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CONSTITUTIONALITY OF STATE CHAIN STORE TAX BASED ON TOTAL NUMBER OF STORES

A LOUISIANA Act of 1934 imposes upon each store operated within the state by a chain store company, a license tax that is graduated according to the total number of stores held under common ownership both within and without the state.[1] Thus chain store companies are classified according to the total number of stores they respectively operate everywhere, and are then taxed for their stores in Louisiana at the rate applicable to the classifications in which they fall by virtue of the aggregate number of stores they operate everywhere, the tax ranging from ten dollars per store operated within the state by a chain com-

1. La. Acts 1934, No. 51. Section 1 of the act reads: " . . . because of the advantages accruing from the operation of multiple stores wherever situated, and because of the basic differences inherent in such character of operations there . . . is hereby levied an annual license tax . . . upon each firm, partnership, or association of persons engaged in the business of operating, or maintaining, as part of a group or chain, any store or stores in this state, where goods, wares, merchandise, or commodities of every description whatever are sold or offered for sale at retail under the same general management, supervision, ownership or control, commonly known as branch or chain stores." Section 3 provides: "that the license tax for such business . . . levied upon the store or stores operated in the state of Louisiana shall be based on the number of stores . . . included under the same general management, supervision, ownership or control, whether operated in this state or not."

posed of less than ten stores, to five hundred fifty dollars for each store in Louisiana operated by a chain organization of over five hundred stores.[2]

Tax measures discriminating against chain stores are extant in sixteen states, other than Louisiana.[3] In general,[4] such statutes are of two kinds: graduated gross sales taxes,[5] and graduated license taxes.[6] Under the first, the

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Bracket	Total Stores Operated by Company	Tax on Louisiana Units	Bracket	Total Stores Operated by Company	Tax on Louisiana Units
1	Less than 10	$10 per store	9	176 to 200 stores	$200 per store
2	10 to 35 stores	$15 per store	10	201 to 225 stores	$250 per store
3	36 to 50 stores	$20 per store	11	226 to 250 stores	$300 per store
4	51 to 75 stores	$25 per store	12	251 to 275 stores	$350 per store
5	76 to 100 stores	$30 per store	13	276 to 300 stores	$400 per store
6	101 to 125 stores	$50 per store	14	301 to 400 stores	$450 per store
7	126 to 150 stores	$100 per store	15	401 to 500 stores	$500 per store
8	151 to 175 stores	$150 per store	16	over 500 stores	$550 per store

3. Ala. Acts 1931, No. 369; Fla. Laws 1933, c. 16071; Idaho Laws 1933, c. 113; Ind. Acts 1929, c. 207, as amended by Acts 1933, c. 271; Ky. Special Session Acts 1934, c. 26; Me. Laws 1933, c. 260; Md. Laws 1933, c. 542; Mich. Acts 1933, No. 265; Minn. Laws, 1933, c. 213; Mont. Laws 1933, c. 155; N. M. Spec. Sess. Laws 1934, c. 33; N. C. Laws 1933, c. 445, § 162; S. C. Acts 1930, No. 829; Vt. Laws 1933, c. 46; Wis. Laws 1933, c. 469; W. Va. Acts 1933, c. 36.

A Georgia statute, Ga. Laws 1927, No. 398, § 109, providing for a tax of $250 for each store over five operated under common ownership, was replaced by another [GA. CODE ANN. (Michie, Supp. 1930) § 993 (280)] which levied a tax of $50 per store on each firm owning a chain of over five stores. The latter act was declared unconstitutional in F. W. Woolworth Co. v. Harrison, 172 Ga. 179, 156 S. E. 904 (1931). The present Maryland act displaces another [Md. Laws 1927, c. 554, § § 1-3] which prohibited the operation of more than five stores by any owner within one county in addition to a $500 license fee upon each of the stores of a chain of five or less, held unconstitutional in a lower Maryland court, Keystone Stores Corp. v. Huster, decided April 21, 1928, by Circuit Court of Alleghany County (unreported). The present North Carolina act stands in place of N. C. Laws 1927, c. 80 § 162, which was held unconstitutional in Great Atlantic and Pacific Tea Co. v. Doughton, 196 N. C. 145, 144 S. E. 701 (1928). The present South Carolina Act displaces S. C. Acts 1928, No. 574, § 24, which was held unconstitutional in Southern Grocery Stores Inc. v. W. G. Query, decided by the Court of Common Pleas (unreported). Many more statutes have been proposed in the state legislatures. Thus in 1930, 13 bills were introduced; in 1931, 175 bills; in 1932, 125 bills; in 1933, 225 bills; and during 1934, up to October 15, there had been 50 bills introduced. See NICHOLS, CHAIN STORES AND THEIR SPECIAL TAX PROBLEMS (1934) 19.

4. A mild form of discrimination against chain stores may be found in statutes of a few states taxing the distribution of goods from warehouses of a chain to its stores at a rate corresponding to that imposed upon wholesalers. See TENN. CODE ANN. (Williams, 1934) § 1248.66; VA. TAX CODE (Michie, 1930) § 188. The Virginia statute was upheld in Commonwealth v. Bibee Grocery Co., 153 Va. 935, 151 S. E. 293 (1930); and again in Great Atlantic and Pacific Tea Co. v. Morrissett, 58 F. (2d) 991 (E. D. Va. 1931), aff'd, 284 U. S. 584 (1932).

5. The present statutes of Minnesota, New Mexico, and Vermont are of the graduated gross sales type, *supra* note 3. The Kentucky graduated gross sales act, Ky. Acts 1930, c. 149, has been displaced by a graduated license tax, *supra* note 3. The repealed Kentucky

percentage of tax is scaled upwards according to the increase in the gross sales of the concern; the discrimination against chain stores resulting from the fact that the sales of all stores of a chain within a state are aggregated, thereby bringing them within the upper brackets of the tax.[7] By the second, the license fees are graduated according to the number of stores under a common ownership within the state, thus discriminating against the chain by reason of its larger number of merchandising outlets in the state. The passage of this anti-chain

act had been upheld in Stewart Dry Goods Co. v. Lewis, 7 F. Supp. 438 (W. D. Ky. 1933); Moore v. State Board of Charities and Corrections, 239 Ky. 729, 40 S. W. (2d) 349 (1931). See 1 NYSTROM, ECONOMICS OF RETAILING (1930) 265. In order to point the discrimination involved in the graduated gross sales tax against chain stores, it has been proposed [Ohio H. B. No. 340 (1929), reported in 1 Op. Att'y Gen. of Ohio (1929) 395] that while classifying stores according to their gross sales, the tax within each class be increased as the number of stores owned by the taxpayer within the state increases. This was done by two South Carolina municipalities. Charleston, License Ordinance 1934; Spartanburg, License Tax Ordinance 1933. The latter was upheld in Great Atlantic and Pacific v. Spartanburg, S. C., Sup. Ct., July 20, 1934. That the graduated gross sales tax in its usual form may be more widely adopted in the future see HAIG AND SHOUP, THE SALES TAX IN THE AMERICAN STATES (1934) 25. A variant of the graduated gross sales tax is found in the Wisconsin statute, *supra* note 3, which levies a tax upon the gross income of every person or company operating chain stores within the state, that is graduated from 6/20 of 1% of the gross income of $100,000 or less to 1 3/20% on the excess of gross income over $5,000,000. See Hardy, *Legal and Economic Aspects of Chain Store Taxation in Wisconsin* (1934) 9 WIS. L. REV. 382.

6. The statutes of Alabama, Florida, Idaho, Indiana, Kentucky, Maine, Maryland, Michigan, Montana, North Carolina, South Carolina, and West Virginia, *supra* note 3, are graduated license tax statutes. That type of statute has been upheld in State Board of Tax Commissioners of Indiana v. Jackson, 283 U. S. 527 (1931), reversing Jackson v. State Board of Tax Commissioners of Indiana, 38 F. (2d) 652 (S. D. Ind. 1930); Liggett v. Lee, 288 U. S. 517 (1933); Fox v. Standard Oil Co. of New Jersey, U. S. L. Week, Jan. 15, 1935, at 442, reversing Standard Oil Co. of N. J. v. Fox, 6 F. Supp. 494 (S. D. W. Va. 1934); Southern Grocery Stores Inc. v. South Carolina Tax Comm., 55 F. (2d) 931 (E. D. S. C. 1932); J. C. Penney Co. v. Diefendorf, 32 P. (2d) 784 (Idaho, 1934). For a discussion of the problem of gasoline service stations as chain stores see (1934) 43 YALE L. J. 1022; Fox v. Standard Oil Co. of New Jersey, *supra*.

7. The chain store organization is not only subject to discrimination in favor of the independent dealer by reason of the graduation of the tax, but since chains often take a smaller profit on a more rapid turnover than the independent retailer, their gross sales are accordingly larger in proportion to their net income than are those of the independent retailer. That chains operate on a small profit and rapid turnover, see HAYWARD AND WHITE, CHAIN STORES (1922) 8, 136. See FED. TRADE COMM., PRICES AND MARGINS OF CHAIN AND INDEPENDENT DISTRIBUTORS, DETROIT-DRUG (1934) Doc. No. 96, at 8-22; FED. TRADE COMM., PRICES AND MARGINS OF CHAIN AND INDEPENDENT DISTRIBUTORS, CINCINNATI-DRUG (1934) Doc. No. 95, at 5-17; FED. TRADE COMM., PRICES AND MARGINS OF CHAIN AND INDEPENDENT DISTRIBUTORS CINCINNATI-GROCERY (1933) Doc. No. 88, at 5-18; FED. TRADE COMM., PRICES AND MARGINS OF CHAIN AND INDEPENDENT DISTRIBUTORS, MEMPHIS-DRUG (1934), Doc. No. 97, at 5-14; FED. TRADE COMM., PRICES AND MARGINS OF CHAIN AND INDEPENDENT DISTRIBUTORS, WASHINGTON, D. C.-DRUG (1934) Doc. No. 98, at 6-16. This factor together with the fact that there may be substantial exemptions would also impart a more or less discriminatory character to flat rate sales taxes.

legislation has, with judicial sanction, been intended primarily to aid the independent retailer in his competitve struggle aganst chain stores.[8] Of the chains, the larger ones have been the particular object of attack in such legislation.[9] This latter fact is indicated, in the first place, by the stock arguments advanced against chain organizations to the effect that they fail to support local banks, do not purchase from local sources, and threaten to gain a virtual monopoly of the retail business of the country.[10] If these arguments are accepted, they would have greatest application to the larger and more widely dispersed chain store organizations. Secondly, the fact that gross sales and license tax statutes are scaled upwards with the proportionate increase in rates being much greater in the higher brackets than in the lower brackets, indicates a definite intention to discriminate more particularly against the larger chains in the state. Presumably this has been due to the feeling that the larger the chain, the greater is the competitive advantage enjoyed over the independent retailer.

While the Louisiana statute parallels these statutes in discriminating particularly against larger chain groups in the state in favor of independent retailers, it embraces as well the further purpose of protecting and enhancing the competitive position of the smaller chains indigenous to Louisiana as against the local branches of the larger sectionally or nationally organized chains by imposing heavier burdens upon the latter. This is graphically illustrated by the reduction in the tax burden to be sustained by local chain store concerns,[11] and

8. While denominated tax measures, the production of revenue has in the past been distinctly subordinate to the purpose of favoring the independent retailer against chain stores in such statutes. Cf. Becker and Hess, *The Chain Store License Tax, and the Fourteenth Amendment* (1928) 7 N. C. L. REV. 113, 122; Legis. (1931) 44 HARV. L. REV. 456; Legis. (1931) 80 U. OF PA. L. REV. 289; Legis. (1931) 31 COL. L. REV. 145, 152; Comment (1931) 40 YALE L. J. 431; Sherrill, *Chain Taxes Hamper Distributive Efficiency* (Jan. 1934) 22 ADVERTISING AND SELLING 21. Of late, however, the necessity of tapping new and additional sources of revenue in order to meet budget deficits has been ascribed as another important reason for the passage of recent tax statutes discriminating against chain stores. Cf. NICHOLS, op. cit. *supra* note 3 at 11-14.

9. Cf. HOADLEY, THE CHAIN STORE WITH SPECIAL REFERENCE TO IOWA (1930) 32; Mowry, *The Menace of Anti-Chain Legislation* (July 1933) 21 ADVERTISING AND SELLING 24.

10. See Caslow, *Why We Are Fighting the Chains* (May 1930) 15 ADVERTISING AND SELLING 22; CHEASLEY, THE CHAIN STORE MOVEMENT IN CANADA (1932) 32-57; Murphy, *How the Small Bank Can Deal with Chain Stores* (1928) 21 AMER. BANKER'S ASS'N JOURNAL 466; Ernst and Hartl, *Chains Versus Independents* (Nov. 1930) 131 NATION 517. The arguments that have been advanced against chain stores are usually stated only for purposes of refutation. See NICHOLS, CHAIN STORE MANUAL (1932) 61-85; SUTHERLAND, A DEBATE HANDBOOK ON CHAIN STORES AND THE ULTIMATE CONSUMER (1930) 45-52, 121-139; BUEHLER, CHAIN STORE DEBATE MANUAL (1931) 39-58; SOMERVILLE, CHAIN STORE DEBATE MANUAL (1930) 31-48; Flynn, *Chain Stores: Menace or Promise* (April, May 1931) 66 NEW REPUBLIC 223, 270, 298, 324, 350. For the consideration of particular charges commonly levelled against chain stores see e.g. Lyons, *Are the Chains the Enemies of the Manufacturer* (May 1930) 18 NATION'S BUSINESS 24; Lyons, *The Chain Store Side* (Sept. 1929) 22 AMER. BANKER'S ASS'N JOURNAL 229; Dovell, *Chains Can be Good Citizens* (June 1931) 19 NATION'S BUSINESS 78.

11. Those local persons or concerns operating two stores within the state, of which

the concomitant increase in that to be borne by sectional and national chain store companies under the new statute, as compared with the displaced act of 1932.[12] Under the previous graduated license tax statute of Louisiana and those of other states,[6] the national and the local chain operating the same number of stores respectively within a particular state have been taxed at the same rate, without consideration of the possible superior ability of the former to absorb the tax by reason of operating nationally as well as locally.[13] Thus such a tax might place the local chain operator at a competitive disadvantage, since, theoretically, the national chain can spread a tax imposed upon its local units over its many stores, local as well as national, thereby reducing to a negligible amount the tax expense to each of its local units. Or it can allow its local units to absorb the tax themselves, the resultant decrease in profits theoretically being recoverable by the company's charging higher prices for commodities in stores

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there were 295 in 1930, and those operating three stores, of which there were 41 in 1930, [15th CENSUS of U. S. (1930) 1 DISTRIBUTION 950] will have their tax expenses per store reduced from $15 per store under the displaced act of 1932 (La., Acts 1932, No. 19) to $10 per store under the new act. Strictly speaking those persons or concerns operating two or three stores are "multi-unit independents" rather than local chains. The latter are those concerns operating 4 or more stores. See NICHOLS, op. cit. *supra* note 10, at 10. In 1930 there were 23 local chain concerns, each operating over 4 stores, together operating 374 stores in Louisiana; an average of about 16 stores per chain [15 CENSUS of U. S. (1930) 1 DISTRIBUTION 950]. Assuming that this represents the usual number of stores owned by each local chain, the tax expense to each of those local chains for all of their stores will be reduced from $375 under the act of 1932 to $240 under the present act.

12. The following chart, based upon one prepared by the Limited Price Variety Stores Ass'n, indicates the operation upon the sectional and national chains of the new act as compared with the old one.

Company	*Total Stores*	*Stores in Louisiana*	*Louisiana Taxes in 1933*	*Louisiana Taxes in 1934*	*% Increase*
A	207	107	$14,200.00	$26,750.00	88.3
B	15,500	100	12,800.00	55,000.00	329.6
C	159	4	60.00	600.00	900.
D	153	3	45.00	450.00	900.
E	230	5	75.00	1,500.00	1,900.
F	667	15	350.00	8,250.00	2,257.
G	1,950	12	260.00	6,600.00	2,438.
H	489	7	125.00	3,500.00	2,700.
I	1,464	8	150.00	4,400.00	2,833.
J	380	3	45.00	1,350.00	2,900.
K	551	7	125.00	3,850.00	2,978.
L	769	6	100.00	3,300.00	3,200.
M	417	2	30.00	1,000.00	3,233.
N	457	5	75.00	2,500.00	3,233.3
O	500	3	45.00	1,650.00	3,566.
Total	23,893	287	$28,485.00	$120,700.00	323.%

13. Cf. FED. TRADE COMM., CHAIN STORE PRICE POLICIES (1934) Doc. No. 85, at 104-118 (local price cutting advantages of larger and more widely distributed chains). No statistical survey, however, has as yet been made showing the effect of anti-chain taxes upon the differently sized chains.

located in other territories where the competition is not so intense. The effect of the tax would in such case be to leave the local chain store concern with a choice of two discouraging alternatives: first, to shift the tax to the consumer, with a probable resultant loss of business to his large chain competitors; second, to absorb the tax with the effect of reduced net income. The new Louisiana act materially prevents the possibility of such a disadvantage. In fact it would seem to create the greater possibility of giving to local chains a positive advantage in comparative tax burdens.[12]

In the policy of effecting a discrimination against sectional and national chains in favor of local chains, the Louisiana act is preceded only by a Florida act of 1931.[14] The latter statute sought to accomplish that end by means of a graduated license tax, which was increased in rate where the taxpayer operated stores in more than one county. Thus while five stores of a chain operated in one county were taxed at a rate of ten dollars each, the same number of stores operated in two or more counties were taxed at fifteen dollars per store. Because of conditions peculiar to Florida, this statute did, in the main, result in a discrimination in favor of local chains as against sectional and national chains.[15] While the United States Supreme Court held this basis of classification void as violative of the equal protection clause of the Federal Constitution,[16] it did so upon the ground that the classification on the basis of counties was wholly arbitrary since it would not necessarily effect a discrimination in favor of local as against sectional and national chains; a national chain might confine its operations within Florida to one county and thus be taxed at a lower rate than a local chain which might operate in two or more counties. This was apart from the question upon which the court was non-committal, namely, whether a classification discriminating in favor of local as against sectional and national chains would be valid.[17]

But in that case, as previously,[18] the Supreme Court held that a classification

14. Fla. Laws 1931, c. 15624. Only the Louisiana and Florida statutes have enacted the policy of discrimination against large national and sectional chains, and in favor of smaller local chains. But cf. U. S. Daily, Feb. 19, 1930, at 3546, col. 3 (proposed Texas law to excuse local chains from the operation of a graduated license tax); Miss. H. B. No. 235 (1927), reported in CHAIN STORE AGE (Groc. Ed. Dec. 1928) 57 (tax only on those chain organizations operating in three or more cities in the state); S. C. H. B. No. 1200 (1930), reported in U. S. Daily, Feb. 14, 1930, at 3494, col. 5 (tax only on foreign chains based on their gross receipts from South Carolina business).

15. See dissent of Cardozo, J., in Liggett v. Lee, 288 U. S. 517, 581 (1933); (1933) 81 U. OF PA. L. REV. 871, 872; (1933) 28 ILL. L. REV. 288.

16. Liggett v. Lee, 288 U. S. 517 (1933). The case has been widely commented upon. Cf. (1933) 19 VA. L. REV. 722; (1933) 81 U. OF PA. L. REV. 871; (1933) 33 COL. L. REV. 754; (1933) 7 ST. JOHN'S L. REV. 350.

17. Yet from the care exercised by the court to point out that the Florida act did not accomplish a classification of national, sectional and local chains, the inference is deducible that such a classification would be regarded as valid. Liggett v. Lee, 283 U. S. 517, 534-535 (1932); cf. (1933) 19 VA. L. REV. 722, 728.

18. State Board of Tax Comm'rs of Indiana v. Jackson, 283 U. S. 527 (1931). Cf. Legis. (1931) 31 COL. L. REV. 145; Legis. (1931) 44 HARV. L. REV. 456; Legis. (1931) 80 U. OF PA. L. REV. 289; Comment (1931) 40 YALE L. J. 431.

according to the number of stores under common ownership within the same state is "reasonable" under the equal protection clause. The Louisiana statute departs from the field of chain store legislation already held permissible, by classifying chain stores for purposes of taxation according to the number of stores operated everywhere, and thus raises novel constitutional questions. The first problem is whether the basis of classification adopted in the Louisiana act results in a denial of the equal protection of the laws to chain concerns operating stores in other states besides Louisiana. The next is whether the act deprives those concerns of their property without due process of law either by the enormity of the tax or by, in effect, taxing their out-of-state stores.

