Federal Taxation of Community Incomes—The Recent History of Pending Questions

George Donworth
University of Washington School of Law

Follow this and additional works at: https://digitalcommons.law.uw.edu/wlr

Part of the Taxation-Federal Commons

Recommended Citation
Available at: https://digitalcommons.law.uw.edu/wlr/vol4/iss4/1

This Article is brought to you for free and open access by the Law Reviews and Journals at UW Law Digital Commons. It has been accepted for inclusion in Washington Law Review by an authorized editor of UW Law Digital Commons. For more information, please contact cnyberg@uw.edu.
FEDERAL TAXATION OF COMMUNITY INCOMES—
The Recent History of Pending Questions

By the constitution of the United States, the Congress has power to lay and collect taxes, to pay the debts and provide for the common defense and general welfare of the United States. The constitution, however, also contains the further provision that no capitation or other direct tax shall be laid unless apportioned among the states in proportion to the population as ascertained by a federal census. In the year 1895 in Pollock v. Farmers Loan & Trust Co., 157 U. S. 429, 158 U. S. 601, 39 L. ed. 759, 39 L. ed. 1108, the Supreme Court of the United States decided that an income tax is a direct tax and as a consequence that Congress could not impose such tax unless apportioned among the states.

As a result of this decision, a long continued agitation arose for a constitutional amendment which would permit the levying of a federal income tax without apportionment. The movement for the constitutional change was successful and on February 25, 1913, there took effect the Sixteenth Amendment reading:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

The first income tax law passed pursuant to this new federal power was enacted in 1913. Ever since that year there has been in force a federal income tax law, but the terms and provisions relating to the tax and its imposition have been changed seven times by the new statutes passed in 1916, 1917, 1918-19, 1921, 1924, 1926 and 1928.

Soon after the enactment of the first statute, taxpayers residing in states where the system of community property prevails asserted
that since husband and wife have an equal proprietary interest in such incomes as by state laws are defined to be community property, their federal income tax returns should truthfully reflect this joint ownership and that consequently husband and wife should file separate returns, each spouse accounting for the ownership of one-half of the entire community income.

There are eight community property states, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington. In all of these states except California, the wife's interest in the community property and income (however income may be defined) is recognized by the statutes and decisions as a vested property right equal in all respects to the property right of the husband.

In California, as will be hereinafter shown, the rule in the past has been different. In that State (prior to the modifications and changes in the California Community Property Law made by recent statutes) it seems that the wife had no vested interest in the community property, her interest therein being a mere expectancy. I have not examined the recent California statutes but I am informed that in one of them the California Legislature adopted a specific declaration of its intent to create a vested interest in half of the community property in the wife. The references made in this paper to the state of the California law are intended to refer to that law as it existed under former statutes and State decisions. It is said that a new test case is being arranged in California to determine whether, in the light of the new legislation, the wife in California now has a vested interest in the community property so as to change the rule laid down by the Supreme Court of the United States in U S. vs. Robbins 269 U. S. 315, 70 L. ed. 285. As this paper is intended to be a chronicle of the conditions leading up to the present situation, the references hereinafter made to the California law, as existing at the time of the court rulings hereinafter mentioned, are not to be deemed as in any way intimating that the present status of the California system would not now call for a rule different from that laid down in the Robbins case.

In Spreckels v. Spreckels, 116 Cal. 339, in 1897, the Supreme Court of that state held that the wife's interest was a mere expectancy, and as to all the world except the wife, there was no distinction between the community estate and separate estate of the husband, that the amendment of 1891, forbidding the husband to give away community property without the wife's
written consent did not change the nature of the title, but merely imposed a restraint upon alienation so far as concerned gifts of community property.

In 1908 the Supreme Court of California held in *Estate of Moffitt*, 153 Cal. 359, 95 Pac. 653, 1025, 20 L. R. A. (N. S.) 207, that since the wife had no vested interest in the community estate and took her one-half on the death of her husband as his heir, the wife must pay an inheritance tax on the share of the community property so accruing to her on the death of her husband. This case was taken to the Supreme Court of the United States (*Moffitt v. Kelly*, 218 U. S. 400, 54 L. ed. 1086) where the judgment of the lower court was affirmed, the court laying down the rule that the nature and character of the rights of the wife in community property for the purpose of taxation constitute a peculiarly local question, and that the determination of the state court in regard thereto was not reviewable by the Federal Supreme Court. There have since been some further statutory changes in California, and I shall not attempt to define their purpose or effect.

A general discussion and consideration of the decisions affecting the rights of the wife in community property in California may be found in the case of *Stewart vs. Stewart*, 199 Cal. 318, 249 Pac. 197, decided in 1926.

Though the first federal income tax statute took effect in 1913, the question of the right of husbands and wives to file separate returns for community income in any of the states does not appear to have been the subject of an official ruling until April, 1920, in Office Decision No. 426, reported at 2 C. B. 198. That decision gave specific recognition to the community property laws of two states, Texas and Washington, and authorized returns dividing the income between husband and wife so far as concerned the income of accumulated community property, but not as to current earnings. About a year earlier than this Office Decision concerning income tax, there appeared Treasury Decision No. 2450, recognizing that one-half of the common estate belongs to each spouse in determining the method of assessing the federal estate tax upon the estate of a decedent spouse.

It should be also noted that as early as 1914 Treasury Decisions 2090 and 2137, without any reference to community property, established that under the Revenue Act "the income of husband and wife should not be combined in a return of income for the purpose of assessing the additional or surtax," and that "the addi-
tional or surtax imposed by the act will be computed on the basis of the income of each individual,’” and that these decisions have never been modified.

The ruling of Office Decision 426 in April, 1920, giving only partial recognition to the community property system for income tax purposes was unsatisfactory. At the suggestion of parties in interest, the Secretary of the Treasury requested the opinion of the Attorney General.

