statute was to prevent fraudulent insurance claims against Colorado companies. Since the insurance was based in New York, New York's "strong and long-standing policy 'of requiring a tort-feasor to compensate his guest for injuries caused by his negligence'" should have been given effect. *Id.* at 131, 209 N.E.2d at 798, 262 N.Y.S.2d at 472. (Fuld, J., dissenting opinion). The majority, on the other hand, found the policies underlying Colorado's law threefold. In addition to the protection against fraudulent claims, it added the prevention of suits by "ungrateful guests" and "the priority of injured parties in other cars in the assets of the negligent driver." *Id.* at 124, 209 N.E.2d at 794, 262 N.Y.S.2d at 466. In Macey v. Rozbicki, 18 N.Y.2d 289, 221 N.E.2d 380, 274 N.Y.S.2d 591 (1966), the court reaffirmed *Babcock*. *See Conflict of Spirit: Babcock v. Dym*, 22 N.Y.U. INTRA. L. REV. 119 (1967).

15. Hopkins v. Lockheed Aircraft Corp., 201 So. 2d 743 (Fla. 1967); Wessling v. Paris, 417 S.W.2d 259 (Ky. 1967); Wartell v. Formusa, 34 Ill. 2d 57, 213 N.E.2d 544 (1966); Clark v. Clark, 107 N.H. 351, 222 A.2d 205 (1966); Thompson v. Thompson, 105 N.H. 86, 193 A.2d 439 (1963); Casey v. Manson Constr. & Eng'r Co., 428 P.2d 898 (Ore. 1967) (adopted newer approach but applied law of place of tort because it had most significant contacts); Griffith v. United Air Lines, Inc., 416 Pa. 1, 203 A.2d 796 (1964).

16. Goranson v. Capital Airlines, Inc., 345 F.2d 750 (6th Cir. 1965); Landers v. Landers, 153 Coun. 303, 216 A.2d 183 (1966) (interspousal immunity); Friday v. Smoot, 211 A.2d 594 (Del. 1965) (guest statute); McDaniel v. Sinn, 194 Kan. 625, 400 P.2d 1018 (1965) (measure of damages); White v. King, 244 Md. 348, 223 A.2d 763 (1966) (guest statute); Cherokee Laboratories, Inc. v. Rogers, 398 P.2d 520 (Okla. 1965) (limitation of damages). Various reasons given for not applying the newer rule included (1) the flexibility of the new involved gradations of contacts as opposed to the certainty of the old, (2) such a basic change in the rights of litigants should come from the legislature, (3) and the new would encourage litigation and forum shopping in a sphere currently closed.

17. "(1) The local law of the state which has the most significant relationship with the occurrence and with the parties determines their rights and liabilities in tort. (2) Important contacts that the forum will consider in determining the state of most significant relationship include: (a) the place where the injury occurred, (b) the place where the conduct occurred, (c) the domicile, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered. (3) In determining the relative importance of the contacts, the forum will consider the issues, the character of the tort, and the relevant purposes of the tort rules of the interested states." RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 379 (Tent. Draft No. 9, 1964).

In *Reich*, the traditional rule would have required the application of Missouri law to the issue of damages. Citing its prior decisions in *Grant* and *Emery*, the court noted that previously it had refused to apply the law of the place of the wrong when to do so would have defeated the interests of the litigants and states concerned. The court noted that because an increasing number of jurisdictions had departed from applying the law of the place of the tort regardless of the issue involved, the older rule no longer had the virtue of predictability claimed by the defendant. Moreover, "[e]ase of determining applicable law and uniformity of rules of decision . . . must be subordinated to the objective of proper choice of law in conflicts cases, *i.e.*, to determine the law that most appropriately applies to the issue involved."[18] It was from this background that the court analyzed the interest of Missouri, the place of the wrong. The parties had stipulated liability, and the sole issue on appeal was the applicability of Missouri's limitation statute. The court reasoned that while Missouri's interests would control the resolution of issues dealing with conduct within her borders, the limitation of damages for wrongful death was directed toward the compensation of survivors and was not concerned with conduct. Thus, when none of the parties was a resident of the place of the wrong, that state had a minimal interest in the issue of compensation. Although the court recognized that an additional purpose of Missouri's limitation on damages was the protection of excessive financial burden on the defendant, it labeled this interest primarily local and found that Missouri would have no substantial interest in extending the benefits of its limitation to out-of-state travelers. The court reasoned that when no party involved resided in a state which limited damages it could not be convincingly argued that a party procured insurance with such limitation in mind. On the contrary, it concluded that "a defendant cannot reasonably complain when compensatory damages are assessed in accordance with the law of his domicile and the plaintiffs received no more than they would have had they been injured at home."[19] Having decided not to apply Missouri law, the court could have stopped its analysis, because neither California nor Ohio limits recovery. It chose not to do so and proceeded to determine which state had the predominant interest in the specific issue before the court. Because of its lack of limitation California had no interest in applying its law on behalf of the California resident-defendant. Furthermore, although the plaintiffs' present domicile was California, their residence at the time of the accident was Ohio; to prevent forum shopping, the court made it explicit that events subsequent to the tort should have no impact on the choice of law.

18. 432 P.2d at 730, 63 Cal. Rptr. at 34.
19. *Id.* at 731, 63 Cal. Rptr. at 35.

Having found Missouri's interests minimal and the forum disinterested in the issue of damages, the court concluded that the interests of Ohio were predominant and could be recognized in giving full recovery to the injured parties without disregarding any substantial interest of the other states. Thus, the court reversed and awarded plaintiffs 55,000 dollars.

The results in earlier cases such as *Grant v. McAuliffe* and *Kilberg v. Northeast Airlines* were proper, but the reasoning was strained and intellectually unsatisfactory. Unlike *Grant*, in which the California court characterized survival of the action as procedural rather than substantive and thus applied the law of the forum, the court in *Reich* refused to base the decision on an ambiguous substantive-procedural dichotomy. Instead the court sought to resolve the conflict by carefully analyzing the interest of each state in the issue of damages. The value of the decision will not be in the result—other courts have reached comparable results[20]—but in its clarity.[21] Perhaps benefitted by having the single issue of damages before it, the court outlined a process which may be utilized in future cases involving many issues: (1) isolate the issues; (2) analyze the policies underlying the local laws of the various states concerned; and (3) determine which state has the predominant interest in the resolution of the particular issue under consideration. Clearly this three-step process involves more than the mere grouping or adding up of contacts; it necessitates an analysis of whether a contact has a significant relationship to a particular issue. *Dym v. Gordon* indicated the New York court's difficulty in applying the principles of *Babcock* and in reaching an harmonious evaluation of the policy and interests of each state. Through the use of the approach employed by *Reich* the contact analysis principle can be applied with greater precision and clarity.

Constitutional Law—Owner of Private Subdivision May Refuse To Sell to Negroes

Defendants,[1] owners, developers and real estate agents of a private subdivision built without state or federal assistance or financing, refused to sell a home to plaintiffs because the plaintiff-husband was a

20. *See* cases cited in note 15 *supra*.

21. The respect Chief Justice Traynor, who wrote the decision, commands both as a conflicts scholar and judge will no doubt influence other jurisdictions to adopt the newer contact-policy analysis approach.

1. The plaintiffs joined four defendants, an individual and three corporations which are engaged in different managerial aspects of the subdivision: (1) the subdivision developer and home builder; (2) the corporate real estate broker; (3) the country club for use of the people in the subdivision.

Negro. The three corporate defendants were chartered under the laws of Missouri and the subdivision was afforded the normal protection and conveniences of state and municipal laws and services.[2] Plaintiffs brought an action in federal district court alleging that defendants' refusal to sell was a denial of their rights guaranteed under the thirteenth[3] and fourteenth amendments.[4] Plaintiffs further alleged a violation of their right to buy property as declared in 42 U.S.C. section 1982.[5] The district court dismissed the action and on appeal to the United States Court of Appeals for the Eighth Circuit, *held,* affirmed. An owner of a private subdivision who refuses to sell to a Negro solely on the basis of race does not deny rights guaranteed under the thirteenth or fourteenth amendments and does not violate section 1982. *Jones v. Alfred H. Mayer Co.,* 379 F.2d 33 (8th Cir. 1967).