In validating classifications based upon common ownership of stores within the state, the Supreme Court was impressed by differences in organization and methods of doing business between independent retailers on the one hand and chain stores on the other,[19] as well as by relatively equal differences between a chain operating a greater number of units within the state, and another operating fewer units therein.[20] An attack upon the Louisiana statute under the equal protection clause, however, may be predicated upon the fact that by considering the number of stores of a chain operated everywhere the act favors one chain over another although both operate the same number of stores within the state. Past decisions of the court are not determinative of the question involved herein of whether possession of additional merchandising outlets in other states imparts to each of the local units of a national or sectional chain such a competitive advantage over the same number of units of a local chain as to justify a tax discrimination in favor of the local chain's units and against each of the national chain's units in the taxing state. If it is "unreasonable" to conclude that such a competitive advantage does exist in favor of each of the units of the national chain in the taxing state, it may be argued that the Louisiana tax classification is "arbitrary."[21] It would thus be taxing at a higher rate the local stores of such a chain solely because those local stores are connected with units outside the state, and not because that connection affords a competitive advantage over an equal number of units of a local chain.[22]

19. State Board of Tax Commissioners of Indiana v. Jackson, 283 U. S. 527 (1931). The decision was confined to the holding that there existed sufficient differences between the independent retailer on the one hand, and chain stores on the other, to justify their separate classification for tax purposes. Nevertheless, it may be said that implicit in the sustenance of the graduated license tax in that case was the holding that a large chain does a different type of retailing than a smaller chain, to afford a basis for a difference in treatment between them.

20. In Fox v. Standard Oil Co. of N. J., U. S. L. Week, Jan. 15, 1935, at 444, col. 1, the court held that a larger chain does a different type of retailing than a smaller one, thus providing a permissable basis for their separate tax classifications.

21. Classification of objects for purposes of different treatment in order to be valid under the equal protection clause of the 14th Amendment must rest upon a difference which is substantial and not trivial, so that all similarly situated will be treated alike; it must be directed to the accomplishment of a purpose within the permissible functions of the state; and the difference must bear a substantial relation to the object of the legislation. See COOLEY, TAXATION (4th ed. 1924) § 334 and cases there cited.

22. Every chain possessing stores outside of, as well as within Louisiana, is a foreign

It may well be demonstrated, however, that local units of a large national chain possess definite competitive advantages over those of a small local chain, which afford a proper basis for their separate classification and treatment. The Supreme Court has recently[20] explicitly enunciated the proposition, hitherto implicit in *State Board of Tax Commissioners of Indiana* v. *Jackson*,[19] that differences in numerical size between chain store organizations provide a reasonable basis for separate tax classification among them. According to the court, the opportunities and powers of the chains become greater with the increase in the number of component links thereof, and the resultant disparity in competitive positions and social effect between the numerically larger and smaller chains furnishes a ground for treating them differently.[23] It would logically follow from these differences that there would be a corresponding disparity in the competitive position of the individual units belonging to differently sized chains; the feature of being an integral part of a larger chain impresses upon the individual units characteristics which must set them apart from the units of a smaller chain.[24] While the generalization of the court, that a larger chain possesses definite advantages over a smaller chain, was made in reference to a statute which considered only the number of stores within the state, it would be equally applicable to a situation in which chains had stores both within and without the state. The advantages accruing from the possession of an increased number of stores would not cease to operate at state lines. Logically, those advantages would be more truthfully reflected by consideration of the total number of stores everywhere operated, rather than of only those stores within the state. That totality would also appear to be the truer determinant of the comparative competitive positions of the individual stores belonging to and therefore partaking of the features of different sized chains. Such differences

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corporation. Unlike some state courts [COOLEY, TAXATION (4th ed. 1924) § 359], the Supreme Court has definitely adopted the rule that once a foreign corporation has been admitted to do business in a state, the 14th Amendment forbids a discrimination against foreign corporations in favor of domestic corporations similarly situated. Southern Ry. Co. v. Greene, 216 U. S. 400 (1910); Hanover Fire Ins. Co. v. Harding, 272 U. S. 494 (1926). Hence the sectional and national chains could not be discriminated against solely because they are foreign corporations.

23. In Fox v. Standard Oil Co. of N. J., U. S. L. Week, Jan. 15, 1935, at 444, col. 1, the Court said, "A chain, as we have seen is a distinctive business species, with its own capacities and functions. Broadly speaking its opportunities and powers become greater with the number of component links; and the greater they become, the more far reaching are the consequences, both social and economic. For that reason the state may tax the large chains more heavily than the small ones, and upon a graduated basis as indeed we have already held. State Board of Tax Commissioners v. Jackson, 283 U. S. 527 (1931); Liggett v. Lee, 288 U. S. 517 (1933)."

24. While each unit of a chain is a purely local institution in the sense that is serves only a local community [FED. TRADE COMM., CHAIN STORE PRICE POLICIES (1934) Doc. No. 85, at 104], the advantages purported to inhere in the chain organization, of which it is a part, naturally accrue to it. Hence if a large chain does a different type of retailing than a smaller chain, or affects the community in a different way, it follows that each unit of a larger chain is similarly distinguishable from each unit of a smaller chain. Cf. Sams, (July 1930) CHAIN STORE AGE 22.

existent in the local stores of a larger as compared to those of a smaller chain, would therefore afford a basis, valid under the equal protection clause,[25] for discriminating in the taxes imposed upon them.

Another justification for validating the act under the equal protection clause may be that it effects a reasonable classification of national, sectional, and local chains for purposes of taxation.[26] It may be shown that, in general, the greater the number of stores under a common control, the wider is the geographical territory served. Thus in 1930, local chain store companies owned an average of nine stores, sectional chains an average of forty-five, and national chains an average of one hundred fifty-four.[27] This condition seems to be reflected in Louisiana, as well as in other states.[28] The greater breadth of geographical distribution of stores of the larger chains has been adduced to afford definite competitive advantages in the form of an increased bargaining power as against labor,[29] an ability to take advantage of price dislocations between different ter-

25. Admittedly, the differences in methods of retailing between the units of a larger chain and those of a smaller chain may not be great. However, they would hardly be any less than the differences between each unit of a chain and an independent retailer who is a member of a cooperative retailing association. See Brief for Appellants 122-185; Liggett v. Lee, 288 U. S. 517 (1933). And, in *Liggett v. Lee*, the Supreme Court held that chain stores might be treated differently than independents who were members of cooperative organizations. Indeed, as a rule, differences between objects separately classified need not be great in order to be valid under the equal protection clause. Cf. American Sugar Refining Co. v. Louisiana, 179 U. S. 89 (1900); Quong Wing v. Kirkendall, 223 U. S. 59 (1912); Toyota v. Territory of Hawaii, 226 U. S. 184 (1912); Bradley v. City of Richmond, 227 U. S. 477 (1913); Singer Sewing Machine Co. v. Brickell, 233 U. S. 304 (1914); Tanner v. Little, 240 U. S. 369 (1916); Armour and Co. v. Virginia, 246 U. S. 1 (1918); Ft. Smith Lumber Co. v. Arkansas, 251 U. S. 532 (1920); White River Lumber Co. v. Arkansas, 279 U. S. 692 (1929); State Board of Tax Commissioners of Indiana v. Jackson, 283 U. S. 527, 538 (1931).

26. The classification of chain store companies into national, sectional, and local chains was adopted in 15th CENSUS OF U. S., RETAIL DISTRIBUTION, RETAIL CHAINS (1930). A chain is national if the stores comprising it are operated throughout the country; it is sectional if it operates stores in a number of communities in certain sections of the country; it is local if substantially all of its stores are located in one community. Id. at 7; NICHOLS, op. cit. *supra* note 10, at 9.

27. In 1930, 5,589 local chains operated 52,465 stores; 1,136 section chains operated 51,058 stores, and 321 national chains operated 51,058 stores. 15th CENSUS OF U. S., op. cit. *supra* note 26, at 11; NICHOLS, op. cit. *supra* note 10, at 12.

28. 15th CENSUS OF U. S., op. cit. *supra* note 11, at 950.

29. While statistics accumulated by the Federal Trade Commission, if valid would tend to indicate that chain stores pay lower wages to their employees than independent retailers [FED. TRADE COMM., ANNUAL REPORT (1933) 36], they do not consider the comparative wages paid by national, sectional, and local chains. Information gathered in the Census of Distribution (15th CENSUS OF U. S., op. cit. *supra* note 26, at 31) indicates that the wages paid by local as against sectional and national chains in the grocery business were about the same that the local chains paid somewhat higher wages than sectional chains in the meat market business, and that local chains paid higher wages than national and sectional chains in the combination grocery and meat business. These figures, however, are obviously inconclusive. But consider the incident of the recent A. & P. strike in Cleveland (see N. Y.

ritories for selling and purchasing purposes, as well as to shift losses sustained in one territory to a more inelastic consuming market in another.[30] These purported advantages, a fortiori, would accrue to the benefit of each unit of the chain, so that each unit of a national chain conducts a business in a different manner from each unit of a sectional and local chain, and each unit of a sectional chain in a different manner from each unit of a local chain.[24] Such differences would afford a reasonable basis for the tax discrimination under the Louisiana statute. The possibility is ever present, however, that a local chain may possess as many stores as a sectional or national organization, and therefore may be taxed at the same rate. This possibility, remote though it may be from actuality, may, as in the Florida case,[16] upset the validity of the means adopted to achieve the classification between national, sectional, and local chains. Still, the numerical basis seems the closest approximation of the national, sectional and local chain classification yet devised. The existence of remote potential exceptions to the general classification would hardly justify vitiating it.[31]

Nevertheless, it might further be objected under the equal protection clause that the difference in rate of taxation of local units of a national chain as compared with the units of a local chain made possible by the consideration of outside stores in fixing the rate under the Louisiana statute, is not related to the actual degree of difference in the value of the privilege enjoyed by the units of each of those types of chains.[32] Thus, admitting that there are differences between a chain store belonging to a local chain of 10 stores and another belonging to a national chain of 500 stores, but possessing only 10 stores within the state, which would justify some difference in treatment between them, it may be argued that those differences can not be so great as to justify a tax of but $10 upon the former and $550 upon the latter. This argument however, would assume that the equal protection clause requires not only that the differences between objects separately classified be substantial, but also that the taxes be proportioned to the differences in the value of the privilege enjoyed by tax-

Times, Oct. 31, 1934, at 1, col. 5) wherein that company was able, by reason of its vast national organization, to threaten seriously to withdraw its 300 stores from that city. For an elaborate discussion of the social significance of the huge corporation as compared with smaller concerns see dissent of Brandeis, J., in Liggett v. Lee, 288 U. S. 517, 564-568 (1933).

30. See note 13, *supra*. The purported advantages outlined in the text are only those which can result from the operation of stores over a wide territory. To these advantages might be added those resulting from the operation of a greater number of units than the smaller local chain, such as greater capital, greater purchasing power, superior management resulting from the employment of specialists in the supervisory activities and large scale advertising. See note 23, *supra*.

31. Even though it be held that the Act does not result in a proper classification of national, sectional, and local chains, the act might still be upheld as resulting in a classification according to the numerical size of chain store concerns. See note 23, *supra*.

32. The Federal District Court in Standard Oil Co. of New Jersey v. Fox, 6 F. Supp. 494, 507 (S. D. W. Va. 1934), stated: " . . . a classification of different chains may be subject to condemnation if the difference between them has no relation to the privilege enjoyed." Finding that the difference between commodity and gasoline chains bore no relation to the privilege enjoyed, the court held invalid the West Virginia statute involved there.

payers. While a dictum of the United States Supreme Court may lend support to the view that the tax exacted must bear some relation to the value of the privilege for which it is imposed,[33] that court has not as yet definitely read the requirement contended for into the equal protection clause. Indeed, decisions of the court seem to suggest that once a classification is reasonable, it will not consider whether the treatment given different classes accords with the actual differences in privileges enjoyed by them.[34] This appears especially true in cases where the tax classification also had a public welfare purpose.[35] Thus in a recent decision involving a Washington statute which levied an excise tax of 15¢ a pound on all butter substitutes and no tax upon butter, the court having found that there were differences between butter and oleomargarine which justified their separate classification, did not consider whether the differences were so great as to justify the difference in treatment given them.[36] And still more recently the Supreme Court has refused to hold that the disparity in the value of the retail privilege enjoyed between gasoline filling station chains and independents, or between gasoline filling station chains and commodity chains rendered a graduated license tax void as violative of the equal protection clause.[20] Therefore, it would seem that once there has been shown to be a valid basis for discrimination between local and national chains, it is not of legal significance that the tax of $550 on the Louisiana unit of a national chain of over five hundred stores, as compared with the $10 tax on the unit of the local chain may not have a substantial relationship to the actual difference in the value of the privilege enjoyed by one as compared with that enjoyed by the other.

The maximum rate of $550 imposed by the Louisiana statute upon all stores within the state which are members of a chain of more than than five hundred stores is the highest fee to which state[37] anti-chain taxes have as yet been

33. In Air Way Electric Appliance Corp. v. Day, 266 U. S. 71, 83 (1924), the Court said, "Without holding that the charge must be measured by the value of the privilege for which it is imposed, it may be said that some relation to such value is a reasonable requirement . . . "

34. See Illinois Central Rr. Co. v. Decatur, 147 U. S. 190, 197 (1893); Union Refrigerator Transit Co. v. Kentucky, 199 U. S. 194, 203 (1905); Southern Pacific Co. v. Kentucky, 222 U. S. 63, 76 (1911); St. Louis and Southwestern Ry. v. Nattin, 277 U. S. 157, 159 (1928); cf. COOLEY, TAXATION (4th ed. 1924) § 261.

35. American Sugar Refining Co. v. Louisiana, 179 U. S. 89 (1901); Quong Wing v. Kirkendall, 223 U. S. 59 (1912); Rast v. Van Deman and Lewis, 240 U. S. 342 (1916); Tanner v. Little, 240 U. S. 369 (1916); Armour and Co. v. Virginia, 246 U. S. 1 (1918); Alaska Fish Salting and By Products v. Smith, 255 U. S. 44 (1921); A. Magnano Co. v. Hamilton, 292 U. S. 40 (1934).

36. A. Magnano Co. v. Hamilton, 292 U. S. 40 (1934).

37. Municipal ordinances however, have been graduated to even higher levels than the Louisiana act. Thus a municipal ordinance of the city of Hamtramck, Michigan, imposed a license tax upon retail establishments that was graduated to $1,000. This ordinance was declared unconstitutional as being confiscatory and beyond the power of the municipality in Kroger Grocery and Baking Co. v. City of Hamtramck, No. 200325, Circuit Court, Wayne County, Mich. (1932) (unreported). A similar ordinance of the City of Maplewood, Mo., was held unconstitutional for the same reasons. Kroger Grocery and Baking Co. v.

graduated.[38] By virtue of this comparatively large fee, the Act is theoretically challengeable on the ground that the fee is confiscatory, and therefore violative of the due process clause of the fourteenth amendment.[39] Actual proof of confiscation in the sense of virtual usurpation of profits might, however, be necessary to sustain such an argument.[40] But even assuming that the act is confiscatory in operation, if it be found that the classification which is adopted is valid, it is possible to invoke the caveat that "the power to tax involves the power to destroy"[41] and so to support the tax despite its effect. Thus, the Supreme Court has frequently upheld tax statutes clearly designed to hamper or destroy particular industries or methods of business deemed to be undesirable upon the ground that, the power to tax the subject matter being clear, the judiciary will not prescribe limits on the extent to which it may be exerted.[42] Yet in these cases, the Supreme Court has been careful to assert that it reserved the power in a given instance to strike down such legislation under the due process clause where the operation of a statute would lead to the inference that the form of taxation was adopted as a disguise to exercise another power denied to the state by the federal constitution.[43] There is no indication, however, that the destruction by a state of chain store type of retailing, deemed by it to be inimical

City of Maplewood, Case No. 98057, Circuit Court of County of St. Louis (1933) (unreported).

38. At the present time no graduated license tax has a maximum limit as low as that present in the Indiana statute which was upheld in the *Jackson* case. The statutes of Maryland, North Carolina and South Carolina have maximum fees of $150 per unit; Michigan and West Virginia have maximum fees of $250 per unit; and Idaho has a maximum fee of $500. See note 3, *supra*. While the Louisiana tax is the highest ever to have been enacted by a state, even higher chain store taxes have been proposed. Calif. A. B. 1609 (1933); Wash. H. B. 11 (1933) proposals to tax each store of a chain over 20 at $2,500; for proposals to graduate the tax up to $1,000 per store over a stated number see Ill. H. B. 121 (1933); Minn. H. B. 108 (1933); N. Y. A. B. 1265 (1933); N. Y. Sen. B. 243 (1933); So. Dak. Sen. B. 145 (1933). For a tabulation of anti-chain store tax acts proposed during 1933 see NATIONAL CHAIN STORE ASSOCIATION, THE CHAIN STORE TAX PROBLEM (1933) 43-52.

39. State courts have often declared municipal license tax ordinances invalid on the ground that they were confiscatory, and thereby deprived their victims of property without due process of law. See note 37, *supra*; City of Monroe v. Endelman, 150 Wis. 621, 626, 138 N. W. 70, 72 (1912); Fiscal Court of Owen County v. Cox Co., 132 Ky. 738, 743, 117 S. W. 296, 298 (1909); State v. Osborne, 171 Ia. 678, 695, 154 N. W. 294, 301 (1915).

40. See J. C. Penney Co. v. Diefendorf, 32 P. (2d) 784, 797 (1934). Of course, this requirement is merely that if complainant seeks to rely upon the argument that the tax is confiscatory, he must prove it: viz., that it would render the continuance of business in the state unprofitable.

41. See McCulloch v. Maryland, 4 Wheat. 316, 431 (U. S. 1819). For a discussion of the implications of the dictum of that case see Levin, *Does the Power to Tax Involve the Right to Destroy a Lawful Business?* (1933) 67 U. S. L. REV. 448, 512.

42. Veazie Bank v. Fenno, 8 Wall. 533 (U. S. 1869); McCray v. U. S., 195 U. S. 27 (1904); Alaska Fish Salting and By Products Co. v. Smith, 255 U. S. 44 (1921); A. Magnano Co. v. Hamilton, 292 U. S. 40 (1934).

43. See A. Magnano Co. v. Hamilton, 292 U. S. 40, 44 (1934); cf. McCray v. United States, 195 U. S. 27, 60 (1904); Child Labor Tax Case, 259 U. S. 20, 37-44 (1922); HALL, CASES ON CONSTITUTIONAL LAW (1926) 659.

to the public welfare of the state, is a power denied to the state.[44] In fact, by the latest Supreme Court decision upon chain store taxation the object was approved "to discourage the multiplication of units of a chain to an extent believed to be inordinate, and by the incidence of the burden develop other forms of industry."[45]

But, assuming that the purpose and method of discrimination adopted are otherwise "reasonable," the most serious objection that may be raised against the Louisiana statute is that inclusion of outside stores in the determination of the rate at which local stores of a sectional or national chain are to be taxed thereby operates, in effect, to tax property and business beyond the jurisdiction of the state. It is elementary that consistently with the due process clause of the fourteenth amendment, a state may not tax objects beyond its borders.[46] The Louisiana statute, however, on its face levies a tax upon the privilege of operating stores within Louisiana, a proper subject of taxation,[47] and merely takes outside stores into consideration as a means of computing the sum at which the privilege is to be taxed. Nominally therefore, it may be said that the Louisiana act does not tax property and business beyond the jurisdiction of the state. But that fact is not conclusive of the question whether the act does tax property and business beyond the confines of the state. If it can be shown that the actual effect of the act is to accomplish that result, it might nevertheless be unconstitutional.[48] In the determination of this matter, consideration of the so-called "subject and measure" tax cases is pertinent.

Analytically, in these cases, the "subject" of the tax "is that on which the statute says the tax is imposed"[49] and has usually been the legal privilege given to the taxpayer by the state in return for which it exacted a tax;[50] the "measure" is "that element whose magnitude in each particular case, given the rate of the tax, determines the amount which the taxpayer must pay."[51] Apparently, a primary test of fatal extraterritoriality in excise tax statutes[52]

44. Cf. dissent of Brandeis, J., Liggett v. Lee, 288 U. S. 517, 574 (1933).

45. Fox v. Standard Oil Co of N. J., U. S. L. Week, Jan. 15, 1935, at 444, col. 1.

46. Union Refrigerator Transit Co. v. Kentucky, 199 U. S. 194 (1905); Buck v. Beach, 206 U. S. 392, 402 (1907); Safe Deposit and Trust Co. of Baltimore v. Virginia, 280 U. S. 83 (1929); see COOLEY, TAXATION (4th ed. 1924) §§ 92-100.

47. The power of a state to exact a tax for the privilege of doing business within its borders is clear. COOLEY, TAXATION (4th ed. 1924) § 829.

48. It is often stated that in determining whether a state tax violates the federal constitution, the court will look at the operation or effect of the tax, and not at its name or form. Western Union Telegraph Co. v. Kansas, 216 U. S. 1, 27 (1910); Sioux Remedy Co. v. Cope, 235 U. S. 197, 203 (1914); St. Louis Southwestern Ry. Co. v. Arkansas, 235 U. S. 350, 362 (1914); Gregg Dyeing Co. v. Query, 286 U. S. 472, 476 (1932).