On September 10, 1920 (date sometimes given as August 24, 1920), Attorney General A. Mitchell Palmer in complying with this request of the secretary, rendered an important opinion concerning rights of husbands and wives domiciled in Texas, 32 Opinions of Attorneys General 229. The opinion is not long, but it shows a careful investigation of the constitutional provisions, statutes and decisions of the state of Texas and a thorough appreciation of the line of demarcation between the province of federal legislation and the province of state legislation in applying the provisions of the Sixteenth Amendment and the statutes enacted thereunder. In defining the nature of the community in Texas and the rights of the spouses therein, the Attorney General said

“‘Their relation partakes of the nature of a partnership in which each partner may have separate estates, or property, as well as common stock of acquisitions and gains. The business of the firm generally is transacted in the name of the husband, and he prosecutes and defends its suits with the same effect as if his partner were named in the case (Simpson v. Brotherton, 62 Tex. 170), and although community property has not all the incidents of partnership property, it has many of them, and is commonly spoken of as partnership property. The fact that one or the other of the spouses may do all the work does not change the character of community property (Yates v. Houston, 3 Tex. 452, 454) And though the management and disposal of community property during marriage are usually given to the husband, this is said to be for reasons of public policy and social economy, and not on the grounds that the husband has any greater interest in it than the wife.’”

The opinion then proceeds to quote from the Washington case of Holyoke v. Jackson, 3 Wash. Ter. 255, 3 Pac. 841, where the Supreme Court of Washington Territory in defining community property rights in this state held that the community “‘is like a partnership, in that some property coming from or through one or
other or both of the individuals, forms for both a common stock, which bears the losses and receives the profits of its management, and which is liable for individual debts, but it is unlike in that there is no regard paid to proportionate contribution, service or business fidelity, that each individual, once in it, is incapable of disposing of his or her interest, and that both are powerless to escape from the relationship, to vary its terms, or to distribute its assets or its profits.”

The Attorney General, after citing numerous other decisions and statutory provisions, continues: “From the above authorities I am convinced that under the laws of Texas the earnings of husband and wife belong to them jointly in equal shares, that the community interest attaches as soon as the right to the wages comes into existence.”

The Attorney General then discusses the provisions of the United States Revenue Act of 1919 (40 Stat. 1065), which, as quoted by him, imposed an income tax on “gains, profits and income derived from salaries, wages, compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property”

The Attorney General accordingly concludes and advises the Secretary of the Treasury that husbands and wives in Texas in rendering separate income tax returns may each report as gross income one-half of the total earnings of the husband and wife, and that the same is true as to the income derived from community property already owned by husband and wife. This opinion was immediately (September, 1920) promulgated as Treasury Decision 3071, reported at 3 C. B. 221.

Upon the rendition of this opinion, the Secretary of the Treasury requested a further opinion of the Attorney General declaring in what states other than Texas, in which the community property system exists, may a husband and wife each report as gross income one-half of the income, which under the laws of such state becomes, simultaneously with its receipt, community property. It was requested that the opinion also cover the right of the United States to impose an estate tax on the one-half of the community property which becomes the sole property of the wife on the death of the husband.

The response was a full and exhaustive opinion of Attorney
General Palmer, dated February 26, 1921, and specifically answering the questions propounded with respect to all of the eight community property states, 32 Opinions of Attorneys General 435. The statutes and decisions of each of the community property states are thoroughly analyzed and considered. The portion of the opinion referring to the State of Washington quotes the pertinent statutory provisions and concludes.

"It appears to be the settled law of that state that the wife has, during coverture, as well as upon the dissolution of the marriage, a vested and definite interest and title in the community property, equal in all respects to the interest and title of her husband therein. Leading cases are Holyoke v. Jackson, 3 Wash. Ter. 235, Mabie v. Whittaker, 10 Wash. 656, 39 Pac. 172, Marston v. Rue, 92 Wash. 129, 159 Pac. 111, Schramm v. Steele, 97 Wash. 309, 166 Pac. 634, Huyvaert v. Roedtz, 105 Wash. 657, 178 Pac. 801."

Similar statements are made with respect to the community property laws of the other seven states except California, with respect to which the Attorney General says the statutes and decisions of that state require a different holding. He says

"Summarizing, it appears that in all of the community property states except California, their own courts have held that the wife has, during the existence of the marriage relation, a vested interest in one-half of the community property. Her rights in the property of the community are perhaps more fully recognized in the state of Washington, where both spouses have testamentary disposition over one-half of the community property, and where in the absence of such disposition it descends to their issue, or, in the absence of issue, to the survivor, while the husband is manager of the community estate in Washington, he may not sell, convey or encumber real estate unless the wife join with him in the conveyance, and as was held in Huyvaert v. Roedtz, ante, and Schramm v. Steele, ante, the separate debt of the husband cannot be satisfied out of community property where it is not incurred in connection with community business, nor for the benefit of the community."

This opinion concludes by stating that the answers to the questions are, therefore

"(1) That in Washington, Arizona, Idaho, New Mexico, Louisiana and Nevada the husband and wife domi-
oiled therein, in rendering separate income tax returns, may each report as gross income one-half of the income which under the laws of the respective states becomes, simultaneously with its receipt, community property.

"(2) In the states mentioned, in answer to question one, there should be included in gross estate, in computing the estate tax of the deceased spouse, one-half only of the community property of husband and wife domiciled therein.

"(3) Neither of the above answers is based upon a statute enacted subsequent to March 1, 1913."

These opinions rendered by the responsible and authoritative legal adviser of the government were, of course, accepted by the Treasury Department and were adopted as the rule of action. This opinion of February 26, 1921, was promulgated by Treasury Decision 3138, approved by the Secretary of the Treasury March 3, 1921. Internal Revenue Bulletin No. 4 for June, 1921, page 238. Later it was submitted to the Senate and printed in the Congressional Record.