Section 1982, which was derived from the Civil Rights Act of 1866[6] and 1870,[7] guarantees to all citizens the same rights to purchase and hold property as are enjoyed by white citizens. Whether section 1982 establishes a right to purchase a specific piece of property from an unwilling seller has not been determined by the court; however, no such right existed for white citizens when the Act of 1866 was passed.[8] Although a district court has held that section 1982 was intended to guarantee the rights of citizenship under the thirteenth amendment on the grounds that a denial of the right to buy or lease property imposes a prohibited "badge of

2. Among those listed by the court were: zoning and building codes, banking and lending laws, approval of plans by county commission, metropolitan sewer services, education of children in tax-supported school district, and gas and electric service provided by state licensed utilities. Jones v. Alfred H. Mayer Co., 379 F. 2d 33, 35. Plaintiffs alleged that this municipal and state involvement was sufficient to constitute "state action" under the fourteenth amendment.

3. "Neither slavery nor involuntary servitude, except as a punishment for crime . . . shall exist within the United States . . . ." Section 2 contains an enabling clause.

4. Section 1. "All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privilege or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." Section 5 contains an enabling clause.

5. "All citizens of the United States shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold and convey real and personal property." 42 U.S.C. § 1982 (1964).

6. Ch. 31, § 1, 14 Stat. 27 (1896).

7. Ch. 114, § 16, 16 Stat. 144 (1870). Section 18 specifically re-enacted the Act of 1866.

8. Avins, *The Civil Rights Act of 1866, The Civil Rights Bill of 1966, and the Right to Buy Property,* 40 S. CAL. L. REV. 274, 306 (1967); Robison, *The Possibility of a Frontal Assault on the State Action Concept, with Special Reference to the Right To Purchase Real Property Guaranteed in 42 U.S.C. § 1982,* 41 NOTRE DAME LAW. 455, 464 (1966).

slavery" upon the individual,[9] the Supreme Court held in *Hurd v. Hodge*[10] that section 1982 applies under the fourteenth rather than the thirteenth amendment. Since the *Civil Rights Cases*,[11] the Supreme Court has consistently held that state action is required to invoke the equal protection clause of the fourteenth amendment. Thus, the application of the fourteenth amendment, independently, or in conjunction with legislation such as section 1982, has traditionally depended upon the presence of state action. Although the state action requirement has been severely attacked as not having been intended by the framers of the fourteenth amendment[12] and as a limitation imposed during the aftermath of the reconstruction period,[13] the Court has refused to deny its necessity. However, in order to maintain the viability of the fourteenth amendment, the Court has pursued a broad interpretation of state action by holding that the amendment does apply when there is "significant involvement" of the state in discriminatory situations.[14] While the mere act of licensing a business or real estate agency has not been held to constitute sufficient state action,[15] the Supreme Court has recently held that a repeal by constitutional amendment of state statutes

9. United States v. Morris, 125 F. 322 (E.D. Ark. 1903); Civil Rights Cases, 109 U.S. 3, 35 (1883) (Harlan, J., dissenting opinion). *See* Avins, *supra* note 8, at 274-75, 292-95; Robison, *supra* note 8, at 466. Although the thirteenth amendment does apply to individual acts of discrimination, there is no indication that in the absence of congressional legislation, that the refusal to sell property to a Negro violates the thirteenth amendment.

10. 334 U.S. 24, 32-33 (1948). *See also* Corrigan v. Buckley, 271 U.S. 323, 330-31 (1926); Virginia v. Rives, 100 U.S. 313, 333 (1880). Although § 1982 was passed by Congress following the ratification of the thirteenth amendment and prior to the formal proposal of the fourteenth amendment, it was re-enacted in 1870 after the ratification of the fourteenth amendment.

11. 109 U.S. 3 (1883).

12. Frank & Munro, *The Original Understanding of "Equal Protection of the Laws,"* 50 COLUM. L. REV. 131, 162-63 (1950); Robison, *supra* note 8, at 460-65; Silard, *A Constitutional Forecast: Demise of the "State Action" Limit on the Equal Protection Guarantee*, 66 COLUM. L. REV. 855, 869 (1966); St. Antione, *Color Blindness But Not Myopia: A New Look at State Action, Equal Protection and "Private" Racial Discrimination*, 59 MICH. L. REV. 993, 995 (1961); Williams, *The Twilight of State Action*, 41 TEXAS L. REV. 347, 348-49 (1963).

13. *See* Silard, *supra* note 12, at 856.

14. Evans v. Newton, 382 U.S. 296 (1966) (private trustees operating privately owned park for public use); Peterson v. City of Greenville, 373 U.S. 244 (1963) (state conviction of trespass where city ordinance requires segregated lunch counter); Burton v. Wilmington Parking Authority, 365 U.S. 715 (1961) (restaurant in building owned by state agency operated by private lessee is state action); Hurd v. Hodge, 334 U.S. 24 (1948) (§ 1982 does prohibit enforcement of restrictive covenant by D.C. court); Shelley v. Kraemer, 334 U.S. 1 (1948) (covenant in contract between buyer and seller excluding future sale to Negroes does not violate fourteenth amendment, but state enforcement of covenant is violation of the amendment).

15. However, for the view that a state-licensed real estate agency is affected with a public interest and is required by the equal protection clause to act in a non-discriminatory manner, see Mr. Justice Douglas' concurring opinion in Reitman v. Mulkey, 387 U.S. 369, 386 (1967).

prohibiting racial discrimination in the sale of real property, in effect makes the right to discriminate a state policy and is unconstitutional state action.[16] Section five of the fourteenth amendment empowers Congress to enforce the provisions of the amendment by "appropriate legislation." Mr. Justice Harlan, dissenting in the *Civil Rights Cases*,[17] contended that Congress, acting under section five, was not limited to counteracting state action. This view, which has received strong support from writers[18] and increasing support in the Supreme Court,[19] would allow Congress to enact legislation to protect citizenship rights and insure equal protection of the laws without regard to state action or state inaction. Thus, if section 1982 were held to give a Negro the right to buy a particular piece of property, it could possibly be held to apply without regard to state action, since it was enacted under section five.

In the instant case the court found that the re-enactment of the Act of 1866 in 1870 and the Supreme Court's decision in *Hurd v. Hodge*[20] compelled an inferior court to apply section 1982 under the fourteenth amendment. After a careful consideration of the recent decisions barring discrimination under the commerce clause and suggestions that section five of the fourteenth amendment might permit Congress to prohibit individual acts of discrimination,[21] the court held that the *Civil Rights Cases* and subsequent decisions made the state action requirement binding upon an inferior court.[22] While recognizing the Supreme Court's substantial extension of the state action concept, the court regarded the state and local functions (*i.e.*, licensing, recording of property transfers, zoning and normal municipal services) which were connected with defendants' activities

16. Reitman v. Mulkey, 387 U.S. 369 (1967), *See also* 20 VAND. L. REV. 1346 (1967).

17. 109 U.S. 3, 54 (1883).

18. *See* Frank & Munro, *supra* note 12, at 167-68; St. Antione, *supra* note 12, at 995; Robison, *supra* note 8, at 461-65.

19. In a case involving conspiracies to deprive another of his rights, Mr. Justice Clark said that there was no doubt § 5 empowers Congress to enaet legislation which would punish all conspiracies that interfere with fourteenth amendment rights, with or without state action. United States v. Guest, 383 U.S. 745, 762 (1966) (Clark, J., concurring opinion, joined by Black & Fortas, J.J.). Since § 1 of the fourteenth amendment guarantees that citizens be treated equally with respect to public accommodations, Congress could base Civil Rights Act of 1964 on § 5 of fourteenth amendment as well as upon the commerce clause. Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 291 (1964) (Goldberg, J., concurring opinion).

20. 334 U.S. 24 (1948).

21. *See* cases cited note 19 *supra*.

22. The Court noted that recent opinions (*e.g.*, United States v. Guest, 383 U.S. 745 (1966); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964)) indicated a change of course in the Supreme Court. "Certainly the opinions in *Guest* indicate that the reasoning of the Civil Rights Cases is in the process of re-evaluation, if not overruling, and that a court may not need to stretch to find state action if congressional legislation is present." 379 F.2d at 42.

as involving only nondiscriminatory assistance, which was held to be insufficient state action under the fourteenth amendment. The court determined that section 1982 applied only under the fourteenth amendment and not the thirteenth amendment. Due to its holding that state action is required under the fourteenth amendment and that the requisite state action was not present in the instant case, the court did not reach the question of what substantive rights are actually guaranteed under section 1982.