49. Isaacs, *The Subject and Measure of Taxation* (1926) 26 COL. L. REV. 939, 940.

50. The "subject" however, need not be a legal privilege given by the state, it may also be property, tangible or intangible; persons; or business. Ibid.

51. Ibid. A typical example of a "subject and measure" tax occurs where a state levies a tax upon a foreign corporation for the privilege of doing a local business at 2% of its total capital stock. The privilege of doing a local business is the "subject," 2% the rate; and capital stock the "measure."

52. It seems that where the "subject" of the tax is local property of a foreign corpora-

containing no maximum limitation was, subsequent to 1910,[53] the inclusion of foreign elements, themselves directly nontaxable, in the "measure" of the tax.[54] Thus, where a foreign corporation, doing business and maintaining property in a number of states, was taxed for the privilege of doing a local business at a specified rate applied to the total amount of its issued or authorized capital stock, with no maximum limitation to the tax,[55] the tax was held invalid as, in effect, a taxation of property and business without the state.[56] The "measure"

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tion, there may be included in the "measure" of the tax, elements which are themselves directly non-taxable. U. S. Express Co. v. Minnesota, 223 U. S. 335 (1912); Cudahy Packing Co. v. Minnesota, 246 U. S. 450 (1918). Cf. Powell, *Contemporary Commerce Clause Controversies over State Taxation* (1928) 76 U. OF PA. L. REV. 773, 774; Isaacs, *supra* note 49, at 949.

53. Previous to 1910, the settled rule was that any tax upon a proper "subject" was valid even though measured by elements in themselves directly non taxable. The basis for the rule was that the state, having the power to grant or withhold a particular privilege, might attach any condition it desired to the exercise of that privilege. See Powell, *Indirect Encroachment on Federal Authority by the Taxing Powers of the States* (1918) 31 HARV. L. REV. 572, and cases there cited. Subsequent to that date the general rule was departed from by means of qualifying the previous reason for the rule. Thus while a state had the power to grant or withold a particular privilege, it might not attach an "unconstitutional condition" to the grant of such a privilege. See Isaacs, *The Federal Protection of Foreign Corporations* (1926) 26 COL. L. REV. 263, 273-284.

54. But a franchise tax upon a *domestic* corporation measured by its total capital stock, irrespective of the fact that it may do business and possess property in states other than that of its incorporation, which necessarily includes in the "measure," elements which are directly non taxable, is now settled to be valid. Cream of Wheat Co. v. County of Grand Forks, 253 U. S. 325 (1920); Nebraska ex rel. Beatrice Creamery Co. v. Marsh, 119 Neb. 197, 227 N. W. 926 (1929), aff'd per curiam 282 U. S. 799 (1931). Similar taxes upon foreign corporations are uniformly held invalid (*infra* note 56). This apparent anomaly is explainable only upon practical grounds. See Powell, *supra* note 53 at 610. Since every chain store concern operating stores without as well as within Louisiana is a foreign corporation, the rule as to domestic corporations, even were the taxes otherwise analogous, would not be relevant to the Louisiana Act.

55. Even where the "measure" of a tax upon foreign corporations for the privilege of doing a local business included elements in themselves directly non-taxable, if a "reasonable" maximum was fixed to the amount of the tax, that sufficed in a number of cases to validate the tax. Baltic Mining Co. v. Massachusetts, 231 U. S. 68 (1913); Cheney Bros. Co. v. Mass., 246 U. S. 147 (1918); General Ry. Signal Co. v. Va., 246 U. S. 500 (1918). See Powell, *supra* note 53 at 777, 941 as to the probable reasons for tolerating those statutes. Whether a maximum provision will render such a tax constitutional at the present time is doubtful. See Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203, 218 (1925); Cudahy Packing Co. v. Hinkle, 278 U. S. 460 (1929); cf. Brief for Appellant 13-21, Cudahy Packing Co. v. Hinkle, 278 U. S. 460 (1929); (1929) 29 COL. L. REV. 834; (1929) 42 HARV. L. REV. 952; (1929) 13 MINN. L. REV. 609.

56. See Powell, *supra* note 53, at 572, 721, 932, and cases there discussed; St. Louis Southwestern Ry. Co. v. Stratton, 353 Ill. 273, 187 N. E. 498 (1933), cert. denied, 291 U. S. 673 (1934). In these cases, the taxpayer was engaged partly in interstate commerce within the state, and it was held that the tax not only constituted a burden upon interstate commerce but also taxed property of the corporation beyond the jurisdiction of the state. No case has as yet arisen in which a foreign corporation doing only a local business within

was in this case the total capital stock of the corporation, and representing, as it did, all of the corporation's business and property, included fatal extra-territorial elements. Similarly, where a tax upon the "subject" of the privilege of transfer of a resident decedent's property was assessed at a predetermined rate against all of his property within and without the state, such property being the "measure" of the tax, it was held unconstitutional in *Frick v. Pennsylvania* as taxing that property included in the "measure" which was beyond the jurisdiction of the state.[57] Where, however, the tax upon a foreign corporation for the privilege of doing local business was imposed at a specified rate upon the proportion of capital stock allocable to the state,[58] this "measure," representing the property and business within the state, was not extraterritorial and the tax was therefore valid.[59] Since in these cases the rate of the tax to be applied against the "measure" was either fixed, or graduated only according to the amount of capital stock of the corporation allocated to the state, the sole problem of extraterritoriality arose in connection with the inclusion of foreign elements in the "measure" of the tax.

The Louisiana statute, however, raises the question whether the measure of

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the state has been taxed for its local privilege at a certain rate applied to its total capital stock. Declarations in the opinions however, indicate that in such a case also the tax would violate the due process clause as taxing extrastate values included in the "measure." See Powell, *Due Process Tests of State Taxation, 1922-1925* (1926) 74 U. OF PA. L. REV. 423, 446.

57. Frick v. Pennsylvania, 268 U. S. 473 (1925). See Isaacs, *supra* note 49, at 947. For a general discussion of state inheritance tax laws raising problems of extraterritoriality, see Powell, *Extraterritorial Inheritance Taxation* (1920) 20 COL. L. REV. 1, 283.

58. A usual method of determining what proportion of capital stock shall be allocated to the state is to take that percentage of the total capital stock of the corporation, that the property located and business transacted in the state bears to the total property and business of the corporation. Thus:

$$\frac{\text{Property within the state} + \text{business transacted in the state}}{\text{Total property} + \text{total business}} = \frac{X}{\text{Total capital stock}}$$

59. St. Louis Southwestern Ry. Co. v. Arkansas, 235 U. S. 350 (1914); Hump Hairpin Mfg. Co. v. Emmerson, 258 U. S. 290 (1922); Schwab v. Richardson, 263 U. S. 88 (1923); International Shoe Co. v. Shartel, 279 U. S. 429 (1929); Western Cartridge Co. v. Emmerson, 281 U. S. 511 (1930); Southern Realty Corp. v. McCallum, 65 F. (2d) 934 (C. C. A. 5th, 1933). But where the "measure" is the proportion of *authorized* capital stock allocable to the state, the tax is held unconstitutional as being extraterritorial. Air Way Electric Appliance Corp. v. Day, 266 U. S. 71 (1924); Montgomery Ward and Co. v. Becker, 69 S. W. (2d) 674 (1934). In some cases, income rather than capital stock is used as the "measure" of the tax levied for the "subject" of exercising a corporate privilege within the state. Where the "measure" income, is allocated to the state, the tax is valid. Bass, Ratcliff, and Gretton Ltd. v. State Tax Comm., 266 U. S. 271 (1924); Gorham Mfg. Co. v. Travis, 274 Fed. 975 (S. D. N. Y. 1921); S. S. Kresge Co. v. Bennett, 51 F. (2d) 353 (S. D. N. Y. 1931). Should, however, the apportionment result in allotting profits to the state which are not fairly attributable to transactions therein, it is probable, upon the analogy of the income tax cases, that the tax would be voided as taxing profits outside the state. Cf. Hans Rees Son Inc. v. North Carolina, 283 U. S. 123 (1931); Standard Oil Co. of Indiana v. Thoresen, 29 F. (2d) 708 (C. C. A. 8th, 1928); Comment (1931) 40 YALE L. J. 1273.

the tax being confined to the state, the rate to be applied against that measure could validly be graduated according to the existence of elements located both within and without the state. There the "subject" is the privilege of doing chain store business in Louisiana, the "measure," the local stores,[60] and the rate, a sum determined by the total number of stores. The nearest approach to a decision on this point is the case of *Maxwell v. Bugbee*,[61] upholding a New Jersey non-resident decedents' transfer tax statute.[62] That statute purported to tax the transfer of local property, but, where the decedent's estate was partly within and partly without the state, the sum payable was to be determined by first computing the tax that would be payable if the entire estate were within the state and then taking the proportion of the amount derived thereby that the value of the property actually located within the state bore to the value of the total estate. The tax rate that would be applied to such a transfer of an entirely local estate was progressively graduated as follows: for the first $5,000, nothing; for the next $45,000, 1%; for the next $100,000, 1½%; for the next $100,000, 2%; and for all over, 3%.[63] It would seem that when progressive percentages are applied to the total property and a proportion of that sum taken, the foreign property is at least partially introduced into the measure.[64] To square with the ideal conception of "measure" not including extraterritorial property, it would have to be said that, in effect, only the "rate" was set by the total property, as a certain amount, and that the "measure" of local property was applied to determine the actual magnitude of the tax, not by the usual method of multiplication, but by division. It is notable in this respect that the subsequent case of *Frick v. Pennsylvania*, in seeking to distinguish the principal case, interpreted the New Jersey tax in such a way as to make a perfect division between the "measure" and the "rate".[65] It nevertheless remains difficult to see

60. The ready determinability of the number of stores in the state obviates any problem of determination of the "measure."

61. 250 U. S. 525 (1919). See Comment (1920) 33 HARV. L. REV. 582; (1920) 14 ILL. L. REV. 661; (1920) 68 U. OF PA. L. REV. 184; (1920) 29 YALE L. J. 464.

62. N. J. Acts 1914, c. 151, §§ 1, 12.

63. Thus where a non-resident decedent left a total estate of $2,500,000, only $250,000 of which was situated in New Jersey the tax would be $7,145. Had he possessed no property outside of New Jersey the tax would have been but $3,950.

64. Thus where two non-resident decedents should leave equal amounts of property in New Jersey and sufficient amounts of outside property to invoke the maximum rate of 3%, the fact that they possessed different amounts of outside property would result in a difference in the tax to be paid upon the transfer of their equal amounts of property within the state. Had the total property been used solely to determine the rate of tax applicable to the local property, since both total estates would come within the 3% limit, the taxes would have been equal. In absence of this equality, the conclusion is inescapable that the New Jersey statute does at least partially introduce foreign property into the "measure" of the tax.

65. 268 U. S. 473, 496 (1925); "The only bearing which the property without the state had on the tax imposed in respect of the property within was that it affected the rate of the tax. Thus, if the entire estate had a value which put it within the class for which the rate was three percent, the rate was to be applied to the value of the property within the state in computing the tax on its transfer although its value separately taken would put it within the class for which the rate was two per cent." In this respect, the court appears to

that the magnitude of the tax actually was not as much determined by the total property as the local property, or in any event, that a "rate" which is in part determined by the existence of extraterritorial property does not to that extent accomplish a tax upon that property.[66] That the existence of foreign property thus used in fixing the amount of the tax resulted in an increase in the tax required of the taxpayer, however, failed to convince the bare majority of the Supreme Court that the statute "really" effected a tax upon foreign property.[67]

The *Frick* case subsequently declared *Maxwell v. Bugbee* to be a borderline case and apparently limited it to its particular facts. But in so doing it defined those facts to be the express use of foreign elements in the determination of the rate of tax to be applied to a local measure.[68] If the *Maxwell* case, together with the distinguishing rationalization of it in the *Frick* case, can fairly be said to stand for the general proposition that a tax is not extraterritorial merely because it determines the rate to be applied to the local measure by considering extraterritorial elements, direct precedent is available for upholding the Louisiana statute.

But the intrinsic weight to be given the *Maxwell* case is rendered questionable not only by its dubious logic but also by reason of the fact that the New Jersey statute, there upheld, is distinguishable in operation from the Louisiana statute. Thus in the former statute, wherein the extraterritorial elements figured in both the "measure" and the "rate," the finding of non-extraterritoriality may be rationalized by the fact that a proportion of the total sum

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have misconstrued the New Jersey statute involved in the *Maxwell* case. The rates were progressively graduated; they did not relate back to cover previous classifications as the court in the *Frick* case assumed, but were applicable only to such property as fell within the bracket which induced the higher rate. Applying the progressive graduated rate of the New Jersey statute to a local estate of $250,000 which was part of a total estate of $2,500,000, the resultant tax would have been $7,145. But had the statute been as the court in the *Frick* case interpreted it to be, the total estate, being over $300,000, would have fallen in a class to which a flat rate of 3% would have been applicable to the local estate. This would have resulted in a tax for the transfer of the $250,000 of local property of $7,500. The latter situation of course, would be directly analogous to the Louisiana tax, for it merely determines the rate by the total number of stores, and then applies that rate against the local stores to arrive at the amount of the tax return.

66. Mr. Justice Holmes, dissenting in Maxwell v. Bugbee, 250 U. S. 525, 543 (1919), said: "Many things that a legislature may do if it does them with no ulterior purpose, it cannot do as a means to reach what is beyond its constitutional power. . . New Jersey cannot tax the property of Hill or McDonald outside the state, and cannot use her power over property within it to accomplish by indirection what she cannot do directly. It seems to me that that is what she is trying to do. . . It seems to me that when property outside the state is taken into account for the purpose of increasing the tax upon property within it, the property outside is taxed in effect, no matter what form of words may be used."

67. Maxwell v. Bugbee, 250 U. S. 525, 539 (1919): "In the present case the state imposes a privilege tax, clearly within its authority, and it has adopted as a measure of that tax the proportion which the specified local property bears to the entire estate of the decedent. That it may do so within limitations which do not really make the tax one upon property beyond its jurisdiction, the decisions to which we have referred clearly establish."

68. See also possible argument set forth in note 71 *infra*.

derived from a consideration of those elements was allocated to the property within the state. But in the latter statute, the extraterritorial elements are determinative only of the "rate," and no apportionment of the resultant increased sum is made beyond the fact that it is imposed upon each of the local stores. The clarity with which the stark issue of extraterritoriality is here presented is emphasized by the sharp upward curve of the "rate" in relation to total stores, the result of which is frequently to determine the greater portion of the tax return by the existence of the foreign stores.[69] Thus, a national chain owning fifteen stores in Louisiana and five hundred and thirty-five stores elsewhere, by reason of the method of rate adjustment adopted in relation to the local stores, would find itself taxed $8,250. Had it no foreign stores the tax would have been $225. In this manner 97.27% of the tax return is determined by the existence of foreign stores. Similar percentages are reflected in many of the national and sectional chains operating in Louisiana.[70] Especially in the light of the actual gross disproportion of taxes upon the Louisiana units of sectional and national chains, resulting from the existence of their foreign stores, it may strongly be urged that the statute effects an unconstitutional taxation of those stores.[71]

But the success of such a demonstration is by no means assured. The result in the *Maxwell* case and the occurrence of logical anomalies in others of the "subject and measure" tax cases[72] indicate that in deciding whether a particular

69. Both the *Maxwell* and *Frick* cases affirmed the principle that, consistently with due process, a state may not impose a tax on a local privilege in such a way as really to amount to taxing that which is beyond its authority. Maxwell v. Bugbee, 250 U. S. 525, 540 (1919); Frick v. Pennsylvania, 268 U. S. 473, 496 (1925). If this has any meaning, it would seem that actual proof in any given instance of extraterritorial allocation of the tax cannot be precluded.

It may be found that the tax, computed upon the basis of foreign as well as local stores, where the number of foreign stores so far exceeds the number of local stores as to be determinative of the classification of the chain under the Louisiana act, can have no relation to the value of the privilege enjoyed by members of the national chain in Louisiana. Hence, the amount of tax above that which would be a reasonable exaction for the privilege conferred, must of necessity be imposed upon foreign stores. The statute could therefore be declared unconstitutional as taxing extraterritorial elements. Cf. Airway Electric Appliance Corp. v. Day, 266 U. S. 71, 83 (1924); St. Louis Southwestern Ry. Co. v. Stratton, 353 Ill. 273, 187 N. E. 498 (1923), cert. denied, 291 U. S. 673 (1934).

70. Under the table set forth in note 12, *supra*, it may be noted for example that Co. *A* would have 80% of its tax return determined by the existence of its foreign stores; Co. *C*, 90%; Co. *D*, 98.18%; Co. *E*, 96.66%; Co. *F*, 98.28%; Co. *N*, 98%.

71. Yet the dialectic may be indulged that the rate is not determined by the total number of stores, but rather by the character of business done by the local stores, a purely local matter; and the total number of stores is used as but a convenient determinant of that character. So the increase in taxes is due not to the existence of foreign stores but to the existence of a different mode of business in the local stores, that mode being apprehended by consideration of the totality of stores. Realistically, however, it is difficult to see that the rate is not directly, or in substantial effect, determined by the total number of stores.

72. It is anomalous that while a tax upon a foreign corporation for the privilege of doing a local business measured by its total capital stock, where it does business in a

tax is extraterritorial, the Supreme Court frequently considers something more than the empirical effect upon the taxpayer or the weight of inconclusive precedent.[73] In this connection, the fact cannot be overlooked that the Louisiana Act does represent an endeavor to promote the local welfare of the state by strengthening the competitive positions of the local and smaller chains in Louisiana as against the larger organizations operating stores there, and by discouraging the latter. The past decisions of the Supreme Court, approving chain store taxes, have settled the validity of the state purpose to preserve local welfare by use of tax discrimination designed to adjust the competitive positions of the various independent and chain store units doing business within the state. Logically, that sanction would seem to carry over to effective discrimination based upon the size of the parent chain.[74] The reasonableness of the tax classification to accomplish this purpose is likewise indicated.[75] The inference that the precedent of *Maxwell v. Bugbee* is invocable to deny the extraterritoriality and uphold the constitutionality of the statute would then appear to be inevitable.[76]

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number of states, is unconstitutional as violative of the due process clause of the fourteenth amendment, a similar tax upon a domestic corporation, likewise doing business in a number of states, is constitutional. See note 54, *supra*. Furthermore, if a tax upon a proper "subject" which is measured by elements directly taxable, is actually a tax upon the elements within the measure, it is anomalous that a tax for the privilege of doing a local business measured by net income which includes non taxable income from a federal instrumentality, is constitutional. Educational Films Corp. of America v. Ward, 282 U. S. 379 (1931); Pacific Co., Ltd. v. Johnson, 285 U. S. 480 (1932). Cf. Powell, *An Imaginary Judicial Opinion* (1931) 44 HARV. L. REV. 889.

73. Cf. Lowndes, *Spurious Conceptions of the Constitutional Law of Taxation* (1934) 47 HARV. L. REV. 628, 639; Powell, *supra* note 53, at 610.

74. See *supra* p. 626. 75. See *supra* p. 626.

76. The possibility is open, however, that national and sectional chains may escape the rigors of the Louisiana tax by reincorporating their local units into separate subsidiary corporations. A similar device was used subsequent to Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113 (1920), to effect a reduction in state income taxes imposed upon foreign corporations conducting business in a particular state, in connection with their business in other states. See (1927) 27 COL. L. REV. 753; (1931) 31 COL. L. REV. 719. As a rule, if a parent corporation does not directly intervene in the affairs of its subsidiary, but permits it a good deal of autonomy, the parent company is usually held not to be "doing business" within the state for purposes of service [Peterson v. Chicago, Rock Island and Pacific Ry. Co., 205 U. S. 364 (1907); Cannon Mfg. Co. v. Cudahy Packing Co., 267 U. S. 333 (1925)] or taxation [Proctor and Gamble Co. v. Newton, 289 Fed. 1013 (S. D. N. Y. 1923)]. See Ballantine, *Separate Entity of Parent and Subsidiary Corporations* (1925) 14 CALIF. L. REV. 12. That rule would appear to be applicable in this instance where the tax is upon such firms as do business in the state. If local units of a national chain are incorporated into a separate local corporation, only the latter would "be engaged in operating . . . as a part of a . . . chain any store . . . in the state," and only the stores in the state may then be used for purposes of tax classification. But the Louisiana legislature might readily amend its present act so as to consider, regardless of corporate organization, the local units of the subsidiary as part of the national chain, if such in reality it is, and classify it accordingly. Many graduated license tax statutes at present have provisions disregarding corporate forms. See e.g. Ala. Acts 1931, No. 369, § 7; Fla. Laws 1933, c.