During and since the year 1921, it has been the practice for husbands and wives in the State of Washington and in other community property states, except California, to make separate returns, each reporting one-half of the community income, and the federal income tax has been imposed and collected accordingly. The application of this practice, however, has not been without occasional objection from responsible sources. As a result of a suggestion emanating from the Treasury Department, the Revenue Act of 1921 as introduced in the House of Representatives, as reported by the Ways and Means Committee of the House and as passed by the House contained the following clause.

"Income received by any community shall be included in the gross income of the spouse having management and control of the community property"

The same Revenue Act of 1921 as reported by the Finance Committee of the Senate, substituted for the above quoted clause the following:

"Income received by any marital community shall be included in the gross income of the spouse having the management and control of the community property, and shall be taxed as the income of such spouse."

The Senate Finance Committee in making its report to the
Senate discussed the foregoing provisions as follows, at page 14 of the report.

"Under an opinion of the Attorney General, residents of the states having a community property law enjoy marked advantage over residents of other states. Income which in other states is taxed as a unit to the husband, is divided between husband and wife in states having community property laws, and surtaxes are correspondingly reduced. An amendment is added to this section designed to restore uniformity of treatment by providing that income received by any marital community shall be included in the gross income of the spouse having the management and control of the community property and shall be taxed as the income of such spouse."

The naive statement of a design "to restore uniformity of treatment" in the manner indicated, is noteworthy. In none of the forty so-called common law states is the income of the wife added to the income of the husband and surtaxed accordingly. In all of those states the wife's earnings instead of being combined with the husband's for federal taxation are reported and taxed separately. Such property as the husband transfers to his wife to assure her of a proprietary interest produces an income which is taxed only to the wife. In the State of Washington by common consent, in lieu of a voluntary transfer from husband to wife, the law creates in her, for her protection, a half interest in the community property. Is this interest of the wife less entitled to recognition than that transferred voluntarily by a husband in an Eastern state? Of course not.

In other words, this apparently innocent but really guileful suggestion would use the community property laws of the State of Washington and six other states to penalize husband and wife by recognizing and enforcing the community property law so far as it combines the earnings of the wife with the earnings of the husband and places in one common fund the income of her share of the marital accumulations along with the husband's share of those accumulations. Having recognized the community property law so far, this suggestion would then by arbitrary fiat make the combined income all the husband's for federal taxation and surtaxation, thus ignoring the true purpose and effect of the state rule of property and refusing to recognize the ownership to be where the state law puts it, namely, in the two spouses jointly. This would be to make use of the community property law only for
the purpose of combining the two incomes as a partnership fund and then to repudiate it by surtaxing the two incomes as one.

However, this entire proposed amendment was stricken out in the Senate, and the Revenue Act of 1921, as enacted, contained only the pre-existing provisions for the taxation of individuals on the one hand and corporations on the other. For the debate and action in the Senate see Vol. 61, Congressional Record, No. 140, for October 27, 1921, page 6872 et seq., and same volume No. 146, for November 3, 1921, page 7229.

Again when Congress was about to meet in December, 1923, Secretary Mellon in his report, which was submitted to Congress, recommended that the new revenue law about to be enacted should contain provisions similar to those which had been suggested but had been refused enactment in the previous Congress, relating to community incomes. As a result of the recommendation of the Treasury, the revenue bill introduced at the opening session of the Congress on December 17, 1923 (which bill as later amended became the Revenue Act of 1924), contained the following provision.

"Income received by any marital community shall be included in the gross income of the spouse having the management and control of the community property, and shall be taxed as the income of such spouse."

This proposed amendment, however, got no farther than the Committee on Ways and Means of the House, and the bill as reported by that committee to the House eliminated the foregoing clause and contained no reference to community incomes. Thus again the proposed change failed to meet with favorable consideration in Congress when analyzed in the light of natural justice and constitutional limitations. See Hearings before Committee on Ways and Means, House Reports, Revenue Revision 1924, pp. 194, 348, 375, 478, 482.

So the Revenue Act of 1924, like all of its predecessors (and, it may be said in anticipation, like all of its successors), imposed a tax upon the net income of every individual with no reference to community property and consequently no attempt at differentiation between individuals in any part of the United States. Since the Congressional session of 1923-24, no further effort has been made, either by any of the executive departments of the United States government or by anyone else, to have Congress legislate specifically against the interest of community property taxpayers,
and no one in Congress has brought forth any proposition to supplement the word "individual" in the revenue acts by any language referring to community incomes.

It should be noted that in December, 1920, before the rendition of the second opinion of Attorney General Palmer extending his Texas ruling to all the community property states except California, the question of the right of the United States to impose an estate tax upon the one-half of the community property passing to the wife on the death of her husband in California, came before Judge Rudkin sitting in the United States District Court for the Northern District of California. _Blum v. Wardell_, 270 Fed. 309. There Judge Rudkin held that the wife's share of the community property was not subject to the federal estate tax. This decision was affirmed by the Circuit Court of Appeals, in October, 1921, _Wardell v. Blum_, 276 Fed. 226. The government's petition for certiorari was denied March 6, 1922, 258 U.S. 617, 66 L. ed. 793. These decisions regarding the federal estate tax on community property in California, until overruled by the same Circuit Court of Appeals six years later, as shown below, seemed to create for the time being an anomalous situation, in that the federal estate tax and the federal income tax, which should logically have the same basis of application, were governed by different rules of property in California.

The decision of _Wardell v. Blum_ led to two further opinions by Attorneys General of the United States.

In December, 1923, the Secretary of the Treasury addressed a letter to Attorney General Daugherty requesting a reconsideration of so much of the second opinion of Attorney General Palmer (February 26, 1921) as held that that portion of the community property passing to the wife upon the death of the husband in California was subject to the federal estate tax. In an opinion dated March 8, 1924, addressed to the Secretary of the Treasury (34 Opinions of Attorneys General 376) Attorney General Daugherty reviewed the California statutes and the decisions of the Supreme Court of that state. He found cases tending to support the theory of some sort of an actual interest on the part of the wife and other cases tending the other way. In resolving this confusion the Attorney General followed the decision of the Circuit Court of Appeals in _Wardell v. Blum_, 276 Fed. 226, and ruled that the opinion of Attorney General Palmer should be modified to the extent of declaring that no federal estate tax should be
levied on community property in California passing to the wife on the death of the husband. He says:

"In fact, I am of opinion no established rule can be gathered from the decided cases in that state. The conclusion I have announced above, as based on the Blum decision, is, however, in harmony with decisions of the courts of other states where the community property system is maintained and with pronouncements of the Supreme Court of the United States.