The present decision follows the traditional interpretation of the application of the thirteenth and fourteenth amendments and of the reliance of section 1982 upon the fourteenth amendment. By granting plaintiffs' request for certiorari,[23] the United States Supreme Court has agreed to re-examine these traditional concepts in their application to the instant case. Should the Court choose to extend federal constitutional protection into the area of racial discrimination in private housing, there are several alternative legal bases for reversal of the decision. By applying section 1982 under the thirteenth amendment, the Court could find that this section prohibits private acts of discrimination without regard to state action. Should the Court conclude that section 1982 cannot be applied under the thirteenth amendment, it will be squarely faced with either meeting or avoiding the state action requirement of the fourteenth amendment. The Court may find that either the licensing of a business (real estate agency) affected with a public interest, or the city's regulation of and affording services to the subdivision is sufficient state action under the fourteenth amendment.[24] Such an application of the fourteenth amendment would prohibit the refusal to sell to a Negro on the basis of the equal protection clause alone or in conjunction with section 1982. On the other hand, by holding that section five of the fourteenth amendment does not require state action, the Court could avoid a determination as to whether state action exists in the present situation and find that section 1982, enacted under the enabling provision of section five, prohibits the refusal to sell real property solely on the basis of race.[25] Likewise, it has been suggested that the state action requirement mentioned in the second sentence of section one of the fourteenth amendment was not intended to apply to the first sentence on citizenship.[26] Thus, by interpreting section 1982 as describing the

23. *Cert. granted,* 36 U.S.L.W. 3107 (U.S. Sept. 22, 1967) (No. 645).

24. The court could adopt Mr. Justice Douglas' view that licensing of a business affected with a public interest is sufficient state action. *See* note 15 *supra.* Also, the position of owner-developer of large subdivision is different from that of the individual home owner.

25. *See* note 19 *supra.* For implications of the *Guest* case see 20 VAND. L. REV. 170 (1966).

26. Mr. Justice Harlan, dissenting in *Civil Rights Cases,* 109 U.S. 3, 54 (1883), felt that when enforcing the first sentence of § 1 granting citizenship, Congress is not

rights of citizenship protected under the citizenship clause in section one, the state action requirement may be avoided.

Of perhaps more importance than the technical rules which may be used in determining plaintiffs' rights are the policy issues which must be considered by the Supreme Court in the instant case. It is submitted that the Court should view the problem of private racial discrimination in housing in much the same manner as it approached school segregation in *Brown v. Board of Education*.[27] Applying that approach to the instant case, the Court must consider housing discrimination in light of its full effect upon life in the United States today. If the Court feels that housing discrimination is responsible in large measure for the racial ghettos, city slums and segregated suburbs, a problem which has led to increasing alienation of a large portion of the Negroes in our society, and that this results in a denial of equal protection of the law, then it should act to remedy the situation unless there are other compelling factors which weigh against this result. One of these countervailing factors is the traditional Anglo-American view of the sanctity of property and the bundle of rights which an owner acquires. One of the most valued property rights is the power to sell or not to sell to whomever the property owner desires. However, our history shows that property rights have generally yielded to regulation under the police power of the city, state and national governments.[28] Therefore it may be said that to the extent that the refusal to sell property to a Negro is contrary to the general welfare, there is no property right which would allow a denial of the Negro's civil rights. Another serious policy issue is whether or not a reversal of the present decision under the fourteenth amendment would result in an infringement upon our federal system of government under which the Constitution delegates certain powers to the central government and reserves the remainder to the states. If the Court reverses the present decision, it is entering into an area of private law formerly reserved to the states. Such a decision might have drastic implications in other areas of state law in which a question of equal protection or due process might arise, and the

limited to legislation restricting state action. *See also* Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 291-93 (1964) (Goldberg, J., concurring).

27. "In approaching this problem, we cannot turn the clock back to 1868 when the Amendment was adopted . . . . We must consider public education in light of its full development and its present place in American life throughout the Nation. Only in this way can it be determined if segregation in public schools deprives these plaintiffs of the equal protection of the laws." Brown v. Board of Educ., 347 U.S. 483, 492-93 (1954).

28. "Property rights have been redefined in response to a swelling demand that ownership be responsible and responsive to the needs of the social whole. Property rights cannot be used as a shibboleth to cloak conduct which adversely affects the health, the safety, the morals, or the welfare of others." Powell, *The Relationship Between Property Rights and Civil Rights*, 15 HASTINGS L.J. 135, 149-50 (1963).

removal of the state action requirement would presumably extend federal constitutional protection to these areas. Another factor which may weigh against judicial resolution of this problem is the possibility that Congress, under the commerce clause or section five of the fourteenth amendment, might adopt a comprehensive plan which would prevent racial discrimination in private housing and yet give recognition to certain factors which would result in a more acceptable and equitable result. However, recent developments indicate a Congressional reluctance to enact equal housing legislation, and this hesitancy may prompt the Supreme Court to provide a judicial remedy. It is submitted that there is sufficient legal authority for either an affirmance or reversal of the Eighth Circuit's opinion. In view of the trend in recent cases involving racial discrimination[29] and in light of the previously mentioned political and social implications of segregated urban housing, it is submitted that the Supreme Court should reverse the instant decision. The course of least resistance would be to extend the state action doctrine to include state licensing of real estate agencies. If the Court does not make this extension, it seems that now is the time for a thorough re-evaluation of the state action doctrine as set forth in the *Civil Rights Cases.*

Eminent Domain–Compensation for Substantial Impairment of Riparian Owners' Right of Access Denied

Plaintiffs were owners of shipyards at the upper end of a navigable channel. After defendant, California Department of Public Works,[1] proposed to build highway bridges over the channel which would prevent a substantial proportion of the ships presently built at plaintiffs' yards from reaching deep water,[2] plaintiffs sought a declaratory judgment establishing their right to compensation under the eminent domain provision of the California constitution.[3] The trial court held that the proposed impairment of plaintiffs' access would

29. *See* cases cited notes 14, 16 and 27 *supra.*

1. Hereinafter referred to as "state."

2. The proposed bridges would be 45 feet above the water line; one plaintiff alledged that 81% of his business involves ships standing more than 45 feet above the waterline, and the other that such ships constitute 35% of his business. The channel is the sole means of access to deep water from plaintiffs' shipyards, and thus construction of the bridges would effectively deprive plaintiffs of much of their business. Colberg, Inc. v. State, 55 Cal. Rptr. 159 (Ct. App. 1966).

3. "Private property shall not be taken or damaged for public use without just compensation . . . ." CAL. CONST. art. 1, § 14.

not take or damage plaintiffs' property rights and granted the state's motion for judgment on the pleadings. The court of appeals reversed, holding that plaintiffs had an easement of access, the substantial impairment of which would constitute compensable damage.[4] On appeal to the Supreme Court of California, *held*, reversed. The property rights of riparian owners on navigable waterways are subject to the superior right of the state to use these waterways for the improvement of commerce and navigation, and their termination gives rise to no compensable taking or damage. *Colberg, Inc. v. State*, 432 P.2d 3, 62 Cal. Rptr. 401 (Sup. Ct. 1967).

Although California,[5] and almost every other state,[6] holds that a riparian owner has a right of access to the channel of the watercourse on which the land is situated, it does not necessarily follow that this right is a property right for which compensation is required when taken or damaged for public use. With respect to navigable waterways, the federal power over navigation, by virtue of the commerce clause of the Constitution, is superior to all other rights, and in the proper exercise of this power the riparian owner's access may be terminated without compensation.[7] This power has been explained as a dominant servitude, or dominant right, in the federal government,[8] burdening all riparian rights from their inception, and its exercise does not constitute a taking of private property.[9] The states possess a like power over navigation, subject only to the dominant federal right.[10] However, while the dominant servitude of the federal government rests only upon its power over navigation, the states, as holders of their navigable waters in trust for their citizens,[11] are not so confined; it is well within the powers of the state to "use the waters in behalf of the public for any purpose to which it could lawfully devote any other portion of the public domain."[12] Thus

4. Colberg, Inc. v. State, 55 Cal. Rptr. 159 (Ct. App. 1966).

5. San Francisco Sav. Union v. R.G.R. Petroleum & Mining Co., 144 Cal. 134, 77 P. 823 (1904) (riparian owner has right of access against private interference); Shirley v. Bishop, 67 Cal. 543, 8 P. 82 (1885) (right of access held a property right and interference with it may be enjoined).

6. 2 AMERICAN LAW OF PROPERTY § 9.48 (A.J. Casner ed. 1952); 2 H. TIFFANY, REAL PROPERTY § 665 (3d ed. 1939).

7. Scranton v. Wheeler, 179 U.S. 141 (1900) (riparian owner held to have no right to compensation for loss of access due to improvement in navigation); 2 P. NICHOLS, EMINENT DOMAIN § 5.7914[1] (rev. 3d ed. 1963) [hereinafter cited as NICHOLS].