The question of extraterritoriality of this statute can hardly be considered in vacuo; it is inextricably bound up with the larger purpose of the act and the necessary method of its achievement.[77] In the absence of compelling case precedent it would appear, therefore, that to hold the tax extraterritorial would necessarily be to deny the legitimacy of the state's purpose to protect domestic welfare by using the tax power to affect the intra-state competitive positions of multi-state chains operating there. The halt that this would represent in the logical extension of the policies and principles already enunciated by the Supreme Court[78] would require a dual assumption. The first is that protection of large sectional and national chains from discriminatory state taxation[79] is vital to the national economic welfare. And the second is that the enhancement of such welfare, thereby to be achieved, is more important to the national public interest than the freedom of individual states to provide for what they conceive to be their domestic welfare. These assumptions remain yet to be proved. In absence of such proof there appears scant reason to remove the question of public concern with the treatment of national and sectional chains in a particular state from the exclusive province of that state.[80]

16071, § 7; Idaho Laws 1933, c. 113, § 7; Me. Laws 1933, c. 260, § 6. And statutes disregarding corporate forms set up to evade local income taxes, have been passed and upheld as a proper means of allotting to the state its just portion of the corporation's income. Palmolive Co. v. Conway, 43 F. (2d) 226 (W. D. Wis. 1930); Buick Motor Co. v. City of Milwaukee, 43 F. (2d) 385 (E. D. Wis. 1930); cf. People ex rel. Studebaker Corp. v. Gilchrist, 244 N. Y. 114, 155 N. E. 68 (1926). See Magill, *Allocation of Income by Corporate Contract* (1931) 44 HARV. L. REV. 935; Comment (1932) 32 COL. L. REV. 513.

77. It is difficult indeed to perceive how the competitive equalization sought between the stores of the various chain organizations doing business in the state can effectively be accomplished otherwise than by such tax discrimination.

78. See *supra* p. 626.

79. In this respect the vast possibilities opened up for municipalities to impose discriminatory taxes on one or more stores of longer chains situated in their jurisdictions, cannot be overlooked. As to municipal chain store taxes already enacted see NATIONAL CHAIN STORE ASSOCIATION, THE CHAIN STORE TAX PROBLEM (1933) 19-30; NICHOLS, CHAIN STORES AND THEIR SPECIAL TAX PROBLEMS (1934) 35-47.

80. The question of extraterritoriality does, however, present the opportunity for the Supreme Court to reconsider its previous refusals to review the local wisdom or policy in taxing chains, without the necessity of formally finding the action of the state legislature arbitrary and capricious. Thus an independent judicial policy, recognizing the economic utility and desirability of large chain organizations, could indirectly be given effect to prevent possible destruction or excessive restriction of such organizations, by the device of finding a fatal extraterritoriality in the Louisiana tax. Such a result, however, would appear to await a change in the climate of opinion now prevalent in the Supreme Court.

ACCOUNTS RECEIVABLE AS COLLATERAL SECURITY

FREQUENTLY a merchant who needs additional credit for his business operations has no unincumbered asset that can be used as security except his accounts receivable—that is, debts owed to him for goods sold to customers. Such an asset may have a fairly constant value, and be of a highly liquid nature, where in the course of business new accounts are created as existing ones are paid. Yet the economic and legal aspects of a transaction wherein a loan is made and the lender is given a lien against this asset that will be effective to protect him from the claims of other creditors or a trustee in bankruptcy are such as to make this type of financing unsafe and expensive.[1]

Generally the transaction, to be successful, must be made with the greatest possible secrecy.[2] Obtaining credit on the security of book accounts is frequently a measure of last resort to continue a business that has exhausted all other sources of credit.[3] The high interest rates and other charges paid to lenders that specialize in this type of finance indicate that the credit risk is great.[4] Knowledge that a business has been forced to resort to this practice would raise the suspicions of the general creditors, to the detriment of the business. Where the business is insolvent, bankruptcy might result if the creditors feel that the lien against the accounts can thus be destroyed, or that the business will eventually fail. Thus, if it is discovered that this type of transaction has occurred, the result may be ruinous.[5]

1. The assignment of book accounts has become increasingly popular in the last few years. They may be utilized not only to secure credit, but may be sold outright. Sometimes a complete transfer of the accounts is made and the assignee is permitted to collect them. This is not the general practice in a business of large proportions. See Hanna, *The Extension of Public Recordation* (1931) 31 COL. L. REV. 617. The name given to the agreement does not determine its legal incidents. Whether the transaction be called a sale, pledge, assignment or mortgage, the court will examine its actual nature and rule accordingly. Chapman v. Hunt, 254 Fed. 768 (C. C. A. 2d, 1918); Petition of National Discount Co., 272 Fed. 570 (C. C. A. 6th, 1921); Reynolds v. Ellis, 103 N. Y. 115, 8 N. E. 392 (1886); Preston v. Southwick, 115 N. Y. 139, 21 N. E. 1031 (1889).

2. Recordation, which is required in the case of chattel mortgages, is not necessary Ward v. American Agricultural Chemical Co., 232 Fed. 119 (C. C. A. 4th, 1916); In re Leterman, Becher and Co. Inc., 260 Fed. 543 (C. C. A. 2d, 1919); In re Leslie-Judge Co., 272 Fed. 836 (C. C. A. 2d, 1921); In re Macauley, 158 Fed. 322, 327 (E. D. Mich. 1907); Booth v. Kehoe, 71 N. Y. 341 (1877). Secrecy has itself never been thought sufficient grounds for avoiding an assignment, nor need the debtor be informed. See Greey v. Dockendorff, 231 U. S. 513, 516 (1913); Benedict v. Ratner, 268 U. S. 353 (1925); In re Hawley Down-Draft Co., 238 Fed. 122 (C. C. A. 3d, 1916); Robertson v. Henochsberg, 1 F. (2d) 604 (W. D. Tenn. 1924); Williams v. Ingersoll, 89 N. Y. 508, 522 (1882).

3. Such transactions are generally managed by finance companies because they have the necessary facilities and are willing to bother with its manifold details. Lauchheimer, *Some Problems in Modern Collateral Banking* (1926) 26 COL. L. REV. 129, 130.

4. The relationship is obviously a reciprocal one. The cost incidental to such financing is the reason why it is used only when absolutely essential to continue business. See Hanna, *supra* note 1.

5. The description given herein is discussed in greater detail by Hanna, *supra* note 1. Secrecy and the cost of collection are the reasons why the obligor is not informed and the assignor is himself permitted to collect. For an interesting description of this type of finance

The legal side of the problem is complicated by the fact that, although economically the accounts may be considered as a unit of more or less constant value, they are a group of constantly changing choses in action, each one of which has a separate legal significance. Whereas in a few jurisdictions it is legally permissible to create a "floating charge," by assigning at one time all present and future accounts as collateral, that will be valid against third persons,[6] in many others such an assignment would be ineffective because of the rule against the transfer of after-acquired property.[7] Under the old common law, ownership is identified with the idea of physical possession; therefore one cannot transfer that which he does not own or that which does not exist.[8] According to this view future accounts have been held by some courts to represent no existing legal interest and hence to be unassignable at law.[9] Other courts have treated the question somewhat differently, but in such a manner that the exact effect of such an assignment is not yet clear. Following the English rule[10] that is based on the maxim that equity considers done that

ing and the methods used to keep them secret see McGill v. Commercial Credit Co., 243 Fed. 637, 640-645 (D. Md. 1917); Lauchheimer, *supra* note 3, says the success of such hypothecations depends completely on their secrecy.

6. The assignor may use for his own benefit the funds he collects. Union Trust Co. v. Bulkley, 150 Fed. 510 (C. C. A. 6th, 1907); In re MacCauley, 158 Fed. 322 (E. D. Mich. 1907); Preston National Bank of Detroit v. George T. Middlings Purifier Co., 84 Mich. 364, 47 N. W. 502 (1890); Buvinger v. Evening Union Printing Co., 72 N. J. Eq. 321, 65 Atl. 482 (1907). In order to avoid a possible ground for successful objection, it is advisable to assign all accounts or some specific accounts, since the courts require that there be some designation. In re Imperial Textile Co., 255 Fed. 199 (N. D. N. Y. 1919); Tailby v. Official Receiver, 13 App. Cas. 523 (1888). Although a written agreement is desirable, and has been thought necessary, oral assignments of accounts have been upheld. Union Trust Co. v. Bulkley, 150 Fed. 510 (C. C. A. 6th, 1907); In re Macauley, 158 Fed. 322 (E. D. Mich. 1907); see Lichtenberg v. Harvey, 57 F. (2d) 82, 83 (C. C. A. 2d, 1932).

7. The problem discussed herein is to be distinguished from the assignment of an account under an existing executory contract or an expectancy. For the latter problem see In re Duncan Construction Co., 280 Fed. 205 (S. D. W. Va. 1922); United States Fidelity and Guaranty Co. v. Armstrong and Bro., 225 Ala. 276, 142 So. 576 (1932); Claycraft Co. v. John Bowen Co., 191 N. E. 403 (Mass. 1934); Huling, Brockerhoff and Co. v. Cabell, 9 W. Va. 522, 526, 527 (1876).

8. Low v. Pew, 108 Mass. 347 (1871); Taylor v. Barton Child Co., 228 Mass. 126, 117 N. E. 43 (1917); (1917) 27 YALE L. J. 272; See Comment (1924) 34 YALE L. J. 175, 176. The common law rule in regard to the importance of physical transfer in gifts and realty perhaps explains why some courts say that a subsequent physical transfer of an account will create good legal title in the assignee, as is noted *infra*.

9. Clanton Bank v. Robinson, 195 Ala. 194, 70 So. 270 (1915), and cases cited therein; Ellis v. Sabine County Coal Co., 199 Ill. App. 219 (1916); In re Nelson's Estate, 211 Iowa 168, 233 N. W. 115 (1930); Eagan v. Luby, 133 Mass. 543 (1882); Lehigh Valley Rr. Co. v. Woodring, 116 Pa. 513, 9 Atl. 58 (1887); Huling, Brockerhoff and Co. v. Cabell, 9 W. Va. 522 (1876); O'Neil v. Helmke, 124 Wis. 234, 102 N. W. 573 (1905).

10. The leading English case dealing with chattel mortgages is Holroyd v. Marshall, 10 H. L. Cas. 191 (1862). It was applied to accounts receivable in Tailby v. Official Receiver, 13 App. Cas. 523 (1888). This doctrine is generally referred to as the English rule, and was first suggested in the United States in 1843 in Mitchell v. Winslow, 17 Fed. Cas. No. 9673, p. 527 (C. C. D. Me. 1843).

which ought to be done, they have held that as soon as an assigned account comes into existence it is subject to a lien in favor of the assignee as against the assignor.[11] But it is not certain that all courts that have accepted this reasoning will apply it to make the assignment of future accounts good against third persons. In the analogous case of chattel mortgages at least one jurisdiction that has held the assignment of after-acquired property good as between the parties has also held that it creates no rights against creditors.[12] Thus,

11. Cox v. Hughes, 10 Cal. App. 533, 102 Pac. 956 (1909); Edwards v. Peterson, 80 Me. 367, 14 Atl. 936 (1888); Field v. Mayor of New York, 6 N. Y. 179 (1854); Coats v. Donnell, 94 N. Y. 168, 177 (1883); cf. Bank of Oakman v. Union Coal Co., 15 F. (2d) 360 (C. C. A. 5th, 1926); Coppard v. Martin, 15 F. (2d) 743 (C. C. A. 5th, 1926); see note 6, *supra*. The right is thought to be a personal claim against the assignor which matures into a lien when the property is acquired.

Greey v. Dockendorff, 231 U. S. 513 (1913), is generally cited as authority for the right to assign after-acquired accounts. The facts however are much more limited in scope, and the language of the court does not warrant the statement. Cf. National City Bank v. Hotchkiss, 231 U. S. 50 (1913); Mechanics' Bank v. Ernst, 231 U. S. 60 (1913); Irving Trust Co. v. Bank of America National Association, 68 F. (2d) 887 (C. C. A. 2d, 1934).

In analyzing the decisions of the courts in the past, it is particularly important to distinguish the cases before and after 1910 when the Bankruptcy Act was amended. Prior to that date the trustee only stood in the position of the bankrupt, and a lien against the bankrupt would be good against the trustee. At present, the trustee has the right of a creditor holding a legal or equitable possessory interest in the property of the debtor, so that the lien of the assignee must not only be good against the assignor but good also against third persons in order to escape the court of bankruptcy. See York Manufacturing Co. v. Cassell, 201 U. S. 344 (1906); Hayes v. Gibson, 279 Fed. 812 (C. C. A. 3d, 1922); Godwin v. Murchison National Bank, 145 N. C. 320, 59 S. E. 154 (1907).

The fact that the account accrues after involvency is known and within four months of bankruptcy does not create a preference if the original agreement was valid. Godwin v. Murchison National Bank, 145 N. C. 320, 59 S. E. 154 (1907); Coats v. Donnell, 94 N. Y. 168, 178 (1885); cf. Coppard v. Martin, 15 F. (2d) 743 (C. C. A. 5th, 1926) (and cases cited therein).

Consideration must be given at the time of the original assignment; otherwise there is a completely executory contract which is not effective. The theory is that equity acts in such cases in a manner similar to that of specific performance. Where, however, there is no consideration, there can be no specific performance since there is no element of irreparable damage. In re Cotton Manufacturers' Sales Co., 209 Fed. 629 (E. D. Pa., 1913).

Contracts assigning, in praesenti, rights to arise in the future are to be distinguished from contracts to assign in the future. If the agreement be the latter, a transfer within four months of bankruptcy when insolvency is known has been held a preference. In re Great Western Manufacturing Co., 152 Fed. 123 (C. C. A. 8th, 1907); Hayes v. Gibson, 279 Fed. 812 (C. C. A. 3d, 1922). Whether courts in these cases are merely interpreting similar types of contracts in different ways, no attempt has been made to determine.

12. Rochester Distilling Co. v. Rasey, 142 N. Y. 570, 37 N. E. 632 (1894); MacDonnell Buffalo Loan and Safe Deposit Co., 193 N. Y. 92, 85 N. E. 801 (1908); Titusville Iron Co. v. City of New York, 207 N. Y. 203, 100 N. E. 806 (1912); cf. O'Neil v. Helmke, 124 Wis. 234, 102 N. W. 573 (1905); see Westinghouse Electric and Manufacturing Co. v. Brooklyn Rapid Transit Co., 263 Fed. 532 (C. C. A. 2d, 1920). It has been suggested that New York will enforce an assignment of future accounts as against third persons, but there is no direct authority for the proposition. See Stone, *The "Equitable Mortgage" in New York* (1920) 20 COL. L. REV. 519, 531.

although an assignment of future accounts is valid in such jurisdictions, it may not be an adequate protection for the assignee.

In spite of this restriction on the freedom of assignment, the desired result may be reached. A loan may be made upon the security of present accounts. Then, when all or part of the accounts have been paid, a new loan may be made for other collateral, or the merchant may substitute and assign new accounts for the sums collected and retained, which is in effect the same thing.[13] The only difficulty still to be avoided when either method is used arises out of the application of the Bankruptcy Act. If new accounts are assigned within four months of bankruptcy and after insolvency is known to the assignee, the collateral must coincide in amount and time with the new loan;[14] for example, if the collateral is assigned after the new loan has been made, the assignment might be considered as given for an antecedent debt and therefore a voidable preference.[15] These legal barriers are, however, weakened, by the fact that seizure or transfer of "possession", after an account previously assigned has been created, has been held to establish good title against all creditors who have not meanwhile established a lien against the property.[16] Even in

A mortgage on after-acquired chattels is good against purchasers with or without notice in New York. See Irving Trust Co. v. Bank of America National Association, 68 F. (2d) 887, 889 (C. C. A. 2d, 1934); Diana Paper Co. v. Wheeler-Green Electric Co., 228 App. Div. 577, 240 N. Y. Supp. 108 (4th Dep't, 1930). For the New York rule in regard to public utilities see Pintsch Compressing Co. v. Buffalo Gas Co., 280 Fed. 830 (C. C. A. 2d, 1922). For the law in regard to day loans to brokers see Irving Trust Co. v. Bank of America National Association, 68 F. (2d) 887 (C. C. A. 2d, 1934).

Whether a creditor must be a lien creditor before he can attack a transfer, invalid in any way, is not clearly settled. For a discussion of this problem see GLENN, THE LAW OF FRAUDULENT CONVEYANCES (1931) §§ 75-89.

13. The validity of substitutions after insolvency is known is well established, regardless of what law exists as to after-acquired property or fraudulent conveyances. Clark v. Iselin, 21 Wall. 360 U. S. (1874); Sawyer v. Turpin, 91 U. S. 114 (1875); In re Reese-Hammond Fire Brick Co., 181 Fed. 641 (C. C. A. 3d, 1910).

14. The rule of bankruptcy is particularly effective in such transactions where the assignor acts as the agent of the assignee, since the assignor's knowledge has been imputed to the assignee. In re Cotton Manufacturers' Sales Co., 209 Fed. 629 (E. D. Pa. 1913).

15. Wolfe v. Bank of Anderson, 238 Fed. 243 (C. C. A. 4th, 1916); In re Lambert and Braceland Co., 29 F. (2d) 758 (E. D. Pa. 1928); cf. Irving Trust Co. v. Bank of America National Association, 68 F.. (2d) 887 (C. C. A. 2d, 1934). The Bankruptcy Act requires the presence of all three factors, insolvency, knowledge of transferee, and diminution of the estate in order to create a preference. Pirie v. Chicago Title and Trust Co., 182 U. S. 438 (1901); Farmers' Bank of Edgefield v. Carr and Co., 127 Fed. 690 (C. C. A. 4th, 1904); Federal Finance Corp. v. Reed, 296 Fed. 1 (C. C. A. 1st, 1924); In re Herman, 207 Fed. 594 (N. D. Iowa 1913); Robertson v. Henochsberg, 1 F. (2d) 604 (W. D. Tenn. 1924).

16. The idea of using seizure or possession in regard to accounts, as is done in the case of chattels, seems somewhat strained since seizure connotes some element of tangibility. See In re Macauley, 158 Fed. 322, 327 (E. D. Mich. 1907); In re Borok, 50 F. (2d) 75 (C. C. A. 2d, 1931); Note (1923) 23 COL. L. REV. 279, 280. Delivery of accounts was accomplished in In re Hub Carpet Co., 282 Fed. 12 (C. C. A. 2d, 1922), rev'd on other grounds, sub nom. Benedict v. Ratner, 268 U. S. 353 (1925), by transfer of a list of accounts. See also Savage Tire Co. v. Stuart, 61 Mont. 524, 203 Pac. 364 (1922). But cf. Clanton Bank v. Robinson, 195 Ala. 194, 70 So. 270 (1915) (delivery of list of accounts does not constitute a pledge).

some of those states that do not accept the theory of equitable lien, the efficacy of prior possession has been carried further, perhaps illogically, to relate the transfer of possession back to the date of the original assignment, thereby not only avoiding the claim of other creditors, but also preventing the trustee in bankruptcy from claiming that a preference was given.[17]

The cumbrous method of financing necessary to circumvent the rule against the assignment of future accounts has, of course, features that are objectionable to the parties, and that perhaps serve a restrictive function. The lender must be constantly on his guard since the prior existence of a lien creditor will make seizure ineffective.[18] This adds expense, for the finance company may deem it necessary to employ a representative to observe the assignor's business and to determine when seizure appears necessary. Moreover, the amount of collateral given when the loan is made cannot be easily increased. Unless a new loan is made that would raise the assignor's total investment, an increase in collateral might bring into play the bankruptcy rule against preferences.[19] Even more important, the finance companies and banks which engage in such secret financing are faced with a high degree of legal uncertainty due to the incomplete status of the law in most jurisdictions. Any prediction must be largely based on analogy from the decisions of courts in regard to mortgages of after-acquired chattels.[20] Although the identity of the two classes is supported by the trend of some courts,[21] others may not consider such analogy

It is not clear what the position of the Supreme Court was in the case of Benedict v. Ratner, 268 U. S. 353 (1925). In the light of the cases cited by the Court it cannot be said that the Court thought the assignment to that extent good. The most effective method of taking complete possession would be to notify the debtors. In re Robert Jenkins Corp., 17 F. (2d) 555 (C. C. A. 1st, 1927). Possession may be taken over the objection of the assignor. Cf. Humphrey v. Tatman, 198 U. S. 91 (1905). The New York rule in regard to chattel mortgages is that seizure is of no effect. Skilton v. Coddington, 185 N. Y. 80, 77 N. E. 790 (1906); Zartman v. First National Bank of Waterloo, 189 N. Y. 267, 82 N. E. 127 (1907).

17. Thompson v. Fairbanks, 196 U. S. 516 (1905); Fisher v. Zollinger, 149 Fed. 54 (C. C. A. 6th, 1906); In re Robert Jenkins Corp., 17 F. (2d) 555 (1927); Chase v. Denny, 130 Mass. 566 (1881). A similar rule is followed in regard to recordation immediately prior to bankruptcy. See Martin v. Commercial National Bank, 245 U. S. 516 (1918).