On May 27, 1924, Attorney General Stone, having recently succeeded Attorney General Daugherty, on his own motion recalled the last mentioned opinion of Attorney General Daugherty for further consideration and review. On October 9, 1924, the subject was again treated in an opinion by Attorney General Stone (34 Opinions of Attorneys General 395.) This opinion calls attention to the difficulty of extracting any rule from the California cases, saying:

"The confusion in the decisions of the California courts has undoubtedly arisen from the fact that the courts have been attempting, in their opinions, to apply the terminology of the common law to community property, which embodies a legal concept wholly foreign to the common law, and to which the terminology of the common law cannot be applied with accuracy and precision."

Speaking of the principles applicable to community property generally he quotes from Arnett v. Reade, 220 U. S. 311, 55 L. ed. 477, where the court said.

"For it is conceded by the court below and everywhere, we believe, that in one way or another she has a remedy for an alienation made in fraud of her by her husband."

Attorney General Stone also called attention to the fact that since 1916 there had been two general revisions of the Revenue Law (that of 1921 and that of 1924), and that despite endeavors of officials of the Treasury to have Congress insert special provisions requiring so-called joint income of husband and wife to be returned as a single income of the husband, Congress had stricken
from the revenue bills all provisions to that effect and had enacted the new revenue laws in the old language so far as concerns the point under consideration. He finally concluded by saying:

"I am unable to find those considerations, which would, in my opinion, justify the government in beginning anew in some other case a judicial controversy which was litigated to a final conclusion in Blum v. Wardell and in which the government's position was fully presented. Since the opinion of the Attorney General (Daugherty) above referred to was an affirmation of the rule laid down in that case, I am constrained to re-establish and re-affirm that opinion."

Attorney General Stone, however, took pains to say that he was speaking only of the estate tax and that he expressed no opinion with respect to the principles concerning the taxation of community incomes.

It was in the judicial department of the United States government rather than the executive or legislative that the subject of federal taxation of community incomes was next mooted. Community tax payers in California were much dissatisfied with the ruling of Attorney General Palmer in holding that the laws of California, although generally known as community property laws, were not such as to give a wife a vested interest in the community income with the consequent right to file an individual return, reporting a share of that income as her own. A test suit was accordingly begun in 1925 in the United States District Court for the Northern District of California to reverse as to California taxpayers the ruling of the Attorney General. The action was brought by R. D Robbins, Jr., and Sadie Robbins as executors of R. D. Robbins, to recover back from the United States a sum which had been paid as income tax by the decedent for the year 1918 consequent upon the refusal of the Commissioner of Internal Revenue to recognize a division of that income between Robbins and his wife.

The case was heard before District Judge Partridge. In stating the facts, Judge Partridge said of the case

"Admittedly, however, it is presented here as a test case in order that appeal may be had directly to the Supreme Court, and it is said that, if the suit goes against the government, the Treasury will be compelled to refund to citizens of the State of California a sum in excess of $77,000,000."
The District Judge made a lengthy review of the statutes and decisions in the several community property states, comparing the law of California with the laws of the seven other states, and arrived at the conclusion that the amendments to the statutory laws of California enacted in 1901, 1913, and 1917 had so restricted the rights and powers of the husband with respect to community property, that the wife's interest therein must be regarded as vested and that the husband's dominion over the community property in California was no broader (so far as concerned the questions before him) than in other community property states. Accordingly he held that the wife was really the owner of one-half of the community income and entered judgment that Robbins recover back from the United States the amount sued for.

Judge Partridge's decision in the Robbins case was appealed to the Supreme Court of the United States.

The nature of the rights of the spouses in community property had already been considered by that court in several cases, notably Warburton v. White, 176 U. S. 484, 44 L. ed. 555, a case from Washington decided in 1900, and Arnett v. Reade, 220 U. S. 311, 55 L. ed. 477, a New Mexico case decided in 1911. In both of those cases, the court held that the wife possessed a present vested interest in community property and in both the court used the expression that the control of community property was given to the husband "not because he was the exclusive owner, but because by law he was created the agent of the community". In the New Mexico case (Arnett v. Reade), Mr. Justice Holmes wrote the opinion and Mr. Justice McKenna, the California member of the court, dissented, he evidently being imbued with the deep-seated California idea that the wife's interest is a mere expectancy and not a vested property right.

The appeal in the Robbins case was argued in the Supreme Court in December, 1925. On January 4, 1926, the court rendered a decision completely reversing the decision of Judge Partridge, U. S. v. Robbins, 269 U. S. 315, 70 L. ed. 285. Justice Holmes wrote the opinion and was supported by seven other justices. Justice Sutherland dissented and Justice Stone took no part.

In the opinion by Justice Holmes, the learned justice says.

"We can see no sufficient reason to doubt that the settled opinion of the Supreme Court of California, at least with reference to the time before the latter statutes, is that the wife had a mere expectancy while living with
her husband. The latest decision that we have seen dealing directly with the matter explicitly takes that view, says that it is a rule of property that has been settled for more than sixty years, and shows Arnett v. Reade, supra, would not be followed in that state (California) Roberts v. Wehmeyer, 191 Cal. 601, 611, 614, 218 Pac. 22 (decided in 1923) In so doing it accords with the intimations of earlier cases and does no more than embody the commonly prevailing understanding with regard to California law as shown by commentators and the action of the Treasury Department as well as by the declarations of the court."