8. *See, e.g.*, United States v. Willow River Co., 324 U.S. 499 (1945); United States v. Chicago, M., St. P. & P. R.R., 312 U.S. 592 (1941); Lewis Blue Point Oyster Cultivation Co. v. Briggs, 229 U.S. 82 (1913). *See also* Comment, *Federal Eminent Domain Power in the Development of Water Projects*, 50 YALE L.J. 668, 672 (1941).

9. Since the riparian owner takes his property subject to the servitude of the government, when that servitude is exercised he loses no rights which he had before.

10. *See* Shively v. Bowlby, 152 U.S. 1 (1894); 2 NICHOLS § 5.7914[2].

11. Shively v. Bowlby, 152 U.S. 1 (1894).

12. 2 NICHOLS § 5.792, at 260.

some states appear to recognize no private rights in connection with navigable waters as superior to the state's right to use those waters for any public purpose,[13] and in effect extend the dominant servitude to its fullest limits. However, the great majority of the decided cases limit the scope of the servitude to public actions connected with the improvement of navigation.[14] Yet, even those states which have recognized the private right of access as superior to public uses not in aid of navigation have consistently held that the right of access is to the channel fronting the owner's land, and obstruction of passage upstream or downstream deprives the riparian owner of the public right of navigation only, for which no redress can be had.[15] In California, the precise extent of the state's servitude had not been decided prior to the present case. Several decisions spoke of the state's power over navigable waters for the purposes of "*commerce* and navigation," and suggested, without clearly holding, that the scope of the servitude thus exceeded the traditional navigational limits.[16] However, a line of California highway cases could be construed to support a compensable private right of access. Just as the riparian owner has a right of access to the channel fronting his

13. Lovejoy v. City of Norwalk, 112 Conn. 199, 152 A. 210 (1930) (property right in oyster beds held subordinate to state's use of navigable water for sewage disposal); Nelson v. De Long, 213 Minn. 425, 7 N.W.2d 342 (1942) (private riparian rights held subordinate to public use of navigable waters for the "ordinary uses of life"); Crary v. State Highway Comm'n, 219 Miss. 284, 68 So. 2d 468 (1953) (private riparian rights of maintaining oyster beds and bathing subordinate to paramount right of public to construct highway bridge); Darling v. City of Newport News, 123 Va. 14, 96 S.E. 307 (1918) (public right to use navigable water for sewage disposal superior to private right in oyster beds), *aff'd*, 249 U.S. 540 (1919); 2 NICHOLS § 5.792.

14. 1 AMERICAN LAW OF PROPERTY § 9.48 (A.J. Casner ed. 1952); 2 NICHOLS § 5.792; 1 R. POWELL, REAL PROPERTY ¶ 160 (1949); 2 H. TIFFANY, REAL PROPERTY § 665 (3d ed. 1939).

15. *E.g.*, Moore v. State Rd. Dep't, 171 So. 2d 25 (Fla. 1965); Frost v. Washington County R.R., 96 Me. 76, 51 A. 806 (1901); Marine Air Ways, Inc. v. State, 201 Misc. 349, 104 N.Y.S.2d 964 (Ct. Cl. 1951); State *ex rel.* Andersons v. Masheter, 1 Ohio St. 2d 11, 203 N.E.2d 325 (1964); 2 NICHOLS § 5.792[1]. Apparently only one case has allowed recovery in such a situation. *In re* Construction of Walnut St. Bridge, 191 Pa. 153, *reported sub. nom.* Gumbes v. City of Philadelphia, 43 A. 88 (1899).

16. Several cases had also used the expression "for purposes of commerce, fisheries, and navigation" when speaking of the nature of the trust in which the navigable waters or tidelands were held. In all of the servitude cases, however, the factual situation involved what was apparently actual improvement of navigation. In no case did the word "commerce" appear to add to the scope of the dominant right of the state. *See* City of Newport Beach v. Fager, 39 Cal. App. 2d 23, 102 P.2d 438 (1940) (littoral owner held to have no right of access superior to state's right to fill tidelands for purpose of improving "commerce and navigation"); City of Long Beach v. Lisenby, 175 Cal. 575, 166 P. 333 (1917) (dredging and improving harbor held within public trust of "commerce and navigation"); Henry Dalton & Sons v. City of Oakland, 168 Cal. 453, 143 P. 721 (1914) (harbor improvement held within paramount right of state to improve "commerce and navigation").

land, distinct from the public right of navigation,[17] one whose land abuts the public streets has a right of access to them, apart from his right of passage along the streets as a member of the public.[18] The total deprivation of the landowner's access, as by obstruction or discontinuance of the street in front of the property for some public purpose, is almost universally held to be a taking or damage of private property requiring compensation under eminent domain provisions.[19] Where some other portion of the street is obstructed or discontinued, so that the land owner may still pass to the general system of streets in one direction, but not in the other—the so-called *cul-de-sac* situation—whether there is damage compensable under eminent domain provisions is a point upon which there has been considerable disagreement. Although perhaps the weight of authority denies recovery,[20] a number of courts have allowed compensation, usually upon a finding of injury different both in degree and kind from that suffered by the general public.[21] California, facing the *cul-de-sac* issue for the first time in *Bacich v. Board of Control of California*,[22] approached the problem from its most basic aspect. Reasoning that in cases of first impression public policy should control, the court weighed the underlying policy of eminent domain—the distribution of loss from public improvements over all the people rather than the individual—against the possibility that liberal granting of compensation might prevent beneficial public improvements, and held that a substantial impairment of access should be compensated.[23]

In the instant case, the majority, after pointing out that plaintiffs' claim to a private right of access went beyond traditional limits, declined to decide the scope of that right and rested its decision instead on the concept of servitude. After reviewing the California decisions

17. *See* notes 6 & 15 *supra*.

18. *See, e.g.*, People *ex rel.* Department of Public Works v. Russel, 48 Cal. 2d 189, 195, 309 P.2d 10, 14 (1957); Wenton v. Commonwealth, 335 Mass. 78, 80, 138 N.E.2d 609, 611 (1956); McMoran v. State, 55 Wash. 2d 37, 345 P.2d 598 (1959). *See generally* 3 NICHOLS § 10.221[2]; Kratovil & Harrison, *Eminent Domain—Policy and Concept*, 42 CALIF. L. REV. 596, 643 (1954).

19. *See* 2 NICHOLS § 6.4443, at 577-78.

20. *Id.* § 6.4443[3], at 582.

21. *See* Knowles, *Loss of Access: A Twentieth Century Enigma*, 6 ST. LOUIS U.L.J. 204, 209 (1960). It has often been pointed out that the decisions are varied in reasoning and often conflict, even in the same jurisdiction. *See* Note, *California and the Right of Access*, 38 S. CAL. L. REV. 689, 690 (1965). For a collection of the cases, generally sustaining the test of injury different in kind from that suffered by the public as a whole, see Annot., 49 A.L.R. 330 (1927), *supplemented by* Annot., 93 A.L.R. 639 (1934).

22. 23 Cal. 2d 343, 144 P.2d 818 (1943).

23. California, after appearing to have restricted the *Bacich* test for compensable damage in a later decision, People v. Symons, 54 Cal. 2d 855, 357 P.2d 451, 9 Cal. Rptr. 363 (1960), clearly reaffirmed it in two more recent cases. Breidert v. Southern Pac. Co., 61 Cal. 2d 659, 394 P.2d 719, 39 Cal. Rptr. 903 (1964); Valenta v. County of Los Angeles, 61 Cal. 2d 669, 394 P.2d 725, 39 Cal. Rptr. 909 (1964).

concerning the state's power over navigable waters for the purposes of commerce as well as navigation, the court reasoned that the servitude of the state should be coextensive with that power, and determined that the dominant servitude extended to public use of navigable waters for the improvement of highway commerce. The court characterized the limitation of the servitude to public uses in aid of navigation as an outmoded concept stemming "from a time when the sole use of navigable waterways for purposes of commerce was that of surface water transport," and emphasized that the demands of modern commerce required the rejection of such a restriction.[24] Stating that its decision was supported by both the prior California law and sound public policy,[25] the court dismissed the street access cases as not truly analogous because of the underlying differences between private rights in highways and in navigable waters.[26] Thus, viewing the construction of highway bridges as an exercise of the dominant property right of the state, the court held that no property was taken or damaged, and that consequently plaintiffs were not entitled to compensation. The dissent stated that as there was no compelling precedent in the California decisions, the analogy of the highway cases should be followed, and that if plaintiffs' right of access had in fact been substantially impaired, public policy demanded they be compensated.[27]

The court's decision in the instant case was undoubtedly based upon sound legal principles. The doctrine of dominant servitude in respect to navigable waters is firmly established, and it is unques-

24. 432 P.2d at 12, 62 Cal. Rptr. at 410.