18. Thompson v. Fairbanks, 196 U. S. 516 (1905). The trustee has the right of a creditor holding a lien by legal or equitable proceedings as of the time a petition in bankruptcy is filed. Bailey v. Baker Ice Machine Co., 239 U. S. 268 (1915); General Securities Co. Inc. v. Dricoll, 271 Fed. 295 (C. C. A. 5th, 1921). Seizure, if it is to be at all effective, must occur prior to the filing of the petition. Fairbanks Shovel Co. v. Wills, 240 U. S. 642 (1915). However if the trustee also represents a prior lien creditor, he assumes all the privileges they would have. Note (1923) 23 COL. L. REV. 279.

19. In re Mandel, 127 Fed. 863 (S. D. N. Y. 1903); In re Dismal Swamp Contracting Co., 135 Fed. 415 (D. Va. 1905).

20. Most jurisdictions do not appear to have decided either this issue or the subsequent question of fraudulent conveyances. Both points of view in regard to these issues have been upheld by eminent authority.

21. Union Trust Co. v. Bulkley, 150 Fed. 510 (C. C. A. 6th, 1907); Taylor v. Barton Child Co., 128 Mass. 126, 117 N. E. 43 (1917). In the case of fraudulent conveyances discussed *infra*, the federal courts have come to identify chattel mortgages and the assignment of accounts, employing the same rules for both.

conclusive, and a court should find practically no difficulty in most jurisdictions in making the law as it will.

A second and more serious limitation on the law of assignment has appeared in recent years.[22] Until 1925 it was thought to be the general rule that an assignment of accounts could be valid regardless of the disposition to be made of the proceeds.[23] In that year the Supreme Court sharply reversed this current belief in the decision of *Benedict v. Ratner*,[24] which settled the law for all federal courts in the absence of controlling state opinion.[25] The doctrine there stated in regard to assignments had never been previously expressed,[26] although it was perhaps implicit in previous decisions of some state courts when dealing with the same problem in the analogous cases of chattel mortgages.[27] In that decision, Mr. Justice Brandeis, either because of economic ideals or obedience to past learning, and perhaps both, affirmed the materialistic philosophy found in the common law theory of ownership which associates the legal right with physical possession,[28] and held that not only an agreement but also a sufficient

22. The remarkable number of cases in which assignments, obviously drawn by experienced counsel, have been held bad bears witness to this fact. Note two recent decisions, City National Bank of Beaumont v. Zorn, 68 F. (2d) 566 (C. C. A. 5th, 1934); Irving Trust Co. v. Manufacturers Trust Co., 6 F. Supp. 185 (S. D. N. Y. 1934).

23. Cf. In re Michigan Furniture Co., 249 Fed. 978 (S. D. N. Y. 1918); In re Hub Carpet Co., 282 Fed. 12 (C. C. A. 2d, 1922), rev'd, sub nom. Benedict v. Ratner, 268 U. S. 353 (1925); see GLENN, op. cit. *supra* note 12, § 203. *Contra:* Radford Grocery Co. v. Haynie, 261 Fed. 349 (C. C. A. 5th, 1919). A contrary view, based on a doubtful application of the doctrine of "ostensible ownership," prevailed as to chattel mortgages in many jurisdictions. Means v. Dowd, 128 U. S. 273 (1888); see Einstein's Sons v. Shouse, 24 Fla. 490, 499, 500, 5 So. 380, 384 (1888); Edelhoff and Rinke v. Horner-Miller Mfg. Co., 86 Md. 595, 612, 613, 39 Atl. 314, 317 (1898). To the effect that such an application of the doctrine of ostensible ownership was not completely justifiable see Brown v. Leo, 12 F. (2d) 350, 351 (C. C. A. 2d, 1926) (applies rule of *Benedict v. Ratner* to chattel mortgages).

24. 268 U. S. 353 (1925). The Court found it necessary to decide on the basis of general jurisprudence since it did not consider a lower New York court decision of Stackhouse v. Holden, 66 App. Div. 423, 73 N. Y. Supp. 203 (4th Dep't, 1901), of sufficient weight to control its decision. It is stated in Irving Trust Co. v. Finance Service Co., 63 F. (2d) 694, 695 (C. C. A. 2d, 1933) that the New York Court of Appeals was to have decided the issue for itself in Foreman v. Louis Jacques Construction Co., 235 App. Div. 494, 257 N. Y. Supp. 45 (2d Dep't, 1932). The case does not seem to have come up.

25. The Court noted in the instant case, as the Supreme Court has before, that the decisions of state courts control in regard to the validity of an assignment. Hiscock v. Varick Bank of New York, 206 U. S. 28 (1907).

26. This view is urged by GLENN, op. cit., *supra* note 12 § 204. Although the court cited New York decisions in regard to chattel mortgages, it is not certain that it thought the analogy controlling. But see note 27, *infra*.

27. In a Comment (1924) 34 YALE L. J. 175, one year prior to the Court's decision a view similar to that adopted by the Court is suggested as then existing, and is criticized. See also In re Stiger, 202 Fed. 791 (D. N. J. 1913); Edgell v. Hart, 9 N. Y. 213, 218 (1853); New York Security and Trust Co. v. Saratoga Gas and Light Co., 159 N. Y. 137, 53 N. E. 758 (1899); Stackhouse v. Holden, 66 App. Div. 423, 73 N. Y. Supp. 203 (4th Dep't 1901) (dissenting opinion).

28. The doctrine rests upon a "supposed conceptual repugnancy between the mortgage and the reserved power, quite regardless of any evils which may result from their coupling." Brown v. Leo, 12 F. (2d) 350, 351 (C. C. A. 2d, 1926).

change of dominion was necessary for the transfer of an interest in property. Thus, it was held that in order to create a good assignment it is not enough for the assignor to make an instrument of assignment; it is also necessary that some immediate control over the accounts be actually transferred from borrower to lender. Since that decision the courts that are bound by it have sought to mark out the elements constituting sufficient dominion in order to determine what transfers are fraudulent in law because of "unfettered dominion" reserved in the transferor.[29]

The exact nature of the restriction as it has been subsequently interpreted by the courts is not certain, although its outlines may be indicated. From the language and the holdings of the cases, and the general practise of finance companies, it seems that in order to make a valid transfer certain formal requisites must be met.[30] For the sake of certainty, specific accounts should be assigned and marked on the books for the assignor,[31] and a copy of these accounts must be delivered to the assignee,[32] although no court has held an assignment void or voidable solely because either was left undone.[33] The borrower, if requested to collect the accounts assigned without notifying the obligors of such an assignment, may act in the capacity of agent for the lender if all the funds he receives are immediately applied in payment of the debt secured,[34] or deposited in a separate account for the benefit of the assignee[35] and an accounting rendered. The due date of any assigned accounts may not be extended without the express permission of the assignee. Some courts have upheld the validity of an assignment though some of the funds were used by the assignor for his own benefit, with the knowledge and acquiescence of the lender;[36] but the trend

29. It seems, by the language of the Court, that it was impressed by the possible fraudulent effects of such an assignment, although the gravamen of the decision is otherwise.

For the application of *Benedict v. Ratner* to the assignment of stock exchange seats, see In re M. J. Hoey Co. 19 F. (2d) 764 (C. C. A. 2d, 1927).

30. The discussion here deals solely with the question of validity in regard to third persons. For the distinction between rights of prior and subsequent creditors, and a trustee in bankruptcy, see In re Joseph, 43 F. (2d) 252 (M. D. N. C. 1930).

31. Note the procedure in Young v. Upson, 115 Fed. 192 (S. D. N. Y. 1902); In re Almond-Jones Co., 13 F. (2d) 152 (D. Md. 1926).

32. See In re Monumental Shoe Manufacturing Co., 14 F. (2d) 549 (D. Md. 1926); R. C. Poage Milling Co. v. Economy Fuel Co., 128 S. W. 311 (Ky. 1910).

33. In re Boggs-Rice Co. Inc., 4 F. Supp. 431 (W. D. Va. 1933); see Queen City Printing Ink Co. v. Rochester Herald Co., 38 F. (2d) 254 (W. D. N. Y. 1930).

34. It has never been doubted that the assignor may collect the funds himself for the benefit of the assignee. Clark v. Iselin, 21 Wall. 360 (U. S. 1874); In re Leterman, Becher and Co., Inc., 260 Fed. 543 (C. C. A. 2d, 1919).

35. Radford Grocery Co. v. Haynie, 261 Fed. 349 (C. C. A. 5th, 1919); Irving Trust Co. v. Finance Service Co., 63 F. (2d) 694 (C. C. A. 2d, 1933); In re Almond-Jones Co., 13 F. (2d) 152 (D. Md. 926); cf. McCluer v. Heim Overly Realty Co., 71 F. (2d) 100 (C. C. A. 8th, 1934). Parker v. Meyer, 37 F. (2d) 556 (C. C. A. 4th, 1930) is contrary but should not be taken as authority in the second circuit in the absence of state law. In regard to the situation where the assignee is also the depository bank, see In re Monumental Shoe Mfg. Co., 14 F. (2d) 549 (D. Md. 1926).

36. Chapman v. Emerson, 8 F. (2d) 353 (C. C. A. 4th, 1925); cf, Coppard v. Martin, 15 F. (2d) 743 (C. C. A. 5th, 1926). The authority of In re Dulberg, 60 F. (2d) 601 (E. D.

of authority is directly contrary. If the assignor is allowed the use of these funds until the due date of the loan, the assignment has been held to be no assignment at all.[37] Moreover, the requisite dominion will not be satisfied merely by a stipulation in the assignment agreement that the assignee has the right to demand or seize funds collected by the borrower before default.[38]

These limitations affect not only the agreement drawn by attorneys, but also the actual relationship determined from the practice of the parties. Recent decisions have demonstrated, perhaps because such conveyances are disfavored, that a properly drawn agreement will not of itself adequately protect the assignee against the borrower's creditors.[39] Evidence may be introduced to show the intent of the parties or their actual understanding at any particular time.[40] If it is found that the terms of the agreement have in effect been varied so that the existing relation is fraudulent according to the standards previously stated, all subsequent assignments will be held avoidable and the assets collected will be subject to the rights of creditors.[41] If the debtor and creditor renew the loan periodically, assign new collateral, and reassign the old, the entire security, old as well as new, may be invalidated by subsequent conduct. Under some earlier decisions[42] the courts have considered a reasonably express agreement necessary to vary the terms of the first contract.[43] But one court has more recently in effect held the failure to prohibit any incidental deviation from the agreed terms which is brought to the notice of the assignee, and which would make the transfer fraudulent, suffices to indicate a new agreement.[44] Following this tendency a court may even say that, regardless of actual knowledge, under particular circumstances the lender should reasonably have ex-

N. Y. 1932) is doubtful. Moreover, that case involved a summary proceeding, in which the courts act differently. In re Paramount Fireproof Door Co. Inc., 43 F. (2d) 588 (E. D. N. Y. 1930). When the money collected is used by the assignee without the acquiescence of the lender, the assignment remains valid. McCluer v. Heim Overly Realty Co., 71 F. (2d) 100 (C. C. A. 8th, 1934).

37. City National Bank of Beaumont v. Zorn, 68 F. (2d) 566 (C. C. A. 5th, 1934); In re Almond-Jones Co., 13 F. (2d) 152 (D. Md. 1926); In re Edelstein, 18 F. (2d) 963 (S. D. N. Y. 1926); Irving Trust Co. v. Manufacturer's Trust Co., 6 F. Supp. 185, 191 (S. D. N. Y. 1934).

38. Benedict v. Ratner, 268 U. S. 353 (1925); In re Almond-Jones Co. 13 F. (2d) 152 (D. Md. 1926). In jurisdictions having no decisions in regard to accounts, it would seem advisable to rely on the state law of chattel mortgages.

39. Very often the assignee carefully observes and controls the assignor's business. Shifts in their relationship are therefore likely to occur without the knowledge or consent of counsel.

40. In re Edelstein, 18 F. (2d) 963 (S. D. N. Y. 1926); Potts v. Hart, 99 N. Y. 168, 1 N. E. 605 (1885); Freeman v. Rawson, 5 Ohio St. 1. (1855).

41. Lee v. State Bank and Trust Co., 54 F. (2d) 518 (C. C. A. 2d, 1931); In re Lambert and Braceland Co., 29 F. (2d) 758 (E. D. Pa. 1928).

42. See particularly Chapman v. Emerson, 8 F. (2d) 353 (C. C. A. 4th, 1925).

43. Brown v. Leo, 12 F. (2d) 350 (C. C. A. 2d, 1926); Spaulding v. Keyes, 125 N. Y. 113, 26 N. E. 15 (1890); cf. Frost v. Warren, 42 N. Y. 204 (1870); Brackett v. Harvey, 91 N. Y. 214 (1883).

44. Lee v. State Bank and Trust Co., 54 F. (2d) 518 (C. C. A. 2d, 1931); cf. Walradt v. Miller, 45 F. (2d) 686 (C. C. A. 2d, 1930). A different view is found in In re Hanover Milling Co., 31 F. (2d) 442 (D. Minn. 1929).

pected that the assignor would use the collected funds for his own benefit, and if he has in fact done so, the assignment is invalid.[45] Therefore, the assignee must, for his own protection, take active steps to enforce strict compliance with the details of the agreement.[46]

The grounds on which the courts are willing to find that the original agreement has been changed and a new and fraudulent conveyance created, have in fact resulted in another formal requirement for the validity of a transfer. Sometimes the goods sold to create the account are returned to the borrower after the account has been assigned. If the assignee who has provided for the conveyance of such goods to himself appears to acquiesce to the assignor's use of such goods for his own benefit, by merely remaining silent after he should have known of the matter, the agreement of the parties will be held to have been varied.[47] And since it is a well established rule in many jurisdictions that the assertion of unfettered dominion by the assignor as to any part of the security taints the entire transfer, the agreement will be declared fraudulent.[48] The assignee must, then, in order fully to protect himself against such a contingency, not only provide in the contract, but actually demand that all goods be turned over to him or require the assignor to set aside the returns for his benefit.[49] If the amount of the returns is large, and the assignee wishes to protect them or the proceeds of their sale against creditors or a trustee in bankruptcy, he must also observe various rules in regard to chattel mortgages in general, and the state statutory requirements of recordation.[50]

45. Such an argument might prove particularly effective if there were also a chattel mortgage, and the business constituted the assignor's sole source of support. Note the situation facing the court in Walradt v. Miller, 45 F. (2d) 686 (C. C. A. 2d, 1930).

46. It might be that if the assignee made no attempt to find out what the assignor was doing, but rested on his agreement, that under certain circumstances he would not be held ot have acquiesced to a new agreement. However, since a certain amount of control is always taken for the sake of protection, it will generally suffice to permit the court to find that the assignee knew of the acts of the assignor. Strict control is therefore desirable.

47. Lee v. State Bank and Trust Co. 54 F. (2d) 518 (C. C. A. 2d, 1931). Different views are held by courts in regard to the dominion that must be asserted by a mortgagee in the case of a chattel mortgage. See for example: Robinson v. Elliot, 21 Wall. 513 (U. S. 1874); Etheridge v. Sperry, 139 U. S. 266 (1891); Knapp v. Milwaukee Trust Co., 216 U. S. 545 (1910); In re Marine Construction and Dry Dock Co., 144 Fed. 649 (C. C. A. 2d, 1906).

48. In re Leslie-Judge Co., 272 Fed. 886 (C. C. A. 2d, 1921; Reynolds v. Ellis, 103 N. Y. 115, 8 N. E. 392 (1886); Hangen v. Hachmeister, 114 N. Y. 566, 21 N. E. 1046 (1889); Skilton v. Coddington, 185 N. Y. 80, 77 N. E. 790 (1906). But cf. In re Hanover Milling Co. 31 F. (2d) 442 (D. Minn. 1929).

49. This provision is only noted to indicate how the avoidance of an entire assignment may be prevented. The substitution of accounts for the chattels when sold in the absence of recordation introduces again the question of rights of third persons and preferences in bankruptcy. See In re Bernard and Katz, Inc., 38 F. (2d) 40 (C. C. A. 2d., 1930). Whether failure to take notice of returns in the contract of assignments will make the conveyance fraudulent is not very clear. See In re Vanity Fair Slippers, 4 F. Supp. 83 (S. D. N. Y. 1933). It is most advisable that such returns be segregated, since failure to do so, might be grounds for arguing that in fact there never was an assignment.

50. Goldstein v. Rusch, 54 F. (2d) 86 (S. D. N. Y. 1931); Failure to record will not invalidate the entire transfer. In re Bernard and Katz Inc., 38 F. (2d) 40 (C. C. A. 2d, 1930).

Although compliance with the doctrine set forth in *Benedict v. Ratner* would seem to require repayment of the loan as soon as the assigned accounts were collected, and hence to prevent the borrower from retaining the money in his business, such is not in fact the case. Here, as under the rule against the assignment of future accounts, it is possible to finance a business over an indefinite period of time on the security of accounts receivable. One method that might be followed is to allow the assignor to use the money collected to purchase new stock subject to a chattel mortgage in favor of the assignee. But such a practice is rare, since recordation which might notify creditors would be required. Assuming that future accounts are assignable, a better method is available. The money collected is formally turned over to the assignee, and by him reloaned to the debtor. Thus the accounts are liquidated and replaced by others newly accruing which must only be stamped and transferred upon their creation. Unless the business of the assignor decreases, the security of the assignee remains constant or increases. Thus the assignee, if he desires to keep his loan secure, need but make certain that the amount of collateral does not decrease; if it does, he can protect himself by refusing to make further loans. If on the other hand the assignment of future accounts is not permissible, the method of substitution previously noted may be employed. However, the assignment might easily become fraudulent if the substitutions are improperly made. That is to say, when the assignor collects the proceeds of the accounts assigned, either new accounts must be hypothecated immediately in equal amounts; or if that be inconvenient, the funds may be segregated in a separate account, and held by the assignor in a fiduciary capacity for the assignee until other accounts are transferred.[51] Care must be taken that the assignor does not intermingle proceeds of assigned accounts with other funds prior to the substitution,[52] even though the assignee be the depository bank;[53] and the amount of new accounts assigned must bear some relation to the sum collected.[54] In some states a conveyance that is ineffective for failure to meet these requirements may be validated by a subsequent taking of possession of the accounts, thus insulating it against the attack of creditors.[55] But if the assignor's insolvency is known at the time and he is adjudged bankrupt within four months, the absence of new consideration will make such posses-

51. Radford Grocery Co. v. Haynie, 261 Fed. 349 (C. C. A. 5th, 1919); cf. Sexton v. Kessler, 225 U. S. 90 (1912); Burrowes v. Minochs, 35 F. (2d) 152 (C. C. A. 4th, 1929).

52. In re Lambert and Braceland Co., 29 F. (2d) 758 (E. D. Pa. 1928); cf. Sexton v. Kessler, 225 U. S. 90 (1912). A well executed substitution is described in In re Vanity Fair Slippers, 4 F. Supp. 83 (S. D. N. Y. 1933).

53. Blue v. Herkimer National Bank, 30 F. (2d) 256 (C. C. A. 2d, 1929); see McCluer v. Heim Overly Realty Co., 71 F. (2d) 100, 103 (C. C. A. 8th, 1934).

54. If the amount of accounts assigned is less than the sum collected, the assignee will in effect have allowed the assignor to use funds belonging to him, without making a new loan. If the variation were serious it might affect the validity of the transfer. The idea of having this relation is to preserve the formal fiction of loan and reloan.

55. See note 57, *infra*. *Contra:* Clark v. Grimes, 232 Fed. 190 (D. Md. 1916); Arbury v. Kocher, 18 F. (2d) 588 (W. D. N. Y. 1927); Zartman v. First National Bank of Waterloo, 189 N. Y. 267, 82 N. E. 127 (1907); but cf. In re Wright and Weissinger, 277 Fed 514 (N. D. Miss. 1921); Stephens v. Perrine, 143 N. Y. 476, 39 N. E. 11 (1894).

sion a preference which the trustee in bankruptcy may set aside.[56] Some jurisdictions, however, have held that possession will cure the defect in the original transfer and date it back to that time,[57] thus totally eliminating any rights of creditors under the Bankruptcy Act unless the trustee also represents a lien or judgment creditor whose right attached prior to the seizure by the assignee.[58]

There are, of course, some restrictive consequences. A creditor must not only show a written or oral agreement, but perhaps a list of accounts and the disposition of the funds collected from the date of the assignment. Thus it becomes more difficult fraudulently to create an assignment of book accounts to a friend or relative immediately prior to bankruptcy, but dated back more than four months in order to remove it from the rules of the Bankruptcy Act.[59] Moreover, the checks of debtors must ordinarily be indorsed or assigned to the lender, or deposited in a separate fund. In either case such a practise might become known to other members of the trade and creditors through the infinite routes by which business men receive information, and the secrecy that borrower and lender have sought to maintain made ineffectual. And the expense of such financing is increased, along with the risk that an assignment will be held invalid.