The announcement of this view by the Federal Supreme Court settled the entire question at issue in that case, because if the California wife did not have a vested interest in community property during the continuance of the marriage but had a mere expectancy, as the Supreme Court finds, the wife had no income on which tax could be levied and there was nothing further to be decided in the case, with the result that the judgment had to be reversed.

However, Justice Holmes added another paragraph to the opinion, which must be regarded as dictum for all practical purposes of the case, though sometimes referred to in discussions of the case as a "secondary line of reasoning." In this final paragraph Justice Holmes considers in detail various provisions of the California community property law and says that even if the court be wrong in viewing the wife's rights as a mere expectancy and if the court should "assume that the wife had an interest in the community income, that Congress could tax if so minded, it does not follow that Congress could not tax the husband for the whole." Further reviewing the nature of the husband's rights in California, the learned justice continues

"Although restricted in the matter of gifts, etc., he alone has the disposition of the fund. He may spend it substantially as he chooses, and if he wastes it in debauchery, the wife has no redress. His liability for his wife's support comes from a different source and exists whether there is community property or not. That he may be taxed for such a fund seems to us to need no argument. The same and further considerations lead to the conclusion that it was intended to tax him for the whole. For not only should he, who has all the power, bear the burden, and not only is the husband the most obvious target for the shaft, but the fund taxed, while liable to be
taken for his debts, is not liable to be taken for the wife's, Civil Code Sec. 167, so that the remedy for her failure to pay might be hard to find. The reasons for holding him are at least as strong as those for holding trustees in the cases where they are liable under the law. Sec. 219."

Some of the government attorneys, anxious to reverse the ruling by which wives having a vested interest in community property in the seven community property states, other than California, are allowed to file separate returns, profess to regard the final paragraph of Justice Holmes' decision as applicable to the other community property states. There is in fact no foundation for this latter view. The entire line of reasoning in the final paragraph of Justice Holmes' opinion is based upon the provisions of California law, none of which are found, for instance, in the community property laws of the State of Washington. In this state it is not true that the husband alone has the disposition of the fund, nor that he may spend it substantially as he chooses, nor that if he wastes it in debauchery, the wife has no redress, nor that his liability for his wife's support comes from a different source and exists whether there is community property or not. Nor is it true in the State of Washington that the community fund is liable to be taken for the husband's debts, and is not liable to be taken for the wife's. The decisions of the Supreme Court of Washington, as far as this state is concerned, negative each of the propositions of law found in the California statutes and decisions which were made the basis of the dictum or secondary line of reasoning of Justice Holmes.

It is important to note that the question treated in the final paragraph of the *Robbins* opinion was not contended for or even suggested by counsel for the United States, either in their briefs or in the oral argument. Both the government counsel and the opposing counsel admitted, as the Treasury Department and the Attorney General had ruled for many years, that the sole question at issue in the case was whether or not the wife had a one-half vested ownership in the community income under the statutes and decisions of California, and that the right to make separate returns under existing rulings and decisions depended entirely and alone on the question of the vested half ownership.

Since the considerations discussed in the final paragraph of Justice Holmes' decision were not contended for by the government, but, on the contrary, were assumed on all sides to be clearly set-
tled in the light of the plain meaning of the various revenue acts as well as the previous executive and legislative history of the community property controversy (to say nothing of the constitutional power of Congress to tax one person for income belonging to another and to surtax one individual by adding income belonging to him to income belonging to another), nothing was said by counsel for either side in the way of stating facts relevant to this new point. Such relevant facts would have included the showing that Congress had twice rejected two amendments attempting to tax and surtax husbands on the entire community income irrespective of the question of vested ownership, and that these amendments, rejected by Congress, embody the same principles as that involved in the idea suggested by Justice Holmes. On the question of the "power and intent," the legislative history (as to which the Supreme Court had no information) clearly negatives the "intent." The "power" to tax and surtax the husband for an income belonging to the wife will be found, on analyzing the final paragraph of the opinion itself, to be asserted as being co-extensive only with the status created by California law and not to extend to the community property status existing in any other state.

The able opinion of Acting Attorney General Mitchell rendered July 16, 1927 (35 Opinions of Attorneys General 265), hereinafter mentioned, declares that the question of federal taxation of community incomes involves only the question of the wife's vested interest as fixed by local state law. That opinion nowhere interprets the decision in the Robbins case as asserting any power or intent on the part of Congress to tax and surtax the husband on the joint income in the states where, by local statutes and court decisions, the community property is recognized to belong to both spouses jointly. If the writer may be permitted to indulge in paraphrase, Mr. Mitchell apparently interpreted the final paragraph of Justice Holmes' opinion as saying in effect.

"Even if we should have regard to those California cases tending toward a more liberal construction of the wife's rights (some of which are mentioned, pro and con, in the opinions of Attorneys General Daugherty and Stone, who call attention to the confused and indefinite nature of the California holdings) and should thereby be led to believe that the courts of that state would hold the wife's interest to be something more than a mere expectancy, nevertheless, taking into consideration all of the provisions of the system in force in California in 1918 (especially those provisions to which we call atten-
tion), it would still be our holding that the wife's interest under that system was not substantial enough to entitle her to return half of the income as her own under the Revenue Act of 1918." (Quotation and paraphrasing mine.)

To avoid misunderstanding I repeat and emphasize the fact that the language enclosed in these quotation marks was not used by Mr. Mitchell but the quoted language is merely my interpretation of what I gather to have been the view that Mr. Mitchell expressed.

So after all the Robbins case would, in any event, rest purely on the indefinite nature of the wife's interest under the California decisions.

Further, Justice Holmes' secondary reasoning does not purport to be self-contained or complete, and could not serve alone as a basis of judgment if divorced from the context which ties it to the California law. The analogy suggested to the case of a trustee would have to be completed by indicating that the income of the beneficiary of a trust is not added to the income of the trustee so that a surtax may be imposed upon the two combined. If there are two identified and living beneficiaries of a trust, the incomes of the two are not added together for tax or surtax. These considerations would not support (outside of California) the conclusion as to the "power and intent" of Congress. Undoubtedly the law can, and in some instances does, require a person having possession of a fund to pay another person's tax out of that fund. This is no more than a statutory garnishment. A surtax based on the combining of incomes belonging to two individuals is a very different matter.