25. The court did not clearly state what this public policy was; apparently it referred to the lower costs of public improvements made possible by not limiting the scope of the servitude to public uses in aid of navigation.

26. The court stated that as the casement of access accorded abutting owners arose from the historical development of roads as a means of providing access to the land, the policies applicable in the highway access cases are not in point when navigable waters are involved. 432 P.2d at 13, 62 Cal. Rptr. at 411. This view of the origin of the abutter's right of access is not clearly accurate, however. It appears, in fact, to have been first recognized in this country in the late 1800's, in a series of New York cases involving elevated railways. For a collection and examination of the cases, see Sauer v. City of New York, 206 U.S. 536, 546-56 (1907). The underlying reasons for its development have been variously explained as the "land service" concept, cited by the court, as judicial protection of the landowner's reasonable expectations that his access would remain unimpaired, and as a combination of these and other factors. *See* Comment, 3 STAN. L. REV. 298, 299-300 (1951); Kratovil & Harrison, *Eminent Domain—Policy and Concept*, 42 CALIF. L. REV. 596, 643 (1954); Covey, *Frontage Roads: To Compensate or Not To Compensate*, 56 NW. U.L. REV. 587, 596-97 (1961). Although certainly navigable waterways were not developed to "service" the individual abutter's land, it is quite likely that the other reasons equally apply to riparian as to highway access, and even if not, the reasoning of the court in *Bacich* was concerned not with the reason for recognition of the right, but with the actual loss suffered by the destruction or impairment of access.

27. 432 P.2d at 15, 62 Cal. Rptr. at 413.

tioned that the states may decide for themselves the extent of that servitude. In its decision, however, the court appears to have repudiated the basic reasoning employed in the highway access cases. The "sound public policy" that denied recovery to the plaintiffs in the instant case seems to be only one side of the balance of policies the court examined in *Bacich*. Although it is undoubtedly advantageous to the public as a whole to have the cost of public improvements reduced by denying compensation for injury to riparian landowners, this ignores the other side of the policy conflict: the loss sustained by the injured landowner. Whatever differences there may be between the riparian and abutting landowner's rights of access, the impairment of each results in injury to the landowner, an injury which the *Bacich* court suggested was more appropriately shared by the public than borne solely by the individual. In addition to recognition of the policy behind the eminent domain provision, the highway access cases provided a test to insure that in the individual case, compensation would not be too liberally granted: by requiring substantial impairment of access before compensation is given, frivolous claims which might unduly restrain the construction of beneficial public improvements are prevented. The instant court, faced with a choice of applying the liberal policy approach of *Bacich* or the rigid no-compensation policy inherent in the dominant servitude concept, chose the latter. In the words of the dissent: "If [the court] were right in the land access cases the majority are wrong in this case."[28]

Taxation—Professional Service Corporations—*Kintner* Regulations Held Invalid

Taxpayer, a lawyer, acquired ten per cent of the outstanding capital stock of his employer, Drexler and Wald Professional Company, an association of attorneys incorporated under the laws of Colorado.[1] On his federal income tax return for the year 1965, he reported as self-employment income ten per cent of the corporation's net income for the months during which he was a shareholder.[2] Contending that

28. *Id.* at 16, 62 Cal. Rptr. at 414.

1. COLO. R. CIV. P. 265, COLO. REV. STAT. ANN. ch. 22 (Perm. Cum. Supp. 1965). On December 5, 1961, the Colorado Supreme Court promulgated the rule permitting professional service corporations organized under the general corporation statutes of Colorado to conduct the practice of law. Drexler and Wald was incorporated on Dec. 29, 1961.

2. Taxpayer had been employed as a lawyer the entire year, but he was a shareholder only for the last two months. He appropriately reflected his salary payments for the first ten months as salary income.

the professional association should be regarded for federal tax purposes as a corporation rather than a partnership, the taxpayer then filed a claim for refund of the tax paid on his 1965 return which was attributable to the excess of the self-employment computation of income over the actual salary payments received as an employee of the corporation during the months in question. The Commissioner asserted that the taxpayer's employer more nearly resembled a partnership than a corporation when tested by the *Kintner* regulations,[3] and disallowed the refund on the basis that the taxpayer was accordingly a partner and not a salaried employee. On trial in the Federal District Court for the District of Colorado, *held,* judgment for the taxpayer. The definitions of partnerships and corporations in the Internal Revenue Code preclude the classification of incorporated professional associations as partnerships for federal tax purposes, and Treasury Regulation 301.7701 is invalid to the extent that it implies otherwise. *Empey v. United States,* 272 F. Supp. 851 (D. Colo. 1967).

For thirteen years the Internal Revenue Service has maintained a policy in conflict with the courts over whether professional service organizations may be accorded corporate status for federal income tax purposes. Ironically, the judicial interpretation of this issue has simply followed the precedent set by the successful argument of the Commissioner in *Pelton v. Commissioner,*[4] that an association of doctors operating a medical clinic should be held taxable as a corporation. The Commissioner was unable to overcome his *Pelton* argument in the case of *United States v. Kintner,*[5] even though under local law a corporation could not practice medicine. The Commissioner's contention that a state law prohibiting the practice of medicine by a corporation precluded the classification of a medical association as a corporation for federal tax purposes was likewise rejected in *Galt v. United States,*[6] which dealt with a factual situation in point with *Kintner.* The Commissioner's defeat in these cases was followed by

3. Treas. Reg. § 301.7701-2 (1965). These regulations required that a professional service organization, even if incorporated under state law, is taxable as a corporation only if it has sufficient corporate characteristics such that it more nearly resembles a corporation than a partnership.

4. 82 F.2d 473 (7th Cir. 1936), *aff'g* 32 B.T.A. 198 (1935).

5. 216 F.2d 418 (9th Cir. 1954) (organization of doctors operating clinic taxable as corporation).

6. 175 F. Supp. 360 (N.D. Tex. 1959), *appeal dismissed,* 5th Cir., Nov. 24, 1959. The original opinion in the *Galt* case contained no reference to any prior case, but rather was "determined under the elementary principles of justice." *Id* at 361. The taxpayer was also successful in the only other case that has dealt with this issue, Foreman v. United States, 232 F. Supp. 134 (S.D. Fla. 1964), where a similar unincorporated medical organization was held to be a *Kintner* association even though a corporation could not practice medicine in Florida. The Commissioner chose neither to appeal *Foreman,* nor to acquiesce. Eaton & Maycock, *Final Professional Corporation Regs Are An Improvement—But Not Much,* 22 J. TAXATION 208 (1965).

non-acquiescence[7] and the issuance in 1960 of the *Kintner* regulations,[8] which severely limited the possibility of finding a corporate resemblance for professional associations under the current state laws. The *Kintner* regulations viewed a corporation as an organization in which associates are united with an objective to carry on business and divide the gains therefrom, while possessing continuity of life, centralization of management, limited liability and free transferability of interests.[9] The existence of these "pure" corporate characteristics was to be determined individually by the applicable state laws.[10] Federal tax classification was then gauged by combining these local law determinations to require that "[a]n organization will be treated as an association if the corporate characteristics were such that the organization *more nearly resembles* a corporation than a partnership or trust."[11] These regulations were so designed to make it as difficult as possible for unincorporated organizations to be taxable as corporations.[12] However, the Commissioner had not fully closed the available remedies for tax-minded professional men,[13] and there developed a movement to alter the federal tax complications by enacting state statutes that would enable professional associations to

7. Rev. Rul. 23, 1956-1 CUM. BULL. 598.

8. Treas. Reg. § 301.7701-2, T.D. 6503, 1960-2 CUM. BULL. 413. The term "*Kintner* regulations" is not intended to imply that they follow the philosophy of that case, since in fact they repudiate the *Kintner* case, but rather it is the generally accepted name used to describe this specific portion of the regulations. Lewis, *Tax Treatment of the Professional Association*, 20 NAT. TAX. J. 227, 230 (1967).

9. Treas. Reg. § 301.7701-2(a) (1960). Because "associates" and an "objective to carry on a business for profit" are considered common to both partnerships and corporations, the Treasury states that the crucial characteristics are the remaining four. *Id.* at (a)(2). These six criteria are developed in Morrissey v. Commissioner, 296 U.S. 344 (1935), and since applied in Pelton v. Commissioner, 82 F.2d 473 (7th Cir. 1936), and United States v. Kintner, 216 F.2d 418 (9th Cir. 1954), *aff'g* 107 F. Supp. 976 (D. Mont. 1952).