Thus it may be seen that the outstanding result of these several legal restrictions upon the assignment of book accounts as collateral security is to penalize heavily the business that is forced to resort to the practice. If this type of financing is not objectionable, this result is unfortunate. On the other hand, the same factors that produce expense and uncertainty serve also as a possible check upon the extent to which the practice is pursued. This may be desirable if the practice is objectionable. But if this is the case, a more effective restraint might be in order; if it is not, the present restrictions might well be changed. From either point of view the present state of the law is unsatisfactory.[60] Yet it is not immediately apparent what, if anything, should be done.

Unrestricted freedom in the credit use to be made of accounts has been said to be in accord with the requirements of present day economy.[61] Small business men often find difficulty in acquiring capital unless they can successfully hy-

56. Johnston v. Huff, Andrews and Moyler Co., 133 Fed. 704 (C. C. A. 4th, 1904); see Walradt v. Miller, 45 F. (2d) 686, 687 (C. C. A. 2d, 1930). Judge Patterson points out that the New York rule is directly opposed to the Vermont and Massachusetts rule. Goldstein v. Rusch, 54 F. (2d) 86 (S. D. N. Y. 1931).

57. Federal Finance Corp. v. Reed, 296 Fed. 1 (C. C. A. 1st, 1924); Massachusetts Trust Co. v. Mac Pherson, 1 F. (2d) 769 (C. C. A. 1st, 1924); Harding v. Federal National Bank, 31 F. (2d) 914 (C. C. A. 1st, 1929); cf. Finance and Guaranty Co. v. Oppenheimer, 276 U. S. 10 (1928).

58. See Martin v. Commercial National Bank, 245 U. S. 513, 519; Comment (1934) 44 YALE L. J. 109, 113 (deals with the problem as applied to recordation).

59. See Lichtenberg v. Harvey, 57 F. (2d) 82 (C. C. A. 2d, 1932).

Note the oral agreement held valid in In re Macauley, 158 Fed. 322 (E. D. Mich. 1907); see also Union Trust Co. v. Bulkley, 150 Fed. 510 (C. C. A. 6th, 1907); Stackhouse v. Holden, 66 App. Div. 423, 73 N. Y. Supp. 203 (4th Dep't, 1901).

60. Comment (1924) 34 YALE L. J. 175 attacks the conceptualism binding the courts in regard to chattel mortgages.

61. See Note (1923) 23 COL. L. REV. 279; Comment (1924) 34 YALE L. J. 175.

pothecate all their available assets. Moreover, when a business happens to be temporarily embarrassed, its ability secretly to use book accounts as collateral may prevent bankruptcy. This may result in a benefit to the creditors, since forced liquidation of the business, which might otherwise become necessary, invariably reduces the debtor's assets below their real value with a resulting loss to creditors.

On the other hand, although these facts urged in favor of the floating charge may be conceded, other consequences of these assignments are a source of objection. When viewed in terms of those cases where a loan so secured has failed to revive the business, and the debtors' assets are depleted, such transactions usually appear unfair. This fact often seems an unavowed premise of court opinions.[62] If resort to this method of securing credit is not usual, but rather unusual, the continued operation of a business is generally an indication that resort has not been had to the practice. Certainly this is true where a once profitable business has encountered misfortune and become insolvent, but continues to function on the strength of credit advances whose existence is not subject to discovery. Thus there is an element of deception that colors the treatment of the unsecured creditors. Moreover, the assignment of accounts, as distinguished from a chattel mortgage which requires recordation for its validity against third persons, offers an opportunity for a type of fraud peculiar to itself. Not only are present and future creditors who have no time for investigation possibly misled, but even those creditors who might use all necessary diligence may be deceived by the active fraud of the assignor of which his assignee might have no notice.[63] Thus, upon being questioned concerning his present assets, the assignor might deny the existence of such an assignment. Or even if the assignee be asked to show his books, and the stamping of accounts be required by law, as was previously suggested, the assignor might defraud creditors by keeping two sets. Granting that such a practice is rare because it may result in exposure and imprisonment, nevertheless it exists, and must be given some weight in analyzing the merits of the different rules. Finally, objection has been made in the analogous field of chattel mortgages on the ground that a merchant may assign all his assets to several creditors, thus forming an effective shield against the claims of the others who would get nothing in the event of bankruptcy. This is said to be unfair.

The outstanding objections to the present practice and the "liberal" view towards assignment of accounts is centered upon the elements of actual or possible deception. Neither of these difficulties has been adequately met by the two attempts that have been made to change the present law. The authors of

62. See Benedict v. Ratner, 268 U. S. 353 (1925); Brown v. Leo, 12 F. (2d) 350, 351 (C. C. A. 2d, 1926); Lee v. State Bank and Trust Co., 54 F. (2d) 518 (C. C. A. 2d, 1931). Note the court's attitude in McGill v. Commercial Credit Co., 243 Fed. 637 (D. Md. 1917).

63. Sometimes the assignee makes two assignments of the same account. Under the prevailing American rule and that of the federal courts, the prior assignee takes, regardless of which assignee first notifies the debtor. See Salem Trust Co. v. Manufacturers' Finance Co., 264 U. S. 182 (1924); Williams v. Ingersoll, 89 N. Y. 508 (1882); Niles v. Mathusa, 162 N. Y. 546, 57 N. E. 184 (1900); Comment (1925) 1 WASH. L. REV. 47. State law does not bind the federal courts in regard to this issue. In re Leterman, Becher and Co., Inc., 260 Fed. 543 (C. C. A. 2d, 1919); Petition of National Discount Co., 272 Fed. 570 (C. C. A. 6th, 1921).

the Uniform Fraudulent Conveyance Act desired merely to abolish the rule which was affirmed in *Benedict v. Ratner*.[64] With but one overruled exception,[65] the courts have refused to hold the act applicable to book accounts.[66] The Uniform Chattel Mortgage Act, which has not yet been passed in any jurisdiction, proposes to permit the floating charge on present and future book accounts, but requires recordation.[67] Recordation has not in the past been considered adequate protection for creditors,[68] and at least one recent writer has shown that this method does not solve the problem.[69] It appears that records do not protect the smaller creditor because he can not afford to examine them, and they are not generally necessary for the finance companies and banks, who are more able to investigate the financial condition of a proposed borrower. Since actual notice, which alone would be completely effective, would destroy this method of financing, the problem to be faced is whether ordinary creditors should be forced to assume a risk greater than they have reason to expect, without notice thereof. A solution is not easily found; it must depend upon what is considered the desirable public policy, in the light of actual business facts, as to how far a debtor may risk the assets of his creditors before their interests become paramount.

CONSTITUTIONALITY OF THE FRAZIER-LEMKE ACT

THE Frazier-Lemke Federal Farm Mortgage Moratorium Act[1] passed by Congress in June, 1934,[2] as an amendment to Section 75[3] of the National Bankruptcy Act[4] which provided for "agricultural compositions and extensions," offers a method whereby a farmer may prevent his creditors from dispossess-

64. GLENN, op. cit. *supra* note 12, § 204.

65. American Steamship Co. v. Wickwire Spencer Steel Co., 42 F. (2d) 886 (W. D. N. Y. 1930), aff'd on another point, 49 F. (2d) 706 (C. C. A. 2d, 1931).

66. Lee v. State Bank and Trust Co., 54 F. (2d) 518 (C. C. A. 2d, 1931); Irving Trust Co. v. Finance Service Co., 63 F. (2d) 694 (C. C. A. 2d, 1933); In re Frey, 15 F. (2d) 871 (D. Minn. 1926). The statute was ignored in the following cases: In re Almond-Jones Co., 13 F. (2d) 152 (D. Md. 1926); In re Monumental Shoe Manufacturing Co., 14 F. (2d) 549 (D. Md. 1926); In re Lambert and Braceland Co., 29 F. (2d) 758 (E. D. Pa. 1928).

67. A description of the act will be found in Legis. (1927) 27 COL. L. REV. 81.

68. The fact is that in the case of chattel mortgages the right of the mortgagor to sell was thought to be constructively fraudulent despite the prevalence of recordation statutes See note 23, *supra*.

69. Hanna, *supra* note 1, at 627, points out that recordation merely adds another charge.

1. 48 STAT. 1289, 11 U. S. C. A. § 203 (1934).

2. P. L. No. 486, 73d Cong., 2d Sess. (1934) (S. 3580). As originally reported to the Senate by the Committee on Judiciary (Sen. Rep. 1215) the Frazier bill was amended by the addition of the present Section 7 and then passed. In the House the McKeown bill supplanted the original Lemke bill. The conference report submitted to Senate and House, and passed by both, was substantially similar to the McKeown bill previously adopted by the House. For a history of the debate on and passage of the bill see 78 CONG. REC. 10184, 11273, 11301, 12070-77, 12130-38, 12356, 12376-12382, 12491 (1934).

3. 47 STAT. 1470, 11 U. S. C. A. § 203 (1933).

4. 30 STAT. 544 (1898), 11 U. S. C. A. § 1 (1926).

ing him of his means of livelihood.[5] Representatives of the western farming communities[6] supported the bill wholeheartedly because of continued agitation on the part of farmers[7] for legislation preventing foreclosures, scaling down their debts, and permitting them to retain their property. There was strong opposition on the part of a few to the purpose of the bill because of its seeming reduction of the liens of secured creditors.[8] Moreover, since debate upon and final passage of the bill in the Senate were unfortunately attended by unusual haste and confusion because of a misunderstanding over the legislative calendar, critics of the act may point to these circumstances to prove that it was ill-considered,[9] overlooking the fact that there is no indication of haste during its formulation in conference, but rather strong evidence that its constitutionality was carefully considered.[10]

The agitation of farmers for further relief was an open manifestation of the need for legislation to aid the farm debtor. Existing relief agencies such as the Federal Land Banks and Joint Stock Land Banks and the Farm Credit Administration had proved quite inadequate for the task of rescuing the farmer from the financial plight into which the unprecedented decline in farm prices had plunged him.[11] Section 75 of the Bankruptcy Act, which was aimed at the relief of these conditions, was evidently not satisfactory, for it was rarely used by farm debtors.[12] It provided a rather cumbersome machinery whereby an insolvent farmer after filing a petition might reach a composition or extension agreement with his creditors under the direction of a Conciliation Commissioner appointed by the court for that purpose. By such means it was hoped that informal and friendly agreements between farmer and creditor would be

5. See remarks of Senator Frazier, 78 Cong. Rec. 11273 (1934).

6. I.e., Senators Frazier, Clark, Long, Shipstead and Thomas, and Representatives Lemke (N. Dak.), Jones (Texas), Johnson (Texas), Lloyd (Wash.), Miller (Ark.), Boileau (Wis.) and Busby (Miss.). Nearly 60 per cent of the farm mortgage debt is concentrated in such middle western states as Ohio, Indiana, Illinois, Michigan, Wisconsin, Minnesota, Iowa, Missouri, North and South Dakota, Nebraska, and Kansas. For an excellent discussion of the farm debt problems see CLARK, THE INTERNAL DEBTS OF THE UNITED STATES (1933) 24.

7. Representative Lemke remarked in defending the measure: "There is not a Member of this Congress who has not received hundreds of letters from farmers asking that something be done by the Government to protect them and their families against pending or threatened mortgage foreclosure." 78 CONG. REC. 12134 (1934). See CLARK, op. cit. *supra* note 6, at 27, 52.

8. Although the bill passed the Senate in final form by a vote of 60 to 16, it was only after bitter attacks upon it had been made by Senators Fess, Hastings, Hebert, Lonergan, and Walsh. For a record of the vote see 78 CONG. REC. 12381 (1934).

9. See the remarks of Senator Hastings, 78 CONG. REC. 12071 (1934).

10. There were 17 lawyers on the Senate Judiciary Committee and 25 on that of the House, both of which drafted the bill with great care. A brief on the constitutionality of the bill was prepared by Representative Lemke. See the remarks of Representatives Johnson and Lemke, 78 CONG. REC. 12133, 12135 (1934).

11. For a discussion of the inadequacy of such agencies, see CLARK, op. cit. *supra* note 6, at 47.

12. For statistics collected from the reports of referees as to the extent of the use of Section 75, see Comment (1934) 43 YALE L. J. 1285.

facilitated and the stigma and hardships of the existing bankruptcy provisions avoided. At least two outstanding defects greatly lessened the efficiency of the amendment.[13] Since the mortgage debt of most farmers represented a majority of their indebtedness, the requirement that a composition or extension be agreed to by a majority in number and amount of all the creditors often tended to grant to a single mortgagee a veto power over composition and extension proposals. Nor was a mere composition or extension without any reduction in the amount of the lien deemed sufficiently effective to remedy the farmer's financial plight, particularly in view of the fact that in the absence of consent by at least a majority of the secured creditors, there was nothing to prevent foreclosure and dispossession of the farmer. Even where state moratorium statutes prevented this, there was no uniform provision to protect the debtor against both secured and unsecured creditors. The present amendment was calculated to eliminate such defects and to afford the farmer adequate relief.[14]

Section 75 remains as a vital factor in farm debtor relief by the terms of the Frazier-Lemke Act. The farmer can invoke the newer procedure by amending his petition for a composition or extension agreement only if he fails to reach such an agreement with his creditors or if he feels aggrieved by the one that is reached.[15] According to recent interpretations of these conditions by the courts,[16] the farmer cannot invoke the Frazier-Lemke Act without restriction, but must first in good faith seek a composition or extension agreement. It necessarily follows that he must also be aggrieved for good cause by any agreement reached before he may proceed according to the terms of the amendment. When these conditions exist, the farmer may petition at the first hearing before the court that the referee take measures for insuring retention of his property. All the property of the debtor is then appraised at its fair and reasonable value, but not necessarily its market value, by appraisers appointed by the Court.[17] After setting aside to the debtor his exemptions subject to any existing liens, the referee must order that any part of the debtor's property which the latter feels he can profitably support shall remain in the possession of the debtor under the control of the court.[18] Such property is to be subject to a general lien in favor of all creditors up to its actual appraised value, which lien in turn is, as to mortgaged property, to be subject to

13. See Richter, *Recent Amendments to the Bankruptcy Act* (1933) 8 NOTRE DAME LAWY. 460, 482, 490; Note (1933) 33 COL. L. REV. 704; Comment (1934) 43 YALE L. J. 1285, and articles there cited.

14. In the words of Representative Lemke, the amendment "puts a few teeth into Section 75." See 78 CONG. REC. 12135 (1934).

15. Set forth at the beginning of the amendment, under subsection (s) of Section 75 of the Bankruptcy Act. The seven sections of the present amendment follow.

16. In re Wilkin, 8 F. Supp. 222 (S. D. Iowa 1934); In re Coller, 8 F. Supp. 447 (E. D. Pa. 1934); In re Samuelson, 8 F. Supp. 473 (S. D. Iowa 1934).

17. § 1. Objections to appraisals are allowed in accordance with the Bankruptcy Act. In case of real estate either the debtor or creditor may file objections within one year from the date of the order approving the appraisal.

18. § 2.

any prior liens of secured creditors. As to the secured claims, if the amount of the secured debt is greater than the appraised value of the pledged property, apparently the excess can be proved as a general claim and participate in the distribution of the appraised value of the unencumbered property ratably with unsecured claims.[19] Upon request of the debtor and with the consent of the lien holders the trustee may arrange a "sale" to the debtor of the property in his possession[20] under one of two alternative methods of procedure. Under the first of these, provided by Section 3, the property is to be sold to the debtor at the appraised price, which is to be paid over a period of six years in gradually increasing annual installments along with interest on the unpaid balance. The debtor may at any time consume or dispose of any property in his possession provided he pays over the full appraised value to the creditors.[21] If the debtor defaults in any payments, the creditors may proceed to enforce their respective liens at law.[22] All proceeds from the sale of the property, and the interest, are to be distributed to the various creditors. The only major change in this procedure to be found in the second alternative, set forth in Section 7, is that there the debtor is granted an extension of only five years in which to pay the appraised value of the property in his possession, and is required to pay a reasonable annual rental in place of interest or installments on the appraised value. Reappraisal of the value of real estate at the end of five years at the request of any lien holder is also provided. Thus allowance is made for any rise in land values throughout the period, since the lien holder may choose whether to accept the appraised or reappraised price. Under either section, if the debtor complies with all requirements throughout the respective extension periods, he receives his discharge and takes full title to the property.

Such a novel combination of provisions presents a constitutional problem that has incited a great deal of controversy.[23] According to Article I, Section 8, of the United States Constitution, Congress has the power to establish "Uniform laws on the subject of bankruptcies throughout the United States." Since the Frazier-Lemke Act is an amendment to Section 75 of the Bankruptcy Act, it must be justified as an exercise of the bankruptcy powers so delegated to Congress. This involves the question whether the act does in fact deal with "bankruptcy." The varied history of bankruptcy in the United States emphasizes the broad and ill-defined nature of the subject.[24] In the four

19. Since the general lien created by the provision is not limited specifically to unsecured creditors, lienholders would apparently be general creditors to the extent of the excess. This allows secured creditors the same rights that they possess under Sections 56 (b) and 57 (e) of the Bankruptcy Act. See 30 STAT. 560 (1898), 11 U. S. C. A. §§ 92 (b), 93 (e) (1926). Such an interpretation was accepted by the court in In re Radford, 8 F. Supp. 489, 497 (W. D. Ky. 1934). See Hanna, *Agriculture and the Bankruptcy Act* (1934) 19 MINN. L. REV. 1, 18.

20. § 3. 21. § 4. 22. § 5.

23. See Hanna, *supra* note 19, at 1, and references cited, id. at 10, n. 13; Legislation (1934) 23 GEO. L. J. 87; Note (1934) 3 GEO. WASH. L. REV. 86; Comment (1935) 29 ILL. L. REV. 645; (1935) 83 U. OF PA. L. REV. 375.

24. For a historical summary of bankruptcy law in the United States, see 1 REMINGTON, BANKRUPTCY (3d ed. 1923) 1; HANNA, CASES ON CREDITORS' RIGHTS (1931) 527.

National Bankruptcy Laws, each one enacted toward the end of a major depression to check the resulting detrimental economic forces,[25] the concept of the specific function intended to be performed has differed greatly.[26] From the theory inherent in the first law of 1800 that the primary function of a bankruptcy law was the protection of creditors against the fraudulent practices of debtors[26] has gradually evolved the much broader modern concept that bankruptcy is for the benefit of both debtor and creditor, relieving the debtor by a discharge from the remainder of his debts while affording the latter a pro rata distribution of the debtor's assets and protection from fraudulent conveyances and preferences.[27] In addition there has been a provision for enforcing upon the minority of creditors acceptance of a plan of composition assented to by the majority, thus making it possible to leave the debtor in possession of his property after changing his debt structure.[28] In view of these various provisions the only definition of bankruptcy that is both appropriate and comprehensive is that it deals generally with the relations between "insolvent debtors" and their creditors.[29] The manner of dealing with such relations, however, may apparently change considerably with time and economic conditions.

If the limits of the "subject of bankruptcies" are so extensive, the Frazier-Lemke Act meets the requirements of the Constitution. Upon its face it deals with the relations of insolvent debtors and their creditors. The fact that the procedure under the act may differ somewhat from previous concepts of bankruptcy proceedings is immaterial. The laws which first extended bankruptcy relief to debtors other than traders[30] and provided for voluntary bankruptcies[30] and composition and extension proposals[31] were radical departures from previous ideas on the subject, but have been upheld as constitutional. The only really new elements in the present act are the extension of time allowed for effecting distribution of the farmer's assets during which the creditor is deprived of his share, and the method of converting the assets into cash

25. The Act of 1800 following the depression of 1798; the Act of 1841 following the panic of 1837; the Act of 1867 necessitated by the crises of the Civil War; the present Act of 1898 passed as a result of the panic of 1893.

26. The Act of 1800 aimed at the suppression of fraudulent and criminal practices of debtors; the Act of 1841 was the first to provide for voluntary bankruptcy; the Act of 1898 changed the meaning of insolvency from inability to meet one's obligations to include an excess of liabilities over assets. See REMINGTON, op. cit. *supra* note 24, at 14.

27. Williams v. United States Fidelity and Guaranty Co., 236 U. S. 549 (1915); In re Munford, 255 Fed. 108 (E. D. N. C. 1919); Gilbert v. Shouse, 61 F. (2d) 393 (C. C. A. 5th, 1932); see In re Leslie, 119 Fed. 406, 410 (N. D. N. Y. 1903).

28. Section 12 of the Bankruptcy Act of 1898.

29. Mr. Justice Catron gave some indication of the indefinability of the subject in In re Klein, reported in a note to Nelson v. Carland, 1 How. 265, 277 (U. S. 1843). Chief Justice Marshall found trouble in "discriminating with any accuracy between insolvent and bankrupt laws." See Sturges v. Crowninshield, 4 Wheat. 122, 195 (U. S. 1819).