Judge Partridge's remark in the record in the Robbins case that a decision adverse to the government would compel the refunding to the citizens of the State of California of sums in excess of $77,000,000 may have created in the Supreme Court a psychology unfortunate for the taxpayers. I may remark here that success of the taxpayers in suits now pending would not involve the Treasury in any refund whatever.

Immediately upon the publication of the decision of the Supreme Court in the Robbins case in January, 1926, Treasury officials raised the question whether under the final paragraph of the decision, the ruling of Attorney General Palmer should not be reversed as to all community property states. Objections to such reversal of the long-prevailing ruling and the practice were immediately
voiced in all the states affected and the matter was called to the attention of the delegations of these states in both houses of Congress.

The general feeling was expressed that while the dictum or secondary line of reasoning in the opinion manifestly was not based upon anything found in the community property laws of the other states, nevertheless it would be wise to have any doubt set at rest as far as past liabilities were concerned. Senator Wesley L. Jones of the State of Washington took the initiative and early in February, 1926, while the Senate was considering the Revenue Act of 1926, he moved as an amendment that the following provision be inserted in page 12 of the bill, namely

"The liability of any taxpayer under any internal revenue law shall be determined, unless such taxpayer otherwise consents or requests, in accordance with the Treasury decisions, opinions of the Attorney General and regulations made by the commissioner or the secretary, or by the commissioner with the approval of the secretary, in force at the time his return was made, whether such return was made before or after the enactment of this act. As used in this subdivision, the term return means, in the case of a return which has been amended, the return as finally amended."

This amendment was accepted and inserted in the bill by the Senate. Later the Senate amendment was objected to by the Treasury Department because it was considered too broad in its scope, although it was agreed that claims based on the community property status should be quieted. The amendment was, therefore, redrafted to quiet only claims that might be made with respect to the community property status. Other matters which Congress desired to quiet were treated in separate amendments. It is stated on reliable authority that the substitute amendment for the Jones amendment was prepared by the attorneys for the Internal Revenue Bureau as a quieting statute, in order to meet the views of the senators and congressmen from community property states. The substitute amendment was accordingly enacted and became Section 1212 of the Revenue Act of 1926, as follows

"Sec. 1212. Income for any period before January 1, 1925, of a marital community, in the income of which the wife has a vested interest, as distinguished from an expectancy, shall be held to be correctly returned if returned
TAXATION OF COMMUNITY INCOMES

by the spouse to whom the income belonged under the state law applicable to such marital community for such period."

Three observations are suggested by this section: First, the section recognizes that there are marital communities where under the state law community income belongs to more than one spouse. This recognition is of importance because naturally income cannot be taxed to one to whom this income does not belong by adding such income to the individual income of another and surtaxing both. Second, this section is a statute of repose intended to set at rest any question of liability for federal taxation of community incomes for the year 1924 and previous years where separate returns had been filed by husband and wife. Acting Attorney General Mitchell in his opinion of July 16, 1927 (hereinafter considered) says "it is only in the nature of a statute of limitations." Third, the Revenue Act of 1926, so far as concerned its enactments for the future, embodied the identical language of the former acts in taxing the income of "individuals," which language had been uniformly interpreted by Attorneys General and administrative officials as calling for separate returns and separate taxation of husbands and wives for community incomes in seven states.

It may be remarked here parenthetically that the assessment of additional income taxes for the year 1924 and previous years is now barred not only by Section 1212, but also by the three-year statutory limitation. As to any additional assessment for the year 1925, the bar became effective March 15, 1929. The three-year bar will apply to any additional assessment for the year 1926 on March 15, 1930.

Besides leading to the enactment by Congress of the above quoted Section 1212 of the Revenue Law of 1926, the final paragraph of the decision in the Robbins case has had another important effect. It has led to the institution of test suits in all the community property states except California, with the intention of having those suits carried to the Supreme Court of the United States, one from each of the seven community property states concerned, so that an authoritative decision may be had in that tribunal concerning the rights of husbands and wives to file separate returns.

In the latter part of January, 1926, some three weeks after the announcement of the decision of the Supreme Court in the Robbins
case, Attorney General Sargent, in conjunction with Solicitor General Mitchell, publicly announced that the Attorney General was considering whether the dictum or secondary line of reasoning of Justice Holmes applied to states other than California. He gave public notice that on a fixed date in February, he would give a hearing to any representatives of taxpayers in the community property states desiring to state their views on the subject and at the same time inviting the filing of briefs.

The hearing duly took place. There were oral statements by representatives of taxpayers from the states of Washington, Louisiana and Texas and some other states and printed briefs were filed. In behalf of taxpayers of the State of Washington a printed brief was submitted and an oral argument made by counsel of the Seattle Chamber of Commerce. As a result of that hearing the Solicitor General wrote a letter on March 12, 1926, to each of the counsel who had appeared before him, in which he said.

"Owing to the question arising under the uniformity clause of the federal constitution, I feel that the real problem in the case is to ascertain the intrinsic nature of the wife's interest in the community income in each of the states. The way to determine whether the wife has such an ownership in the income as entitles her to return a part of it as her own, is to ascertain, from the statutes and decisions of her state, just what rights of ownership she may exercise respecting the community income."

The letter further set forth a list of specific questions on which the Solicitor General requested the counsel in each community property state to prepare a further brief to be submitted to him in the following month of April. In obedience to this question, further briefs were filed in April, 1926, by counsel of the Seattle Chamber of Commerce and counsel representing tax-paying bodies in several other community property states, especially Louisiana and Texas, making direct answers to the questions propounded by the Solicitor General and setting forth the pertinent statutory provisions and decisions. For more than a year the matter was held under advisement by the Attorney General and Solicitor General.

