Marquette Law Review

Volume 11
Issue 3 *April 1927*

Article 2

Constitutionality of Federal Gift Tax

James T. Guy

CONSTITUTIONALITY OF FEDERAL GIFT TAX

JAMES T. GUY*

THE United States Supreme Court is being called upon to pass definitely on the constitutionality of the Federal Gift Tax. This (Revenue Act of 1924, Section 319-324, 43 Stat. L. 253, 313-316) became effective June 2, 1924, and was repealed by the Revenue Act of 1926. It provides in part:

Sec. 319. For the calendar year 1924 and each calendar year thereafter, a tax equal to the sum of the following is hereby imposed upon the transfer by a resident by gift during such calendar year of any property wherever situated, whether made directly or indirectly, ...

Considerable revenue was collected for the two years that the Act was in effect.

Since this Act was passed there has been considerable discussion among lawyers and text writers as to its constitutionality. The taxation of gifts *causa mortis* is not unusual, but never before has there been any attempt to impose a tax upon gifts *inter vivos.*

Several suits have been started to test the constitutionality of the act with the result that so far the federal judges who have considered the question have been unable to agree. Two District Court judges have held the act unconstitutional; one has held it constitutional. One Circuit Court of Appeals has held it constitutional and another has certified the question to the United States Supreme Court without decision.

The first decision was by Judge A. N. Hand of the District Court of the Southern District of New York—*Geo. McNeir* v. *Charles W. Anderson.*[1] This court held the tax unconstitutional on the ground that it was a direct tax. The Court said:

There is, I believe, no case where such a tax as the one now under consideration has been regarded as a tax upon an excise or privilege. Moreover, so far as I can discover, it is a form of taxation new in both America and Europe. Testamentary gifts and gifts in contemplation of death have been, both in England and in the United States, treated as excises, and subjected to taxation upon that theory. If there is anything left of the general views of the court in *Pollock* v. *Farmers' Loan and Trust Company,* 158 U.S. 601, as to the nature of so-called direct taxes, the tax upon a gift not made in contemplation

* Member of the Milwaukee Bar.

[1] 10 Fed. (2nd) 813.

of death and not to take effect upon death would seem to be necessarily a direct tax imposed upon the donor purely as the owner of property.

. . . . . .

The tax under consideration seems to have no more warrant than that before the Supreme Court in the recent case of *Dawson* v. *Kentucky Distilleries,* 255 U.S. 288. There the tax was described as a license tax of persons engaged in the business of owning and storing whiskey in bonded warehouses. The Supreme Court, however, held that the tax was really one on the right to take possession and remove whiskey from a bonded warehouse and was a direct tax upon property and not upon an occupation or license. Mr. Justice Brandeis said in the opinion:

"To levy a tax by reason of ownership of property is to tax the property. . . . . It cannot be made an occupation or license tax by calling it so."

About the same time Judge Raymond of the United States District Court of the Western District of Michigan reached the opposite conclusion in the case of *John W. Blodgett* v. *Charles Holden.*[2] The court was of the opinion that the tax was on the transmission or transfer itself and not on the property, nor on the right to transfer, and that hence it was an excise tax as distinguished from a direct tax and therefore did not need to be apportioned. This court further held that the retroactive feature of the law, i.e., its application to all gifts made during the calendar year of 1924, although the law did not become effective until June 2, 1924, was not an abuse of congressional powers nor the taking of property without due process of law and therefore not in violation of the Fifth Amendment to the Federal Constitution.

That case also involved the question as to whether state and municipal securities could be taxed. The court held that the act of the federal government in taxing such securities was not an unlawful interference with governmental functions and did not violate the Tenth Amendment to the Constitution.

The *McNeir* case was appealed to the Circuit Court of Appeals for the second circuit and was reversed. Volume 3, Commerce Clearing House, Federal Tax Service 1927, paragraph 7073. The court held that the tax is not a direct tax but an excise tax on one of the uses of property and the fact that it is retroactive does not make it unconstitutional. The court says that power to lay and collect taxes, duties, imposts and excises is exhaustive and embraces every conceivable power of taxation; that there is not to be found in the cases, a clear definition of precisely what is meant by either a direct tax or an excise tax. It has become a rule of application to each particular tax, and is not to be answered by the theories of political economists. It further holds that

[2] 11 Fed. (2nd) 180.

the tax is not imposed because of general ownership of the property, but because of the happening of an event. The transfer of the property by gift gives rise to its levy. The excise imposed is like the act of using property or selling property, and the single use of property—the gift of it—which is a use the owner may make, may furnish the occasion for laying a valid excise.

The court's comments on the retroactive feature of the tax are very brief. It states that Congress has the power to enact retroactive tax legislation and in view of the clear language of the statute and its positive direction there can be no doubt that a gift made any time after January 1, 1924, is taxable under the statute. This, of course, presupposes that the tax is an excise rather than a direct tax.

The *Blodgett* case was also appealed. The Circuit Court of Appeals for the sixth circuit, without attempting to decide the questions involved, certified the questions to the United States Supreme Court.

Judge Geiger, in the District Court for the Eastern District of Wisconsin, decided two cases in the latter part of December: *LeFeber* v. *Wilkinson* and *Nunnemacher* v. *Wilkinson*. Both these cases involved the constitutionality of the gift tax. In both cases the gifts were made before the passage of the Act. While all the constitutional questions were argued the judge passed on only the retroactive feature of the Act. The court says in part:

> Now, when that is so, the question is particularly asked. Here are the gifts made in February and May, 1924, prior to the passage of this act. It seems absurd to say that the Nunnemacher and LeFeber donors should be told on June 2, 1924, that they are now subjected to an excise upon an act wholly beyond their power to revoke, recall, or do a thing in respect to what they had previously done; and how then can you escape the idea, although it is called an excise, that it is nothing more or less than a direct tax, either against their property or against them, in respect of a completed transaction, which, if I might put it that way, at the time Congress passed the law was no longer, as to them, *excisable?*

The plaintiffs took judgment in each of these cases and the government appealed to the Circuit Court of Appeals for the seventh circuit where the cases are now pending.