30. Hanover National Bank v. Moyses, 186 U. S. 181 (1902).

31. In re Landquist, 70 F. (2d) 929 (C. C. A. 7th, 1934); In re Burgh, and In re Parmenter, 7 F. Supp. 184 (N. D. Ill. 1933).

for distribution. Such a change in procedure, which is an attempt to meet the conditions of the present economic emergency, by no means robs the act of its character of bankruptcy legislation, since the subject matter is the same regardless of how it is treated.

Although the Frazier-Lemke Act may come within the delegated power of Congress to legislate upon the "subject of bankruptcies," it remains further to inquire whether the exercise of that power under the act is so unjust or unreasonable as to amount to a deprivation of creditors' property without due process of law under the Fifth amendment. The powers of Congress are often said to be "plenary," and considerable discretion may be used in their exercise; but it must be recognized that by judicial interpretation the Fifth Amendment may be used as a check upon them.[32] In applying the test of the due process clause it is permissible to indulge in a presumption in favor of the constitutionality of the act so that it will be pronounced unconstitutional only if definitely unreasonable.[33] And when there are possible alternative interpretations of provisions, the one most conducive to constitutionality should control.[34]

With respect to secured creditors the question of constitutionality depends ultimately upon the reasonableness of the second alternative, open to them under Section 7, since this alone of the two plans can be forced upon them. Acceptance of the first alternative under Section 3 is "voluntary" in the sense that consent of all secured creditors is necessary to make binding the terms arranged by the trustee;[35] otherwise Section 7 alone will apply. Should the secured creditors agree to terms thus arranged under Section 3, they can hardly raise a subsequent complaint as to the reasonableness of their agreement. Certainly this is true if the complaint were that the plan was less favorable than could be had under Section 7, for as between the alternatives their choice is unimpaired. And if the agreement under Section 3 is more favorable than one that would have resulted under Section 7, complaint must be based on the fact that the acceptance was not in fact voluntary, but was influenced by the possibility that refusal to accept would have resulted in application of the other section. This objection is sound only if the terms provided in Section 7 are of themselves unreasonable.

In respect to monetary return, it is contemplated that the lien holders will recover substantially the same amount under the act that they could under their previously existing rights, had the farmer gone into bankruptcy. As the appraised price that must be paid to creditors is the fair and reasonable value

32. See Monongahela Navigation Co. v. United States, 148 U. S. 312, 336 (1892); Hanover National Bank v. Moyses, 186 U. S. 181, 192 (1902); Nichols v. Coolidge, 274 U. S. 531, 542 (1927); In re Billing, 145 Fed. 395, 398 (M. D. Ala. 1906); In re Bradford, 7 F. Supp. 665 (D. Md. 1934). *Contra:* In re Cope, 8 F. Supp. 778 (D. Colo. 1934).

33. United States v. Standard Brewery, 251 U. S. 210 (1919).

34. Interstate Commerce Commission v. Oregon-Washington Rr. and Navigation Co., 288 U. S. 14 (1933).

35. It appears to be a reasonable interpretation of Section 3 that the terms of payment there prescribed are a minimum, above which the trustee may impose any different terms that in his judgment would be "fair and equitable."

of the property that he retains, but not necessarily the market value, presumably the amount thus required is as great, and probably greater, than the present market price of the property on a judicial sale for cash. Thus, in effect, the lien holder receives the full value of the asset, which is determined by the appraisal rather than by the results of competitive bidding on a cash basis regardless of market conditions. Should the appraised value be less than the face of his debt, he also receives the equivalent of a deficiency judgment by virtue of the fact that a secured creditor may prove such a claim as a general debt, and hence be awarded a pro rata share of the other assets.[10] The method of determining the amount of the deficiency is similar in effect to provisions in state moratorium statutes restricting deficiency judgments to the difference between the amount of the debt and the appraised value of the security,[36] while the permission to prove the amount as a general debt is the same that is given to secured creditors under the Bankruptcy Act.[37] Moreover, remuneration in the form of rent is provided during the period that payment is withheld. Thus the decrease in value that is due to future rather than present payment is compensated. In this respect the act conforms perfectly to the chief requirement of reasonableness set up by the courts for testing state moratorium statutes, where the same question has arisen and the element of compensation held to be essential.[38]

Pure monetary return, however, is not the only interest of the secured creditor that is a possible subject of prejudice. Under Section 7 the lien holder is completely deprived of the chance to secure physical possession of the debtor's property, which, under certain circumstances, he might be able to secure despite bankruptcy proceedings. Yet if the farmer makes all required payments, the creditor receives at the end of five years the appraised or reappraised value of the property. It seems reasonable that if the law guarantees to the mortgagee the fair value of his security, he should have no cause for complaint. The large majority of mortgagees are insurance companies, banks, and federal farm relief agencies,[39] creditors that have little interest in acquiring actual possession of the debtor's property.[40] The primary purpose of a mortgage therefore should be a security device and its use for the purpose of dispossessing the farmer in periods of financial distress is a practice that should be discouraged for the welfare of the farming communities and hence the nation as a whole.

The five-year period during which the creditor must wait, without any con-

36. See CAL. CODE CIV. PROC. (Deering, Supp. 1933) § 580a; Idaho Laws 1933, c. 150; Kan. Laws 1933, c. 218; N. Y. Laws 1933, c. 794; N. C. CODE ANN. (Michie, Supp. 1933) § 2593 (d); S. C. Acts 1933, No. 264; Tex. Laws 1933, c. 92.

37. If the proceeds of a foreclosure sale are insufficient to pay in full the secured debt, the mortgagee may share in the distribution of the general assets in proportion to the amount of his deficiency. See In re Medina Quarry Co., 179 Fed. 929, 936 (W. D. N. Y. 1910).

38. Home Building and Loan Ass'n v. Blaisdell, 290 U. S. 398 (1934); Hanauer v. Republic Building Co., 255 N. W. 136 (Wis. 1934).

39. See 78 CONG. REC. 12132 (1934); CLARK, op. cit. *supra* note 6, at 40.

40. Some of the Land Banks have followed the policy of avoiding foreclosures so long as the farmer pays out of his crop receipts the amount that would probably be received in rent from a tenant. See CLARK, op. cit. *supra* note 6, at 44.

trol over the debtor's property and without receiving payment of the appraised value thereof, is another possible source of prejudice to the creditor's rights. Although he is compensated during such a period, and by demanding a reappraisal of real estate may take advantage of a rise in farm land values, he has lost the right to make his own terms with the debtor. As a result there is the possibility that a rise in farm values or an improvement in the debtor's financial condition would not be accompanied by a corresponding increase in the compensation paid to the creditors. Likewise the loss of the opportunity for present liquidation means that the creditor bears the risk of having subsequently to sell the land at a lower price in case the debtor defaults in his payments. Both these elements of deprivation and of risk, however, have been present in the extension provisions of state moratorium laws.[41] It is true that under the latter the postponement of the period of redemption or of the confirmation of sale has never been for a period longer than two years.[41] By comparison a five-year extension under the Frazier-Lemke Act may seem to be unreasonably long and to impose a much greater risk. But the power of the states under their police powers to deal with creditors' rights is much more restricted than is the delegated power of Congress to deal with the subject of bankruptcy.[42] To deprive a creditor of the right to instant payment or of the power to make his own arrangements concerning future risk is no more serious a destruction of rights than has already been permitted under the Bankruptcy Act, where contracts may be disaffirmed, debts discharged and compositions enforced against minority groups. Moreover, the question of reasonableness is not necessarily the same in judging this statute as it is in the case of state moratorium laws. The state laws deal with mortgages generally; the present law deals only with farm mortgages.[43] The latter class may well be distinguished as presenting a peculiar problem of a somewhat more serious nature, the solution of which must be independent of the former. The economic status of the farmer may be such as to make lesser relief inadequate. Therefore the reasonableness of the act should not be considered solely in the light of the emergency conditions that are held to justify state moratorium laws.[44]

41. *Blanket extensions of period of redemption:* KAN. REV. STAT. ANN. (Supp. 1933) § 60-3457-a-b (6 months); N. D. Laws 1933, c. 157 (2 years); S. D. Laws 1933, c. 137 (1 year); Wis. Laws Spec. Sess. 1931, c. 29, § 7. *Discretionary Extension:* MINN. STAT. (Mason, Supp. 1934) § 9633-5. *Blanket postponements of sale:* CAL. GEN. LAWS, (Deering, Supp. 1933) Act 5102, § 1 (6 months); Tex. Laws 1933, c. 105. *Discretionary postponements of sale:* Ark. Acts 1933, No. 21, § 3; MINN. STAT. (Mason, Supp. 1934) § 9633-3; N. H. Laws 1933, c. 161; Pa. Laws 1933, No. 137. For comprehensive discussions of the constitutionality of state mortgage relief legislation see Comment (1934) 47 HARV. L. REV. 660; Comment (1934) 18 MINN. L. REV. 319; Comment (1934) 82 U. OF PA. L. REV. 261.

42. No provision of the Constitution expressly prohibits Congress from impairing the obligations of contracts as the Fourteenth Amendment does the States. See Mitchell v. Clark, 110 U. S. 633, 643 (1883).

43. Section 75, to which the Frazier-Lemke Act is an amendment, comes under the heading "Agricultural Compositions and Extensions." All relief under the section is limited to farmers. Recently a breeder of pedigreed dogs attempted to qualify as a farmer under the act. See N. Y. Times, Dec. 6, 1934, at 8, col. 5.

44. Home Building and Loan Ass'n v. Blaisdell, 290 U. S. 398 (1934).

Reasonableness of the Act with respect to unsecured creditors presents but few additional questions. With one exception the treatment of unsecured creditors under Section 7 differs from their treatment under the terms of the Bankruptcy Act in the same manner as does that of secured creditors: namely in the time of payment and in the ability to dispossess a debtor of his assets. But they do not receive, as secured creditors do, the benefit of a provision for reappraisal of the assets subject to a lien in their favor. The distinction is nevertheless sound, for with respect to general creditors bankruptcy does not modify previously existing rights but rather grants valuable ones not possessed before. This means that unsecured creditors are affected by Section 7 in the same manner as secured creditors although in a slightly different degree because of their previously distinct position.

There is, however, a different limitation upon the rights of unsecured creditors that must be considered. They may be made subject to either Section 3 or Section 7, and their protection against less favorable treatment under Section 3 than under Section 7 depends not upon their own choice, but lies with the secured creditors or the trustee appointed to arrange the terms of sale. Yet the interests of the secured and unsecured creditors are the same for the purpose of arranging terms, since each payment made by the former is distributed to the two classes of creditors in the same proportion under either alternative. The secured creditors will naturally try to obtain terms under Section 3 fully as favorable as those in Section 7, and in this manner will serve to protect the unsecured creditors. This situation is similar to the familiar procedure in composition agreements, under Section 12 of the Bankruptcy Act, where creditors with the same interests can by agreement preclude objection on the part of dissenters. The most that any single lien holder is apt to do that will affect the interests of a general creditor is to force him to proceed under the reasonable provisions of Section 7. If any additional safeguard is needed, it is found in the trustee, whose function it is to prescribe the terms of "sale" under Section 3. Conceivably the provision therein to the effect that he may prescribe "such other conditions" as in his judgment shall be "fair and equitable" give him sufficient discretion to require different though not lesser terms than those prescribed by the act. Thus by community of interest with the lien creditors and by the discretionary power of the trustee, the unsecured creditor is protected against receiving less favorable terms than the reasonable ones that must result under Section 7. As a method of administration calculated to protect creditors and still to permit flexible application, the act seems well adapted to serve both purposes.

The only conclusion with respect to the Frazier-Lemke Act that can fairly be reached at this time is that in its general features it seems to be directed toward a legitimate end and to be appropriate to accomplish that end. No attempt has here been made to deal with all the innumerable criticisms[45] that

45. A few of such criticisms are that the application of the act is not limited to the period of the emergency; that the moratorium periods are too long; that there is no provision for the payment of taxes over the moratorium period under Section 7; that there is no concrete provision for a deficiency judgment; that the terms "value," "appraised value," and "market value" are left vague and undefined; that no provision is made for dis-

have been directed at the act both by courts[46] and legal scholars.[47] Nearly all such objections have been concerned with various procedural defects[45] rather than with the fundamental theory of the statute. Novel pieces of legislation seldom fail to elicit just such a barrage of criticism, for without the aid of experience it is impossible for the authors of a bill or its critics to realize fully all its far-reaching implications. It is reasonable to believe that when sufficient time has been given to courts and legal scholars to familiarize themselves with the new amendment and to explore its resources, many of the previous objections will appear either unnecessary or illusory.

TAXATION OF SUMS RECEIVED UNDER RIGHTS TO FUTURE PERIODIC PAYMENTS

IN THE early stages of our present income tax regime, before the penumbra between that which was clearly within the meaning of the income tax provisions of the federal statutes and that which was clearly without, was penetrated by legal decisions, considerable speculation prevailed on the taxability of sums received under present rights to future periodic payments, such rights having been either purchased by or granted to the taxpayer.[1] While the sums received under these rights were recognized as such periodic increases of wealth to the donee as are generally regarded by economists as constituting "income," there was the possibility that the term "income" as used in the Act included only those increases of wealth derived from services or the use of capital.[2] If the sums at their source were not "income" in the latter sense, they were therefore taxable neither to the donee nor to the donor. Moreover, even were the payments "income" at their source, the fact that these sums were integral parts of a gift, made their taxation to the donee doubtful in view of the specific statutory exemption of gifts;[3] and the fact that the assignment or gift of the

posal of property not retained by the debtor; that no rent need be paid during the first six months under Section 7; that the junior lienholder is placed in a hopeless position; that a judicial review of appraisals is uncertain.

46. See In re Bradford, 8 F. Supp. 665 (1934).

47. See Britton, *The Farm Moratorium Amendment* (1934) 9 J. NAT'L ASS'N REFER. IN BANK. 41; Hanna, *The Frazier-Lemke Amendments to Section 75 of the Bankruptcy Act* (1934) 20 A. B. A. J. 687; Hanna, *supra* note 19.

1. See Magill, *The Income Tax Liability of Annuities and Similar Periodical Payments* (1924) 33 YALE L. J. 229; Maguire, *Capitalization of Periodical Payments by Gift* (1920) 34 HARV. L. REV. 20; Maguire, *Income Taxes on the Realization of Future Interests* (1922) 31 YALE L. J. 367.

2. This has been the Supreme Court's interpretation of the meaning of the term. See Doyle v. Mitchell Bros. Co., 247 U. S. 179, 185 (1918); Eisner v. Macomber, 252 U. S. 189, 207 (1920).

3. Section 22(b) of the Revenue Act of 1932 provides:—"The following items shall not be included in gross income and shall be exempt from taxation under this title." . . .

"(3) Gifts, Bequests, and Devises.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income)." 47 STAT. 178 (1932), 26 U. S. C. A. (Supp. 1934) § 3022 (b) (3).

The above section of the 1932 Act is substantially the same as Section 22 (b) (2) of the 1928 Act and 213 (b) (2) of the 1924 and 1926 Acts.

income prevented it from accruing to the donor seemed to preclude its taxation to the assignor or donor.[4] Yet there remained the powerful consideration that it was the undoubted intention of Congress to tax all increases in wealth derived from services or the use of capital. And even though these difficulties were resolved by the courts in favor of reaching the income, there remained the problem of whom to tax, the donor or the donee. The philosophy behind the surtaxes established by the statute contemplated placing the largest tax on him who could best bear it. Considerations of fairness favored taxing the sums to the donee since it was he who was enjoying the benefits of the income. But such a policy presented possible embarrassment to the administration of the tax since it could permit an owner of property being taxed under the higher brackets to evade the higher surtaxes to some extent by merely making a division in the taxable stream of income among the members of his family, the resulting tributaries of which would all be taxed at lower rates than the single stream.[5] Specifically, the resolution of these considerations has centered about three fact situations: payments received under terminable rights to the income of property held in trust or otherwise; charges on property created by will or grant; and annuities.

The first case to be decided by the Supreme Court involving the taxability of payments received under a terminable right to the income of property held in trust or otherwise, was *Irwin v. Gavit*,[6] wherein it was held that the sums received by a taxpayer pursuant to a legacy of part of the income from a testamentary trust, were taxable income to him. Logically the decision is far from impregnable. Payments received under such a right may plausibly be regarded as part of a continuing gift made by the testator,[7] and therefore exempt under the statute.[8] Or the subject of the gift may be said to be the right to the future payments,[9] in which case the payments themselves would not properly be taxable in full as income.[10] But since tax laws are practical instruments for obtaining income for governmental needs and not perfection of logic, the Supreme

4. The Revenue Act provides for taxing an individual for only that income which accrued to him in the preceding year. See note 11, *infra*. If the income from a fund is assigned away before it is realized, it may be regarded as never accruing to the owner of the fund, and therefore not taxable to him.

5. See U. S. v. Isham, 17 Wall. 496, 506 (84 U. S. 1873).

6. 268 U. S. 161 (1925). Noted in (1925) 25 COL. L. REV. 945; (1925) 20 ILL. L. REV. 405; (1925) 74 U. OF PA. L. REV. 182.

7. See dissent by Sutherland J., in Irwin v. Gavit, 268 U. S. 161, 168 (1925); Irwin v. Gavit, 275 Fed. 643 (N. D. N. Y. 1921); Note (1925) 25 COL. L. REV. 945, 946. See also United States v. Merriam, 263 U. S. 179, 187, 188 (1928) (statutes not to be extended beyond their clear meaning, and every doubt to be resolved in favor of the taxpayer).

8. See note 3, *supra*.

9. Magill, *supra* note 1, at 236 (suggesting that the legatee should not be taxed until the payments received equalled the value of the right to the future payments when first received); Comment (1925) 25 COL. L. REV. 945, 946.

10. Logically, the yearly income which should be taxed to the beneficiary under this theory should be the increase in capital value of the right to the current payment from the time the right was first granted to the time the payment is actually received. But cf. Magill, *supra* note 1, at 236.

Court could well forsake the literal meaning of the statute in favor of Congressional intent and so give effect to the practical exigencies. Thus, it probably was the intention of Congress to tax all earnings from capital investments.[11] But by a specific statutory exemption, the income paid out under such a right as was involved in *Irwin v. Gavit* was deductible by the trustee.[12] Hence if the sums so paid out were not taxed to the beneficiary, a part of the taxing power intended to have been used by Congress, would be negated. Moreover, in terms of income to the donee, the gift here was essentially the same as a gift to the beneficiary of the corpus itself for enjoyment during a like term.[13] Since in the latter case the income from the property would undoubtedly have been taxable to the donee, it seems only fair that the beneficiary in cases like *Irwin v. Gavit* should be taxed likewise for the full amount of the income received from the trust.

But while the decision in *Irwin v. Gavit* precludes further consideration of exactly similar fact situations, other closely allied cases are as yet undetermined. The first group consists of those cases where the trust device is not used, but the right to future income is separated from the fund by gift or gratuitous assignment. The points of similarity between these cases and *Irwin v. Gavit* are commanding. The fact that the trust device is dispensed with makes the gift none the less one of the income from a specific fund, a factor considered important in the *Gavit* case.[14] Moreover, in either case the severance of the income from the fund out of which it flows may be as complete as in the other, thereby depriving the owner of the fund of the future enjoyment or control of the income thereof. And while it was suggested in *Irwin v. Gavit* that the gift of the income of the trust could be held taxable to the beneficiary on the ground that the taxpayer received an equitable interest in the trust fund from which he derived the income,[15] the same can as readily be said of the interest received by the assignee of income. There is, however, the possibility that to hold the assignee taxable for the income, would provide an avenue for wholesale eva-

11. The Income Tax Act of 1913, c. 16, Section II, A. subd. 1, provides for levying a tax on the entire net income accruing and arising from all sources in the preceding calendar year to every citizen of the United States. 38 STAT. 166 (1913). This has been interpreted by the Supreme Court as being "any gain derived from capital, from labor, or from both combined." Stratton's Independence v. Howbert, 231 U. S. 399, 415 (1913); Doyle v. Mitchell Bros. Co., 247 U. S. 179, 185 (1918); Eisner v. Macomber, 252 U. S. 189, 207 (1920).

12. Section 162 of the Revenue Act of 1932 provides: "The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that ". . . (b) There shall be allowed as an additional deduction in computing the net income of the state or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries." 47 STAT. 220 (1932), 26 U. S. C. A. § 3161 (a) (2) (Supp. 1934). This is the same as Section 162 of the 1928 Act, and substantially the same as Section 219 (b) (2) of the 1926 Act.