On July 16, 1927, Hon. William D. Mitchell, Solicitor General, as Acting Attorney General, addressed to the Secretary of the Treasury a very important opinion, (35 Opinions of Attorneys
TAXATION OF COMMUNITY INCOMES

General 265). This able state paper refers to the two opinions of Attorney General Palmer of 1920 and 1921 and considers whether the decision in United States v. Robbins requires any modification thereof. The reasoning of this latest opinion is in entire harmony with the position taken by counsel for the taxpayers of the community property states.

Salient quotations are as follows.

"In determining the nature of an interest in community income created by state law, it is necessary for the federal courts to accept the decisions of the state courts construing the statutes creating the interest and to determine from the statutes and decisions of the state courts the intrinsic nature of that interest."

"Decisions of the state courts holding what rights of a proprietary nature the wife may exercise in respect of community income are binding on the federal courts."

"There are very substantial differences between the so-called community property systems in these various states. No two of them are just alike. Some resemble very closely the system in California dealt with in the Robbins case, but in other states the systems differ very considerably from the California system."

"As the nature and extent of a wife's interest in community income are matters determined by the laws of the state, Congress may not by any enactment change the nature of the wife's interest."

The conclusion of this opinion is that a determination by the United States Supreme Court should be made to settle the problem for each of the community property states. Consequently the Attorney General withdrew the two opinions of Attorney General Palmer and advised that test cases be brought in the several community property states and carried to the Supreme Court of the United States to set the question at rest with respect to taxpayers in each state concerned. He expressed the view that the practice then prevailing for dealing with community income in seven states should not be overturned by administrative action, but should continue, pending final determination by the courts.

Next in chronological order should be mentioned Talcott v. United States, 23 Fed. (2) 897 (certiorari denied 72 L. ed. 686) where the Circuit Court of Appeals of the Ninth Circuit in Janu-
ary, 1928, overruled their holding of six years before in *Wardell v. Blum*, 276 Fed. 226, and ruled that a wife in California must pay a United States estate tax on the one-half of the community property which by statute she receives on the death of the husband. This new view of the law was based in part on the decision of the Supreme Court in the *Robbins* case and in part on recent rulings of the Supreme Court of California reasserting the absence of a vested interest on the part of the wife in community property.

As a result of the opinion of Acting Attorney General Mitchell and his recommendation of test suits, conferences and correspondence were resumed between the counsel representing the taxpayers in the several community property states. At various times these counsel have also had conferences with the General Counsel of Internal Revenue regarding the course to be pursued. As a consequence test suits were begun and carried on as follows.

The Texas test suit, *Bacon v. Hopkins*, was decided in favor of the Texas taxpayers by the United States District Court in Texas in June, 1928. *Bacon v. Hopkins*, 27 Fed. (2) 140. The appeal taken by the Internal Revenue Bureau from that decision is now pending before the United States Circuit Court of Appeals for the Fifth Circuit.

The Washington test suit, *Seaborn v. Poe*, was decided in favor of the Washington taxpayers by the United States District Court in Washington, Judge Cushman presiding, in May, 1929. *Seaborn v. Poe*, 32 Fed (2) 916. This case also has been appealed and is pending before the United States Circuit Court of Appeals for the Ninth Circuit where it will be heard during the coming month of October.

The Arizona test suit, *Koch v. Goodell*, was decided in favor of the Arizona taxpayers by the United States District Court in Arizona in March, 1929. This case also has been appealed and will also be heard before the United States Circuit Court of Appeals for the Ninth Circuit in October.

The Louisiana test suit, *Pfaff v. Bender*, is pending in the United States District Court for Louisiana, not yet having been called up for hearing. It is to come on for final disposition in that court during the coming month of September.

Plans are maturing for similar test suits in Idaho, Nevada and New Mexico.
It is to be noted, therefore, that in all of the states where test suits have been decided by the local District Courts, the decision has been in favor of the taxpayers, that is to say, in favor of sustaining the present practice of individual returns with division of the community income between husband and wife.

No decision has yet been rendered in a Circuit Court of Appeals directly in any of the test suits. There are decisions of two Circuit Courts of Appeals which seem to indicate rather strongly that those courts will affirm the decisions of the District Courts. Last February, the Circuit Court of Appeals for the Fifth Circuit (which includes the states of Texas and Louisiana) had before it a case where husband and wife, citizens of Texas, had made separate returns dividing community property income and the wife asserted the claim that the half of the salary paid to the husband which the wife returned as her own income, must be treated as earned income of the wife as if she had personally worked for it. The court upheld the wife's right so to treat the income. McLarry v. Commissioner, 30 Fed. (2) 789. This ruling is contrary to the practice heretofore pursued by the commissioner, which has been to divide the income between the two spouses, to allow the husband to treat his half as earned income, but to refuse a similar privilege to the wife unless she personally participated in the earning.

Last April the Circuit Court of Appeals of the Ninth Circuit had before it the case of Rucker v. Commissioner, 32 Fed. (2) 222, involving an income tax assessment for 1918 on community income in the State of Washington, for which the husband and wife had made separate returns dividing the income, but the commissioner had assessed the entire income to the husband. The Circuit Court of Appeals in a unanimous opinion written by Judge Dietrich, in which Judges Gilbert and Rudkin concurred, reviewed, in succinct and comprehensive language, the community property statutes of the State of Washington and the court decisions thereunder and upheld the right of separate returns and division of income, saying among other things

"The wife has during coverture, as well as upon dissolution of the marriage, a vested and definite interest and title in community property, equal in all respects to the interest and title of her husband therein,"

citing Marston v. Rue, 92 Wash. 129, Schramm v. Steele, 97 Wash. 309, Huyvaert v. Roeditz, 105 Wash. 657, and the opinion of
Attorney General Palmer of February 26th, 1921. This decision seems clearly to foreshadow an affirmance of the decision of Judge Cushman in Seaborn v. Poe. The only point of distinction so far attempted by opposing counsel is that the case of Rucker v. Blair, being for an assessment for the year 1918, is within the added protection afforded by Section 1212 of the Revenue Act of 1926, already mentioned, which quieted claims for reassessment with respect to certain marital communities for periods before January 1, 1925. The court opinion shows, however, that the decision broadly covers the entire question.