10. Treas. Reg. § 301.7701-1(c) (1960). Local law determines whether the required corporate characteristics are in fact possessed—and can be legally possessed—by the organization in question. Snyder & Weckstein, *Quasi-Corporations, Quasi-Employees, and Quasi-Tax Relief for Professional Persons*, 48 CORNELL L.Q. 613, 656 (1963).

11. Treas. Reg. § 301.7701-2(a)(1) (1960) (emphasis added).

12. 272 F. Supp. 851, 852 (D. Colo. 1967); Sparber & Wolper, *The Current Status of Professional Corporations and Associations*, 19 J. AM. SOC'Y C.L.U. 197, 199 (1965); Note, *Professional Corporations and Associations*, 75 HARV. L. REV. 776, 779 (1962).

13. In addition to the private law benefits inherent in the corporate characteristics required by the *Kintner* regulations, there are specific tax advantages attached to corporate status, such as: (1) Contributions to a profit-sharing plan for benefit of "employees" of up to 15% of the employee's gross income ultimately would be returned with capital gains treatment. INT. REV. CODE of 1954, § 401(a). (2) Corporate employee can enter into a contract with the corporation to defer his income and achieve effective leveling of income. Rev. Rul. 31, 1960-1 CUM. BULL. 174. (3) A tax-free $5,000 death benefit can be given to the widow of a corporate employee. INT. REV. CODE of 1954, § 101(b). (4) Tax-free aceident and health programs are available. INT. REV. CODE of 1954, § 106. (5) Tax-free sickness and disability payments are also available. INT. REV. CODE of 1954, § 105.

satisfy the corporate characteristics required by the new regulations.[14] In response to this legislative movement, the Treasury amended the *Kintner* regulations in 1965. These amendments deleted the example found in the 1960 version which illustrated how seven doctors organized a tax-qualified association.[15] In addition, the Internal Revenue Service practically nullified the effect of the new state laws by inserting several sections directed at the "inherently different" professional corporations.[16]

The court in the instant case interpreted the 1965 *Kintner* regulations as requiring that Drexler and Wald, even though formally incorporated, be taxed as a partnership unless its corporate characteristics were such that it more nearly resembled a corporation than a partnership. This potential classification of an incorporated organization as a partnership was viewed as "inconsistent with the statutory definitions" of partnerships[17] and corporations.[18] Since the definition

14. The final regulations were promulgated on November 15, 1960, only three months before South Dakota enacted the first "professional corporation" statute, the Medical Corporation Act, S.D. Laws 1961, ch. 29, on February 25, 1961. Comment, *Professional Associations and Professional Corporations,* 16 Sw. L.J. 462, 466 n.29 (1962). Since that date 34 states have joined South Dakota by adopting similar "enabling acts," and legislation is pending in 14 additional states. Lewis, *Tax Treatment of the Professional Association,* 20 NAT. TAX J. 227 n.3 (1967).

15. Example 1, Treas. Reg. § 301.7701-2(g), T.D. 6503, 1960-2 CUM. BULL. 418, *deleted,* T.D. 6797, 1965-1 CUM. BULL. 554. This example had served as a blueprint for professional groups to qualify, so that in many cases the state statute's wording followed Example 1. 6 P-H 1967 FED. TAX SERV. ¶ 60,405. The now-deleted Example 1 contained substantially the facts of the *Galt* case. Lewis, *supra* note 8, at 230.

16. *E.g.* Treas. Reg. § 301.7701-1(c) (1965). "[T]he law of a state authorizing . . . a so-called professional service corporation . . . would not [classify] for purposes of taxation . . . a 'corporation' merely because the organization was so labeled under local law." *Id.* Also under a separate new subparagraph entitled "Classification of professional service organizations," the Treasury implements this position by stating that the "relations of the members of such an organization to each other as well as . . . [to all others] are *inherently different* from the relationships characteristic of an *ordinary* business corporation." Treas. Reg. § 301.7701-2(h)(1)(ii) (1965) (emphasis added). *See also* 272 F. Supp. 851, 852 (D. Colo. 1967). Thus the Treasury proposed to ignore the state label and to test the organization by the same, if not more stringent, standards. This attitude on the part of the Treasury was highly criticized in legal literature even to the extent that several writers seriously recommended that the modified *Kintner* regulations be ignored on the basis of their patent invalidity. Eaton, *Professional Associations as Planning Techniques,* N.Y.U. 24TH. INST. ON FED. TAX. 671 (1966); Lewis, *supra* note 8; Sparber and Wolper, *supra* note 12. The Internal Revenue Service granted a general amnesty for the period up to January 1, 1965, to allow all affected organizations *to be classified as they had properly filed in* Rev. Proc. 27, 1965-2 CUM. BULL. 1017. This was interpreted by Eaton, *supra* at 677, as a "tacit admission by the Service that the new [1965] Regulations are an attempt at 'administrative legislation' and that under Kintner and prior regulations the Service had almost no chance in court."

17. "The term 'partnership' includes a syndicate, group . . . *or other unincorporated organization* . . . which is *not* . . . a trust or estate or a *corporation* . . . ." INT. REV. CODE of 1954, § 7701(a)(2) (emphasis added).

18. "The term 'corporation' includes *associations,* joint-stock companies, and insurance companies." INT. REV. CODE of 1954, § 7701(a)(3) (emphasis added).

of "partnership" provided in the Internal Revenue Code refers only to "unincorporated" organizations, then incorporated associations are necessarily excluded.[19] "[N]either the statute nor the case law supports the Treasury's position"[20] that professional organizations must be taxed as partnerships and not as corporations. The court concluded that the *Kintner* regulations are inconsistent with the statute and that the regulations "constitute the exercise of a non-delegable legislative function and are invalid and unenforceable."[21] Therefore, Drexler and Wald was regarded as a corporation for federal income tax purposes, and the taxpayer was entitled to the refund. The court further asserted that even if it were assumed, arguendo, that the regulations were valid and enforceable, the corporate characteristics of the instant organization were such that the test of corporate resemblance was satisfied. The Treasury's position that professional organizations cannot meet such a test was thus not only contrary to the *Pelton* and *Kintner* cases, but also inconsistent with the facts as found by the court here.[22]

The principal case is the first decision to interpret the amended *Kintner* regulations and to deal with an actual professional corporation.[23] The application of the *Empey* decision must be limited to states which have permitted professional corporations, since only in these states could an organization be "necessarily excluded" from taxation as a partnership, even according to the broadest interpretation of this decision.[24] This emphasis upon the incorporation of the organization is crucial, for the instant court regarded the state's

19. 272 F. Supp. 851, 853 (D. Colo. 1967). (Chilson, J., added that the Commissioner had cited no cases which construe such an inconsistency, nor did any legislative history indicate a congressional intent to do so.)

20. *Id.* The court cited *Pelton*, *Kintner* and *Galt* with approval, and took judicial notice of Congress' refusal to "repudiate this uniform and long-standing construction of the statute." *Id.*

21. *Id.*

22. "Drexler and Wald has all the corporate characteristics of the associations in *Pelton* and *Kintner* and in addition is an incorporated organization." *Id.* at 854.

23. The case of Foreman v. United States, 232 F. Supp. 134 (S.D. Fla. 1964), while in a professional corporation state, dealt with an association formed prior to Florida's adoption of the statute. *See* note 6 *supra*. *Pelton*, *Kintner* and *Galt* similarly dealt with unincorporated associations.