13. See Comment (1925) 74 U. OF PA. L. REV. 182, 185.

14. See Irwin v. Gavit, 268 U. S. 161, 168 (1925). See also Burnet v. Whitehouse, 283 U. S. 148, 151 (1931).

15. See Irwin v. Gavit, 268 U. S. 161, 167 (1925).

sion of the spirit if not the letter of the law by intra-family assignments, and similar arrangements to reduce surtaxes.[16] But such a purpose can already be effected through the simple trust device,[17] and hence a similar treatment of assignments would not greatly expand the existing opportunities for evasion. And if a real necessity arises for checking such evasion, Congress can easily provide an effective remedy by merely making income from property taxable to the owner of the fund, a suggestion which the Supreme Court has already intimated would be a lawful use of the taxing power.[18] Considerations of fairness too, point to taxing assigned income to the assignee. Similar to the situation in *Irwin v. Gavit*, a gift or assignment of income is not substantially different from a gift of the corpus for a like term, and as has been pointed out, consistency in the treatment of taxpayers demands that the income be taxed to the assignee as it is to the donee of property for a term.[13] Moreover, since the assignee is the one who receives the benefits of and enjoys the income, the size of the surtax on the assigned income should logically be determined on the basis of the assignee's total income rather than on the assignor's.

But while a resolution of the above arguments would seem to favor taxation of assigned income to the assignee, such a resolution can be made only in those cases in which the severance of the right to future income from its fund, is as complete as in the case of the gift of the income from an irrevocable trust. Where some power to alter the flow of income to the assignee or donee is retained by the assignor or donor, other additional factors become important, and appear to favor a contrary result. Conceptually, the transaction then takes on more of the aspects of a voluntary transfer of income to the donee each year as it is earned; in which case it would be taxable only to the donor.[19] It is true there is the existence of the continuing right of the donee to the future income veiling the transaction; but if the right is subject to the will of the donor it is not substantially more than an expectancy arising out of the donor's generosity, which is the situation where the gifts are made independently, year by year, under no guise of an existing right. Were the owner of property allowed to escape high surtaxes by such a device as this, possibilities of evasion would be considerably broadened.[20] Men's fear for the future and their con-

16. The fact that such arrangements are made for the express purpose of reducing taxation and circumventing the effects of the tax statutes is no ground for holding them void. See U. S. v. Isham, 17 Wall. (84 U. S.) 496, 506 (1873).

17. See Irwin v. Gavit in conjunction with note 16, *supra*. But this result is reached only when the property is subject to an irrevocable trust. Where the settlor retains a right to revoke the trust, the income therefrom is taxable to the settlor by specific statutory provision. See Section 166 of the Revenue Act of 1932, 47 Stat. 221 (1932), 26 U. S. C. A. § 960 (Supp. 1934) § 3166, same as Section 166 of the 1928 Act and Section 219 (g) of the 1926 and 1924 Acts.

18. See Lucas v. Earl, 281 U. S. 111, 114-115 (1930). In this case the court said that Congress had power to tax earnings of wage earners to those who earned them. By analogy the receipts from property could be made taxable to the owners of the property.

19. See Maguire, *supra* note 1, at 22.

20. As has been pointed out before, this avenue of escape where trusts are used, has been obviated by a specific statutory provision taxing the income from revocable trusts to the settlor. See note 17, *supra*.

sequent desire to retain control over their future income, which now tends to restrain them from using such devices as irrevocable trusts and assignments to avoid surtaxes, would no longer provide a barrier to evasion.

Just how much control need be kept by the donor or assignor before taxation will be imposed on him rather than on the assignee, is an open question. So far, the cases seem to indicate that only where, prior to the realization of the income, it has been irrevocably assigned away, will the tax be levied on the assignee instead of the assignor.[21] Thus where an insurance agent assigned to a third person the right to the income from a contract binding an insurance company to pay commissions on renewal premiums of policies which the agent had sold, the assignee was taxed for the income arising under the contract.[22] And where the owner of bonds clipped all the interest coupons from his securities and gave them to another, the donee and not the owner of bonds was held taxable for the income accruing under the bonds.[23] But where an owner of certain stocks assigned to another the right to future dividends therefrom, it was denied that he had shifted income tax liability on the stock to the assignee because of the ease with which the assignor could have avoided the effect of the whole transaction by simply transferring his shares to a third party.[24] And the assignment of the right to the future income from a lease has not had the effect of shifting taxation to the assignee[25] because of the possibility that the lease

21. There is considerable dictum to the effect that the owner of personal property can escape assessment for income tax only by assigning away the corpus as well as the income. See Rosenwald v. Commissioner, 33 F. (2d) 423, 426 (C. C. A. 7th, 1929); Ward v. Commissioner, 58 F. (2d) 757, 760 (C. C. A. 9th, 1932); cf. Bishop v. Commissioner, 54 F. (2d) 298 (C. C. A. 7th, 1931); Mitchell v. Bowers, 15 F. (2d) 287 (C. C. A. 2d, 1926), cert. denied 273 U. S. 759 (1927). However, in several cases where only the income was transferred the assignee or donee was held taxable. See Rosenwald v. Commission *supra*; Hall v. Burnet, 54 F. (2d) 443 (App. D. C. 1931), cert. denied 285 U. S. 552 (1932); Nelson v. Ferguson, 56 F. (2d) 121 (C. C. A. 3rd, 1932), cert. denied 287 U. S. 565 (1932).

22. Hall v. Burnet, 54 F. (2d) 443 (App. D. C. 1931), cert. denied 285 U. S. 552 (1932) (assignee of rights of insurance agent to renewal commissions held taxable); Nelson v. Ferguson, 56 F. (2d) 121 (C. C. A. 3d, 1932) (assignee of rights to the profits from certain patents held taxable to the assignee). *Contra*: Bishop v. Commissioner, 54 F. (2d) 298 (C. C. A. 7th, 1931); Ellis v. Commissioner, 25 B. T. A. 1195 (1932). In the latter cases a distinction was drawn on the ground that only the income from the contracts had been assigned whereas in cases where the assignor had been taxed, the contract right itself had been assigned. This distinction is unwarranted, however, because in the *Hall v. Burnet* and *Nelson v. Ferguson* cases the corpus was the contract itself, which was not assigned; only the right to the income accruing under the contract was assigned.

23. Rosenwald v. Commissioner, 33 F. (2d) 423 (C. C. A. 7th, 1929).

24. Rosenwald v. Commissioner, 33 F. (2d) 423, 426 (C. C. A. 7th, 1929); cf. Bettendorf v. Commissioner, 49 F. (2d) 173 (C. C. A. 8th, 1931) (where donor transferred corpus of stock certificates reserving the right to the dividends, the donor was held taxable for the income from the shares); Turner v. Commissioner, 28 B. T. A. 91 (1933) Varnell v. Commissioner, 28 B. T. A. 231 (1933).

25. Ward v. Commissioner, 58 F. (2d) 757 (C. C. A. 9th, 1932); cf. Bing v. Bowers, 22 F. (2d) 450 (S. D. N. Y. 1927), aff'd per curiam on opinion below, 26 F. (2d) 1017 (C. C. A. 2d, 1928).

might be terminated, or transferred by the lessor, thereby destroying the right of the assignee to the future income.[26] But while the facility with which an assignor of dividends from stock can avoid the consequences of his act may be sufficient reason to justify taxing the dividends to the assignor under the test of control, it may nevertheless be said that an assignment of rent sufficiently divests the assignor of control and future enjoyment of the rents, as to justify taxing the income to the assignee under *Irwin v. Gavit*.[27]

A still more difficult problem for determination is presented where the assignment of the income from securities is for only a single year and is made prior to the year in which the income will be realized. Under *Irwin v. Gavit* will such a transaction accomplish the desired effect of shifting the taxation of the income for the one year to the assignee? If the arguments postulated in *Irwin v. Gavit* are carried to their logical conclusion, this type of transaction would make the income accruing thereunder taxable to the assignee as though he had been given the right to the income for a period of years. And, argumentatively, the same practical considerations exist in regard to the assignment of the income for a single year as for a period of years. It is true the payment of a single sum does not satisfy the usual requirement in income of periodicity of receipt.[28] But in *Irwin v. Gavit* the test which was applied to the payments was not what the payments were to the beneficiary, but what they were at their source, and what they were in terms of the grant by the assignor or donor. The income from a single year, under that test, is as much "income" as if for a period of years. And the courts have consistently refused to endorse periodicity as an essential requisite of income under the Act.[29] Practically, however, where the assignment is for only one year in advance, the transaction approaches remarkably close to the case where there is no assignment at all, but merely a voluntary gift of the income each year. The resultant possibility of evasion may well have the effect of limiting *Irwin v. Gavit* to only those cases where the income has been assigned for a period of years.

A question somewhat analogous to that raised in the latter case is whether the assignee will be taxed for sums accruing under an assignment for a substantial term, subject, however, to revocation on notice to be given in the preceding tax year. Since the assignor can never obtain the use of the income for the current year, it can be said that the tax should be levied on the assignee. The revocation provision, however, opens possibilities of evasion similar to those in the preceding case, which may justify a departure from *Irwin v. Gavit*. A

26. See Ward v. Commissioner, 58 F. (2d.) 757, 760 (C. C. A. 9th, 1932).

27. The fact that the assignee's right to the future income would be defeated by the tenant's forefeiture of the lease seems insufficient to hold the assignor taxable, since this contingency would not be within the control of the assignor, and is exceedingly remote. And it would seem that an assignment of the income of a lease would be valid even as against an assignee of the lease itself if the first assignment were recorded.

28. See Trefry v. Putnam, 227 Mass. 522, 116 N. E. 904 (1917); United States v. Oregon-Washington Rr. & Navigation Co., 251 Fed. 211, 212 (C. C. A. 2d, 1918); Magill, *supra* note 1, at 223.

29. Thus a gain derived from a sale of capital assets has been held taxable income in the year in which the sale was made. Merchant's Loan and Trust Co. v. Smietanka, 255 U. S. 509 (1921); Doyle v. Mitchell Bros. Co., 247 U. S. 179 (1918).

similar problem has arisen in the taxation of the income from trusts subject to analogous revocation provisions, and the tax in the latter instance has been placed on the beneficiary rather than the settlor.[30] But in view of the fact that this result was based solely on an interpretation of the statute prescribing under what conditions the settlor was to be taxed,[31] and that the courts have been slow to carry trust analogies over into assignments, the decisions in these cases do not necessarily preclude a different result in the case of assignments with like revocation provisions.

The leading case involving the taxability of charges on property created by will or grant is *Burnet v. Whitehouse*,[32] in which the Supreme Court held that sums received by the taxpayer under a devise of an annuity chargeable on the corpus of the estate as well as the income thereof, were not taxable income to him. This was followed by the recent case of *Helvering v. Pardee*,[33] involving substantially the same transaction, where it was held that the trustee of the property on which the annuity was charged, could claim no deduction by virtue of the payments made to the beneficiary. Once *Burnet v. Whitehouse* is accepted, the result reached in the latter case may be explained merely as a convenient escape from permitting the income from some capital funds to go untaxed.[34] It is arguable, however, that this type of transaction should be treated no differently than the one involved in *Irwin v. Gavit*. It is not unlikely that the testator intended the same result, in terms of income to the donee, in both cases; and that result is often reached in terms of the source of the payments because the testator usually sets aside enough property to pay the annuity out of the income alone.[35] The fact that in periods of depression the trustee may have to dip into the corpus to pay the income designated by will, hardly appears to alter the basic nature of the transaction sufficiently to justify a distinction in taxation. From the standpoint of surtax philosophy, it would seem fairer, as in the case of a gift only of income, if the tax were measured

30. Langley v. Commissioner, 61 F. (2d) (C. C A. 2d, 1932); Lewis v. White, 56 F. (2d) 390 (D. C. Mass. 1932), aff'd per curiam 61 F. (2d) 1046 (C. C. A. 1st, 1932).

31. The discussion turned almost entirely on the interpretation of the stipulation which taxed the income to the grantor when the trust was revocable "at any time during the taxable year." See *supra* note 17. No such narrow limitation is applicable to similar provisions in assignments.

32. 283 U. S. 148 (1931), noted in (1931) 31 COL. L. REV. 1053.

33. 54 Sup. Ct. 221 (U. S. 1933), consolidating lower court cases of Pardee v. Commissioner, 63 F. (2d) 948 (C. C. A. 3d, 1933); Title Guarantee Loan and Trust Co. v. Commissioner, 63 F. (2d) 621 (C. C. A. 5th, 1933); Butterworth v. Commissioner, 63 F. (2d) 944 (C. C. A. 3d, 1933); Fidelity-Philadelphia Trust Co. v. Commissioner, 63 F. (2d) 949 (C. C. A. 3d, 1933); (1934) 34 COL. L. REV. 183. See also (1933) 33 COL. L. REV. 1076.

34. And it would seem little more than an escape, since even the income paid out regularly under an annuity charged on the fund of a trust comes within the literal meaning of the clause exempting to the trustee such income as is to be paid out regularly to the beneficiaries, and since it is certainly intended that the income shall be so paid out by the trustee, and it generally is so paid out. See relevant provision on the Revenue Act, *supra* note 12.

35. See Burnet v. Whitehouse, 283 U. S. 148, 150 (1931).

by the recipient's income rather than that of the trust. But that there are logical difficulties in treating this case like *Irwin* v. *Gavit,* cannot be denied. Where the annual payments are not limited to income but are chargeable as a matter of legal right on the fund as well, it is not as clear that only "income" is given, when, if necessary, parts of the corpus may be appropriated to the payment of the annuity. And if the beneficiary is taxed only when he is paid out of income, there arises what the Supreme Court has considered the insurmountable incongruity[36] of taxing the beneficiary in some years and exempting him in others, according to the source of the payment. The validity of regarding even periodic payments of capital as taxable income to the beneficiary, has been considerably weakened by *Irwin v. Gavit* where an important element in the test of whether the payments to the beneficiary were taxable income was whether they were income in the hands of the trustee.[37]

But in spite of these logical difficulties the practical factors in favor of treating this case like *Irwin v. Gavit* might well have governed. Factually, the annuity here involved accomplishes somewhat the same result as a gift of income. And the logical difficulties are not insuperable since "income" is a loose term[38] and could have been regarded as including annuities.[39] Moreover, in the relevant sections of the Revenue Act at the time of *Burnet v. Whitehouse,* annuities were specifically exempt to the purchaser to the extent of the consideration which he had paid.[40] In the fact that only this exemption appeared in the Act could have been found an implicit intention that in all other cases annuities were to be taxed to the annuitants. While the statute has been changed to exempt from taxation all annuitants to the extent paid for the annuities by the purchaser,[41] the testamentary annuity of the type appearing in *Burnet v. Whitehouse* is not within the literal meaning of the exemption provisions because no consideration is paid for it,[42] and annuities are even now exempt only up to the consideration paid for them. And the testamentary annuity is not substantially like those annuities to which exemptions have been granted by statutes, since

36. Id. at 151.

37. See Irwin v. Gavit, 268 U. S. 161, 167, 168 (1925).

38. One of the most confusing problems under modern income tax statutes is the determination of just what is income. For discussions of the problem see HEWETT, THE DEFINITION OF INCOME AND ITS APPLICATION IN FEDERAL TAXATION (1925); Rottschaefer, *The Concept of Income in Federal Taxation* (1929) 13 MINN. L. REV. 637; Stracham, *The Differentiation of Capital and Income* (1902) 18 LAW QUART. REV. 274; Stracham, *Capital and Income under the Income Tax Acts* (1913) 29 LAW QUART. REV. 163.

39. In England an annuity has been judically described as one "where an income is purchased with a sum of money, and the capital is gone and has ceased to exist, the principal having been converted into an annuity." See Foley v. Fletcher, 3 H. & N. 779, 784-85 (1858).

40. U. S. Revenue Act of 1921, 42 STAT. 238 (1921), 26 U. S. C. A. § 954 (1926).

41. U. S. Revenue Act of 1932, § 22b (2), 47 Stat. 178 (1932), 26 U. S. C. A. (Supp. 1934) § 3022 (b) (2).

42. The act provides that if amounts received under annuity contracts "exceed the aggregate premiums or consideration paid, then the excess shall be included in gross income." Note 41, *supra.* Logically, this exemption does not preclude taxation of the beneficiary of an annuity paid out of a testamentary trust, since the testator never paid any consideration for the annuity.

purchased annuities contemplate a return to the annuitant of part of the consideration, while generally no such intention prevails in annuities such as the one in the *Whitehouse* case. If *Burnet v. Whitehouse* is not overruled by the Supreme Court, it would seem that the foregoing considerations may warrant a change in the result by statute.

With respect to the third group of cases, those involving purchased annuities, the Revenue Act prior to 1926 provided that only purchasers of annuities themselves were exempt from paying taxes on the payments received under the annuities, up to the value of the consideration paid.[40] But, as has been pointed out, a similar exemption has since been extended to all annuitants.[41] While the taxation of annuities is carefully covered by statute, there remains the problem of determining just what transactions may be considered annuities as exempted under the Act. Certainly, since annuity contracts are referred to in the same phrase and impliedly put in the same classification as insurance and endowment contracts in the statute,[43] regular commercial annuities purchased from insurance companies come within the scope of the statutory exemptions. The determination of the annuity status of a gift of property with a reservation of the income therefrom, or a gift on condition that the donee pay to the donor or a third person a stipulated sum each year, for a term of years, presents a more difficult problem.

In the former case it would seem logically that the income should be taxed to the donor. This type of transaction may be regarded as in effect a reservation by the donor of a life interest in the fund,[44] the income of which, therefore, should be taxable to him. Or it may be said that by the transaction the donee is made a trustee of the fund in favor of the donor for the designated term,[45] in which case the income should be taxable to the donor under the result reached in *Irwin v. Gavit.* Or, to use one of the arguments made in *Irwin v. Gavit,* it may be said that since the payments to the donor under his reserved right are income at their source, and it is income which is specifically reserved, clearly, it is taxable income which the donor receives under his reservation.[46] Nevertheless, the Circuit Court of Appeals has held the donor a purchaser of an annuity and hence tax exempt on the income therefrom up to the amount of the consideration paid.[47] Only the emotional appeal of the donor's

43. The Act provides for exemption on "Amounts received . . . under a life insurance, endowment, or annuity contract . . ."

44. The Supreme Court used the same argument in Irwin v. Gavit in holding the beneficiary of a testamentary trust taxable for the income accruing to him from the trust. 268 U. S. 161, 167 (1925).

45. This view of the conditional gift has been taken by judges in holding such transactions valid transfers of property. See Flint v. Rathruff, 26 App. Div. 624, 625, 53 N. Y. Supp. 206, 207 (1st Dep't 1918); concurring opinion of Smith, J., in In re Humphrey's Estate, 191 App. Div. 291, 299-300, 181 N. Y. Supp. 169, 175 (1st Dep't 1920).

46. This, of course, is the reverse of the transaction in *Irwin v. Gavit,* where only the income was given to the taxpayer, the corpus being reserved. But the fact that in one case the income was granted and in the other it was reserved should not preclude the same test to be applied to determine whether the sums in each case are taxable as "income" under the Act.

47. Continental Illinois Bank and Trust Co. v. Blair, 45 F. (2d) 345 (C. C. A. 7th, 1930).

generosity can account for this result. But the donor was enjoying the income from the property during his life and thereby receiving as much benefit as if he had retained the fund until his death before giving it to the donee. Hence there seems to be no special equity in favor of exempting him.

In the case where a gift has been made on condition that the donee pay to the donor or a third person a stipulated sum each year for a term of years, since payments to be made to the donor or a third person are not merely charges on the income of the property transferred, but are to be paid in any event by the donee,[48] the transaction more closely approaches the regular purchased annuity. And the Department of Internal Revenue has treated this type of case as coming within the purchased annuity category.[49] But looking through the form of this transaction to its substance, it cannot be denied that the purpose the donor probably had in mind and the result which he obtained in this case, is the same as where the income from property is reserved, the specific payments required of the donor usually amounting to less than or approximating the income from the property transferred. Where such appears to be the case no distinction in treatment should be accorded this type of transaction as against the one where the donor reserves the income from the property granted away. But in the light of *Burnet v. Whitehouse* the Court is not likely to submit to taxing the donor on sums received from the donee where the latter is to pay a certain sum periodically irrespective of income.

In conclusion, it need hardly be pointed out that the past decisions of the Supreme Court afford no definite rule or rules for the determination of the taxability of sums received under rights to future periodic payments. If these cases admit of any general conclusion, it is only that language will be liberally construed and logic sacrificed to avoid the result of allowing some income to go tax free, and to give effect to the intention of Congress to tax all earnings from capital funds. But that the Court has not been quite so ready to depart from logical niceties in order to effect equality in the treatment of taxpayers in substantially the same circumstances is evident by its departure from *Irwin v. Gavit* in *Burnet* v. *Whitehouse* and analogous cases. A more liberal trend in this direction seems desirable, however, in striking the balance between the urgent expediency of obtaining funds for governmental needs, and the social as well as political desirability of treating the taxpayers fairly.

48. The donee who accepts a gift is bound to execute the charges and obligations imposed on him by the terms of the gift in the same manner as the obligator in any ordinary contract. Hurley v. Hurley, 146 La. 337, 83 So. 643 (1920); Miles v. Miles, 163 Ia. 153, 150 N. W. 21 (1914).

49. See I. T. 2397, VII-1 C-B. 90 (1928).