Attention should also be given to the decision of the Circuit Court of Appeals for the Ninth Circuit in Earl v. Commissioner, 30 Fed. (2) 898, where in February, 1929, that court upheld the right of separate returns dividing the income between the two spouses even as to residents of California, where it was shown that a written agreement had been made at the time of the marriage agreeing that the earnings of the husband and of the wife should be the joint property of both, a form of agreement recognized and permitted by the California statutes.

Until the case of Seaborn v. Poe has been determined by the Circuit Court of Appeals for the Ninth Circuit and until the Supreme Court of the United States has either reviewed and decided that case or has refused an application for certiorari, it cannot be definitely asserted that the validity of the present practice of divided returns by husband and wife in this state has been put beyond controversy.

What as to the modus vivendi, the temporary arrangement for getting along, pending the time when the Supreme Court shall have decided the contested point? In the informal conferences held between counsel representing community taxpayers in the several states and the General Counsel of Internal Revenue, preparatory to the beginning of the test suits, official assurances were given (by authority of the commissioner, it was understood) that if the test suits were promptly begun and prosecuted with diligence, the existing practice of divided returns would be continued until a contrary ruling should be made by the Supreme Court. This understanding is being carried out. It was put into record form and published by the commissioner on April 6, 1929, Mimeograph 3723, Cumulative Bulletin VIII-17-4182.

The Revenue Act of 1928 contains a provision in Section 1108 to the effect that the Treasury Department, in changing any regula-
tion or practice, may apply the change without retroactive effect, even though the change be required by some authoritative court decision. This provision was inserted in the 1928 law at the suggestion of counsel for taxpayers in the community property states, so that, in the possible event that the pending test suits should result adversely to the taxpayers in any state, the Secretary of the Treasury or the commissioner would not be obliged to impose a re-assessment on community incomes, surtaxing the husband for any year prior to 1927, as to taxpayers in any state so losing in the Courts.

Since the passage of the 1928 Revenue Act containing this provision, counsel for the community property taxpayers have asked the Treasury Department to take a pronouncement declaring that the discretion thereby vested in the Treasury would not be exercised in the direction of making any re-assessment for years prior to 1927 in the event of a reversal of the present practice by reason of an adverse decision of the Supreme Court as to the taxpayers in any state. In May, 1929, Secretary Mellon gave this assurance in the form of a letter addressed to Hon. John N. Garner, representative in Congress from Texas. In his letter Secretary Mellon says.

"The Treasury has decided, as you know, that no change would be made in its position" (permitting separate returns by husband and wife, dividing community incomes) "with respect to years prior to 1927. Because of the exceptionally difficult problems and the conflicting positions of the government, this is clearly a situation in which the authority granted in the Revenue Act of 1928, to make changes in our regulations for future application only, should be exercised."

This assurance applies only to years prior to 1927. The pending test suits will settle the legal status for 1927 and thereafter. The discretion of the Secretary, however, will continue to apply to taxation for all years prior to the date of the final court decision, in the event that the present practice is thereby held invalid as to any state.

Consequently, quoting the words of Webster on Massachusetts, her Lexington and her Bunker Hill, we may say for all years before 1927, "the past at least is secure." As to the future, the taxpayers of Washington and six other states rest confidently on the opinion of Acting Attorney General Mitchell of July 16, 1927,
declaring that the state law is the supreme test of right on the subject.

For the preparation of this paper I desire to make grateful acknowledgment for much valuable data received from Mr. Charles E. Dunbar, Jr. of New Orleans. The cause of the community property income taxpayers has been greatly advanced by the splendid work of eminent counsel in the other community property states, notably Mr. Dunbar and Judge Monte M. Lemann of New Orleans, Mr. R. C. Fulbright of Washington, D. C., Mr. Rhodes S. Baker of Dallas and Mr. Palmer Hutcheson of Houston, all of whom have rendered invaluable service at various stages of the controversy.

GEORGE DONWORTH.

AUTHOR'S SUPPLEMENTAL NOTE

Since the preparation of the foregoing paper my attention has been called to a ruling of the Income Tax Unit published March 4, 1929, reported in Cumulative Bulletin VIII-9-4122, I. T. 2457, as follows

"Revenue Acts of 1926 and 1928

An amendment of the Civil Code of California Passed by the California Legislature, approved by the governor April 28, 1927, in effect July 29, 1927, reads as follows

Section 1. A new section is hereby added to the civil code to be known as section 161a thereof to read as follows

161a. The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the civil code. This section shall be construed as defining the respective interests and rights of husband and wife in community property.

The Supreme Court of California in the case of Stewart v. Stewart, July 18, 1928, (269 Pac., 439), held that this section of the code, whatever effect it may have upon community property acquired subsequent to its effective date, cannot in any manner relate to or govern the ownership of property acquired prior thereto.

In view of section 161(a) of the California Civil Code, and pending final adjudication in court of the questions as to whether

*Of the Seattle bar, formerly United States District Judge for the Western District of Washington. The foregoing paper was read by Judge Donworth at the annual meeting of the Washington State Bar Association at Olympia, August 15, 1929.
the Government may tax to the husband the entire community income which under the State law is under his management and control, husband and wife domiciled in California may each hereafter in rendering original separate returns report one-half of the income from community property acquired on and after July 29, 1927. Where community property was acquired prior to that date, the income therefrom may not be divided for income tax purposes but is taxable to the husband in its entirety, regardless of when such income is received. Husband and wife may hereafter report in original separate returns one-half of salaries, wages, and fees earned by either spouse on and after July 29, 1927, which are community property."

George Donworth.