24. The nine states which merely authorize *Kintner*-type associations are Alabama, Connecticut, Georgia, Illinois, Pennsylvania, South Carolina, Tennessee, Texas and Virginia. 5 P-H. 1967 FED. TAX SERV. ¶ 41,608. *See* Maier, *Don't Confuse Kintner-type Associations with New Professional Corporations*, 15 J. TAXATION 248 (1961). These states are soon to have their situation better defined in a case now pending in a Georgia federal district court. This case was not identified by style at 6 P-H 1967 FED. TAX SERV. ¶ 60,405. For a lengthy analysis of the Georgia statute, in which the law is said not to satisfy the test of the 1960 *Kintner* regulations, see Bittker, *Professional Associations and Federal Income Taxation: Some Questions and Comments*, 17 TAX L. REV. 1 (1961). Assuming the substantive validity of the 26 state professional corporation laws in effect, the *Kintner* regulations can be deemed effective in the 24 remaining states regardless of the final disposition of the instant case.

characterization of Drexler and Wald as a corporation under local law as determinative of the association's federal tax status. This approach disregards the well-established distinction between the designation of an organization by a state for private law purposes and the designation of an organization by the federal government for federal tax purposes. *Pelton, Kintner* and *Galt* have all recognized the principle that state law is not controlling of federal tax questions by explicitly rejecting the contention that the prohibition of such corporations by state law should control their federal tax classification.[25] If to preserve the uniformity of application of federal tax law, a state "can neither raise nor lower the federal taxes . . . by whatever name"[26] it chooses to label an organization, Drexler and Wald should not have been accorded corporate tax treatment merely on the basis of the label applied by the state. If, upon examination of the Colorado professional corporation statute and the professional corporation in question, the court could determine that, in substance, the organization possessed the essential corporate characteristics, the state's determination of the status of the association should be sustained. However, a thorough evaluation of the Drexler and Wald organization reveals that there may be a legitimate doubt as to the existence of limited liability and free transferability of interests. The Colorado Rule under which Drexler and Wald was incorporated provides that all shareholders shall be "jointly and severally liable" except during periods when the corporation maintains professional liability insurance.[27] The court found that Drexler and Wald did maintain the proper insurance coverage[28] and concluded that the nature of the liability of the shareholders was more similar to that of a corporate shareholder than of a partner.[29] However, the *Kintner* regulations provide that if a member remains personally liable under local law, limited liability would not be present, notwithstanding an indemnification agreement.[30] Moreover, the existence of free transferability of interests is also very doubtful. The court passed over the fact that the shareholders' right of transferability was restricted by the charter to transfers to the corporation or to lawyers who are actively engaged in the practice of law in the offices of the corporation. Certainly, a prohibition[31] against

25. United States v. Kintner, 216 F.2d 418, 422-24 (9th Cir. 1954); Pelton v. Commissioner, 82 F.2d 473, 476 (7th Cir. 1936); Foreman v. United States, 232 F. Supp. 134, 136 (S.D. Fla. 1964); Galt v. United States, 175 F. Supp. 360, 362 (N.D. Tex. 1959); *accord*, Burnet v. Harmel, 287 U.S. 103, 110 (1932). *See also* Treas. Reg. § 301.7701-1(c) (1965).

26. Galt v. United States, 175 F. Supp. 360, 362 (N.D. Tex. 1959).

27. COLO. R. CIV. P. 265(G), COLO. REV. STAT. ANN. ch. 22 (Perm. Cum. Supp. 1965).

28. 272 F. Supp. 851, 854 (D. Colo. 1967).

29. *Id.*

30. Treas. Reg. § 301.7701-2(d) (1965).

31. This should not be confused with the first-purchase option form of modified

selling the stock except to a narrowly limited group is so substantial a hindrance upon the free transferability of interests that the corporate characteristic does not exist under Treasury Regulation section 301.7701-2(h)(5) (1965). If one now applies the "more nearly resembles" test to the instant organization, it seems that the absence of free transferability, plus an unsure limited liability would make Drexler and Wald taxable as a partnership.

Taxation—Recovered Charitable Contributions, Previously Claimed as Deductions, Are Gross Income In Year of Receipt

Plaintiff corporate taxpayer made charitable contributions of realty in 1939 and 1940[1] and claimed federal income tax deductions on the donations.[2] In 1957, the donee reconveyed the property, and the taxpayer, characterizing the transaction as a nontaxable return of capital, did not include the recovery in its 1957 gross income. The Commissioner of Internal Revenue viewed the transaction as giving rise to taxable income and adjusted the plaintiff's gross income by adding the total of the charitable contribution deductions previonsly claimed and allowed.[3] Plaintiff paid the resulting deficiency assessment and filed a claim for refund of the difference between the assessment and the original tax benefit,[4] asserting that the assessment could not exceed the tax benefit enjoyed. On decision by the United States Court of Claims, *held*, refund denied. Recovered charitable contributions are includable in gross income to the full amount of tax-saving deductions previously claimed and allowed, and taxed at the current rate in the year of recovery. *Alice Phelan Sullivan Corp. v. United States*, 381 F.2d 399 (Ct. Cl. 1967).

free transferability permitted by Treas. Reg. § 301.7701-2(e)(2) (1965). The instant contract was a further limitation beyond that form, which is also included in this contract. Hence, the Colorado law itself might satisfy the regulations, but Drexler and Wald eliminated all the transferability required.

1. The donations were subject to the condition that the property would be used either for religious or educational purposes.

2. "'[C]haritable contribution' means a contribution or gift to or for the use of . . . . A corporation, trust, or community chest, fund, or foundation . . . organized and operated exclusively for religious . . . or educational purposes . . . ." INT. REV. CODE of 1954, § 170(c).

3. The deductions claimed in the instant case were $4,243.49 for 1939 and $4,463.44 for 1940. The tax rate was 24% in 1940, and 18% in 1939. The corporate tax rate in 1957 was 52%, causing a deficiency assessment of $4,527.60 (.52 x $8,706.93). The aggregate tax benefit for the deductions had been $1,877.49.

4. The alleged overpayment of taxes amounted to $2,650.11 ($4,527.60 minus $1,877.49). *See* note 3 *supra*.

The tax treatment of recovered deductions, especially those representing recovery of capital property, has long been a source of legal conflict between the government and taxpayers. The government first contended that all such recoveries must be treated as gross income.[5] However, the Board of Tax Appeals developed the Tax Benefit Rule[6] which limited includable recoveries to those representing previous deductions which actually gave rise to a tax savings,[7] while some federal circuit courts continued to view all reconveyances of former deductions as giving rise to gross income.[8] Congress stepped into the conflict with section 116 of the Revenue Act of 1942 (now section 111)[9] which applied the judicially-developed Tax Benefit Rule to three types of recoveries: bad debts, prior taxes and delinquency amounts, and the following year the Supreme Court indicated that the Tax Benefit Rule was not confined to the three statutory categories of the 1942 enactment.[10] This interpretation was subsequently embodied in Treasury Regulations[11] which applied the rule to "all

5. Rothensies v. Electric Storage Battery Co., 329 U.S. 296 (1946); Block v. Commissioner, 39 B.T.A. 338 (1939), *aff'd sub nom.* Union Trust Co. v. Commissioner, 111 F.2d 60 (7th Cir.), *cert. denied,* 311 U.S. 658 (1940). It has been held that when the taxpayer once claimed a deduction which saved tax money by offsetting income, he is estopped to deny its recovery is income. Philadelphia Nat'l Bank v. Rothensies, 43 F. Supp. 923 (E.D. Pa. 1942). Another justification has been that the taxpayer, when taking the deduction, impliedly consented that its recovery would be treated as income. Helvering v. State-Planters Bank & Trust Co., 130 F.2d 44, 46 (4th Cir. 1942). "[T]he assertion is made that such debts, though ascertained to be worthless and actually charged off on the taxpayer's books in a particular year, should not be reflected in the computation of tax liability unless the deduction of the bad debt actually reduces the taxpayer's taxable income. With this we can not agree." Lake View Trust & Savings Bank, 27 B.T.A. 290, 292 (1932).

6. "Tax benefit" indicates that the tax deduction actually resulted in a tax savings. This is the essential factor in the Tax Benefit Rule: all recoveries of previously claimed tax deductions are included in gross income of the year of recovery to the full extent of the tax benefit derived therefrom. For another view of the Tax Benefit Rule, see I. T. 3172, 1938-1 CUM. BULL. 150.

7. Amsco-Wire Prods. Corp., 44 B.T.A. 717 (1941) (cancellation of accrued salary).

8. "There is nothing in the regulation or in any statute which makes the inclusion in gross income of collections of bad debts, previously charged off as worthless, dependent upon whether or not the charge off has resulted in a tax benefit to the taxpayer." Helvering v. State-Planters Bank & Trust Co., 130 F.2d 44, 46 (4th Cir. (1942); *accord,* Commissioner v. United States & Int'l Sec. Corp., 130 F.2d 894 (3d Cir. 1942). *See* Plumb, *The Tax Benefit Rule Today,* 57 HARV. L. REV. 129, 133 (1943).

9. INT. REV. CODE of 1939, § 22(b)(12) (now INT. REV. CODE of 1954, § 111). There is a limit to the amount of such recoveries which is includible in current gross income. This restriction is the amount of the deduction claimed in the prior year which did in that year and has since actually produced a tax benefit. The technical term for this boundary is the "recovery exclusion." *See* INT. REV. CODE of 1954, § 111(b)(4).

10. "A specific statutory exception was necessary in bad debt cases only because the courts reversed the Tax Court and established as matter of law a 'theoretically proper' rule which distorted the taxpayer's income [*i.e.* taxation of a recovery though no benefit may have been obtained through its earlier deduction]." Dobson v. Commissioner, 320 U.S. 489, 506 (1943).