Some of the arguments raised in the briefs on the part of the various taxpayers are these:

(*a*) The act being retroactive is unconstitutional in that it deprives the taxpayer of his property without due process of law in violation of the Fifth Amendment.

(*b*) The tax is a direct tax, a tax on property, and since it is not apportioned it violates Article 1, Section 9, subdivision 4, of the United States Constitution.

(*a*) The Fifth Amendment to the Federal Constitution provides that no person shall be deprived of life, liberty or property without due process of law. In the case of *Levy* v. *Wardell*,[3] the United States Supreme Court in construing the 1916 Estates Tax Act held that if the Act were construed as being retroactive it was unconstitutional in view of the Fifth Amendment. That Act provides that the gross estate should include for taxation purposes all gifts made "at any time" in contemplation of or intended to take effect in possession or enjoyment at death. As to gifts made before the passage of this Act the court (p. 544) said that if the act was construed as retroactive it:

> Was in violation of the Constitution of the United States in that it would take the property of plaintiffs without due process of law in violation of the Fifth Amendment. . . . .

The United States District Court for the District of Massachusetts in *Coolidge* v. *Nichols*,[4] held Section 402c. of the Revenue Act of 1919 —the retroactive section as to gifts *causa mortis*—unconstitutional and void insofar as it attempts to impose a tax on transactions entirely completed before the passage of the Act.

The United States District Court for the Western District of Pennsylvania in *Frick* v. *Lewellyn*,[5] held section 402f. of the Revenue Act of 1918 violative of the Fifth Amendment in that the state attempted to collect taxes on the avails of life insurance policies which were vested in a third person and did not pass through the estate.

On the other hand, there are cases holding that the retroactive feature of the 1918 Federal Estates Tax is constitutional. However, apparently the conveyances covered by those cases were not final and complete and did not vest in full possession and enjoyment until the death which occurred after the passage of the Act.

If the retroactive features of the Estates Tax Law is violative of the Fifth Amendment it would seem that the same reasoning would apply to the Gift Tax.

(*b*) Article 1, Section 9, subdivision 4, of the United States Constitution provides that no capitulation or other direct tax shall be allowed unless in proportion to the census or enumeration heretofore directed to be taken.

The principal reliance of the taxpayers is upon the case of *Pollock* v. *Farmers Loan & Trust Co.*,[6] which holds that taxes on the income from realty or personalty and taxes upon personal property are direct

[3] 258 U.S. 542.
[4] 4 Fed. (2nd) 112.
[5] 298 Fed. 803.
[6] 158 U.S. 601.

taxes; and also upon *Dawson* v. *Kentucky Distilleries Co.*,[7] which holds that a tax on persons at so much per gallon for withdrawing whiskey from a bonded warehouse for consumption or sale, is a direct tax upon the property itself.

Also *Levy* v. *Wardell*,[8] where the court directly held that the 1916 Estates Tax Act was a direct tax insofar as it applied to gifts made before its passage. The court states (p. 544-5) that if the law should be construed as retroactive it

> would not be . . . . a transfer tax or indirect tax, but would be a direct tax thereon in violation of Article 1, Section 9, subdivision 4, of the Constitution of the United States because not laid, in proper relation to census or enumeration as therein provided.

This is the most direct and positive holding that a gift tax is a direct tax.

It is also contended that the case of *Schlesinger* v. *Wisconsin*[9] directly supports the contention that the gift tax is a property tax. The court holds that the Wisconsin law, Section 72.01, is unconstitutional, that is, that part of the law which creates a conclusive presumption that gifts made within six years of death are made in contemplation of death. This part of the Act is a gift tax. In the *Estate of Ebeling*,[10] the Wisconsin court says that it is immaterial whether this is considered a tax on gifts *inter vivos* or on gifts *causa mortis*. In other words, as the law relates to gifts not actually made in contemplation of death it is a gift tax as distinguished from inheritance tax. It is this law, that is the law taxing gifts *inter vivos*, that the United States Supreme Court holds unconstitutional in the *Schlesinger* case for two reasons: First, it creates an arbitrary classification in violation of the Fourteenth Amendment in that it taxes gifts made within six years before death while it does not tax other gifts, and "secondly, they are subjected to graduated taxes which could not properly be laid on all gifts, or indeed, upon any gift without testamentary character." The Fourteenth Amendment does not affect the Federal Gift Tax but the *Schlesinger* case is important in that it holds that a gift tax not being testamentary in character is unconstitutional if it is graduated. This shows that the Supreme Court considers the Wisconsin Tax—in effect a gift tax—as a property tax rather than an excise tax. This must be so because it has always been held that an excise tax may be of graduated character. *Magoun* v. *Illinois Trust and Savings Bank*.[11] If the court had con-

[7] 255 U.S. 288.
[8] 258 U.S. 542.
[9] 46 Sup. Ct. 260.
[10] 169 Wis. 432.
[11] 170 U.S. 283.

sidered the Wisconsin tax an excise tax it would not have held it unconstitutional on the second ground named i.e., because of its graduated character.

It will be seen from this brief résumé of the cases that there is a good deal of confusion among the courts as to the constitutionality of the tax in question, and the decision of the United States Supreme Court is therefore awaited with a great deal of interest by all lawyers interested in taxation and constitutional questions.