11. T.D. 5454, 1945 CUM. BULL. 68, *as amended,* Treas. Reg. § 1.111-1 (1956).

other losses, expenditures, and accruals" which had at one time been claimed as deductions from income. Although deciding that only tax benefit recoveries would be includable in gross income, these developments left unresolved the problem of whether the recoveries would be taxed at the rate applicable in the year of the deduction or the current rate in the year of recovery. The problem can be viewed as a conflict between an "annualization" and a "transactional" approach by taxation. *Burnet v. Sanford & Brooks Co.*[12] favored the concept of accounting for expense and income on an annual basis as being the most practical in producing a regular flow of income to the government and in establishing feasible methods of accounting, assessment, and collection. Under this approach: "[E]ach taxable year must be regarded as an independent unit for income tax purposes."[13] The "transactional" approach would permit tax accounting to determine income with a recognition that some commercial transactions stretch over several years but result in a payment in only one year. Therefore, tax considerations should not be confined to the boundaries of a single year.[14] The Court of Claims, in *Perry v. United States*,[15] seemed to follow the transactional approach. Stating that it was

The *Dobson* case and Treasury Regulation § 1.111-1 indicate that the tax benefit statute did not include all of the categories of recovery to which the judge-made rule applied. However, they left unanswered questions as to whether all provisions of the statutory Tax Benefit Rule were present in the judge-made rule. For instance, the statute would include in taxable income only that part of the deduction which had caused a tax savings. Under the judges' rule, it was not clear whether, if only a part of the deduction caused a tax savings, the entire recovery would be income. It could be important in a case where, in a loss year, the total deductions exceeded income. If the subject of the deduction were not one of the three listed in § 111 and if only a small amount of the deduction were to cause a tax savings, would the entire recovery be included in income? A case decided under the judicially-designed rule seven months before the 1942 statutory rule was enacted seems to indicate that the recovery would be taxed only to the extent of benefit derived. Philadelphia Nat'l Bank v. Rothensies, 43 F. Supp. 923, 926 (E.D. Pa. 1942). Yet, when the Board of Tax Appeals presented this proposition, the Fourth Circuit overruled it. Helvering v. State-Planters Bank & Trust Co., 130 F.2d 44, 45 (4th Cir. 1942). The instant case dealt with a deduction which had caused full tax benefit, but dictum in the opinion seemed to indicate that if any tax saving was obtained, the extent is unimportant. The entire recovery will be taxed. Alice Phelan Sullivan Corp. v. United States, 381 F.2d 399 (Ct. Cl. 1967). Such a ruling would seem to defeat the equitable purpose of the Tax Benefit Rule, under both its judicial and statutory development, which was to limit the general rule of taxing all recovered deductions regardless of benefit derived.

12. 282 U.S. 359, 365-66 (1931). Taxpayer failed to utilize two existing code methods to reflect net profit or loss from a long-term contract. Expenses were not permitted to off-set a judgment awarded under the contract in a later year.

13. Helvering v. State-Planters Bank & Trust Co., 130 F.2d 44, 46 (4th Cir. 1942).

14. 8 DUKE L.J. 151 (1959).

15. 160 F. Supp. 270 (Ct. Cl. 1958). The facts were nearly identical to the instant case. In 1944-48 the taxpayers had donated funds to a city for an addition to its library. They deducted accordingly from their gross income and received full tax benefits. In 1953 the city returned the total funds. Taxpayers did not include recovery in their gross incomes.

"inequitable" to require taxpayers to pay more upon recovery than the tax benefit derived from the charitable deduction. In *Perry,* the taxpayers were directed to exclude the recovery from their gross income and to add to their current income tax the amount by which their taxes had been previously reduced due to the deductions. Thus the court achieved the same result as would have followed from an application of the Tax Benefit Rule with a use of the tax rate applicable in the year of deduction. A vigorous dissent would have classified the recovery as income and used the tax rate of the year of recovery. Although the transactional approach gave a more equitable result, the Internal Revenue Service felt *Perry* conflicted with judicial authority and refused to follow the decision.[16] The status of the law regarding the applicable tax rate for recovered deductions became confused in 1961, when the Court of Claims held[17] that the rate current in the year of recovery is applied to recoveries under the statutory tax benefit rule of section 111 of the Code (that is, to recoveries of bad debts, prior taxes, or delinquency amounts).

In determining the proper tax treatment to be given to a recovered charitable contribution, which had been the subject of prior tax-saving deductions, the court in the instant case identified the problem as identical to that in *Perry v. United States.*[18] The court recognized as "well engrained in our tax law" the principle that a gift of property, once taken as an income tax deduction, must be treated as income in the year of recovery.[19] Since the instant recovery had caused full tax deductions, the court concluded that the entire recovery must be included in current gross income. In solving the question of which tax rate was applicable—the rate at time of deduction or at time of recovery—the annualization approach of *Burnet v. Sanford & Brooks Co.*[20] was followed. The Court of Claims felt that our tax system demands not only that income be determined without consideration of losses sustained in earlier years, but also that it be taxed without reference to the rates in those years. Because of the absence of specific statutory permission to do otherwise, the court overruled the *Perry* decision and applied the tax rate of the year of recoupment to the entire recovery.

The decision reached in the instant case was admitted by its author to have produced a "harsh and inequitable result."[21] Although the

16. Rev. Rul. 59-141, 1959-1 CUM. BULL. 17. *See also* 1 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 7.37 (1962).

17. Citizens Fed. Sav. & Loan Ass'n v. United States, 290 F.2d 932, 937 (Ct. Cl. 1961).

18. 381 F.2d at 400.

19. 381 F.2d at 401.

20. 282 U.S. 359 (1931).

21. 381 F.2d at 403, n.5.

Court of Claims felt a necessity for specific statutory authorization before it could render a different verdict, there are compelling arguments that the judiciary possesses the power to render a more equitable conclusion. The court could have taken a less restrictive approach, emphasizing the congressional purpose in originally permitting the deduction. However, by requiring more taxes upon recovery than the tax benefit derived by the deduction, the instant decision seems to have defeated the statutory purpose of encouraging gifts to charity by allowing such tax deductions. This result is caused by two factors: the tax rate in recovery year is higher than in deduction year, and the taxpayer may be forced into a higher tax bracket by recouping in one year what was deducted in several. Also, the nature and development of the Tax Benefit Rule itself is contrary to such an inequitable conclusion. The general principle requiring taxation of recoveries previously deducted was to prevent unjust enrichment of the taxpayer. The judicially-designed Tax Benefit Rule was originated to mitigate harsh consequences where the deduction had caused no benefit. Therefore, judges should continue to enforce the Tax Benefit Rule so as to avoid inequitable conclusions, even if this requires applying the tax rate of the deduction year. The annualization concept of taxation is not such a rigid principle as to require the result in this case. By looking to other years to determine whether the deduction actually caused a tax savings and should be counted as income, the Tax Benefit Rule itself modifies the annual concept.[22] Moreover, the silence of section 111 on the applicable tax rate is no bar to this action by the courts. It is true that Congress did not expressly grant requests that taxes upon recovery be limited to the dollar amount of taxes saved by the deduction,[23] but Congress also ignored pleas to include areas other than bad debts, taxes, and delinquency amounts in section 111.[24] The Supreme Court was not deterred from declaring that the judge-made Tax Benefit Rule applied to areas other than those enumerated in section 111.[25] The complete silence of the statute regarding the applicable tax rate is a stronger argument that courts can exercise their discretion, as the *Perry* court did. However, if this problem is left to Congress, that body could and should provide a remedy. A provision for returned contributions similar to that created for treating unconstitutional federal taxes returned or cancelled[26] is one possibility. It gives the taxpayer an

22. *See* authorities cited in notes 6 and 7 *supra.*

23. *Hearings on Revenue Revision of 1942 Before the Senate Comm. on Finance,* 77th Cong., 2d Sess. 1422-23, 1784, 1802 (1942). This legislation was the origin of what is now § 111.

24. *Id.* at 706, 1499-1500, 2145-46.

25. Dobson v. Commissioner, 320 U.S. 489, 506 (1943).

26. INT. REV. CODE of 1954, § 1346.

option to treat the prior deduction as erroneous and the recovery as non-taxable if he consents to a deficiency assessment for the prior year. An alternative would be legislation requiring a solution such as that arrived at in the *Perry* decision. Similar treatment has been given to recoveries caused by mistaken belief in another's claim of right.[27]

27. INT. REV. CODE of 1954, § 1342.