RIGHT OF A SURETY TO SET OFF DEPOSITS IN AN INSOLVENT BANK

A receiver of an insolvent commercial bank frequently finds among its assets notes which are secured by sureties who have deposits in the bank. If the principal debtor on these notes has no deposit which he can compel the receiver to apply towards the

1 This comment is confined to the set-off of a deposit balance in a commercial bank, or in the commercial department of a bank having both a savings and commercial department, against the obligation of a surety on a note held by the commercial bank or the commercial department. Whether set-offs in savings banks or in savings departments should be allowed may be governed by different considerations, leading to wholly different results. Cf. Bachrach v. Allen, 239 Mass. 272, 131 N. E. 857 (1921) (surety denied set-off of deposit in savings department against liability as surety on note held by savings department). In the following cases the set-off was denied the maker: Osborn v. Byrne, 43 Conn. 155 (1875) (mutual savings bank); Lawrence v. Lincoln Trust Co., 123 Me. 273, 122 Atl. 765 (1923) (savings department of commercial bank); Dole v. Chattabriga, 82 N. H. 396, 134 Atl. 347 (same); Lippitt v. Thames Loan & Trust Co., 88 Conn. 185, 90 Atl. 369 (1914) (same). In Upham v. Bramwell, 105 Ore. 597, 209 Pac. 100 (1922), a set-off in a savings department was allowed a maker.

[881]
extinguishment or reduction of the obligation, the surety may attempt to set off his own deposit. This action may be prompted by a number of factors. The principal debtor may be insolvent or in precarious financial straits, and the surety's reimbursement proportionately uncertain. If allowed the set-off he will at least avoid the additional loss occasioned by the payment of only a partial dividend on his deposit. If, on the other hand, the principal debtor is solvent the surety may escape all loss if he is allowed the set-off, and will be in a better position than other depositors. Or, instead of obtaining full reimbursement from the solvent principal, the surety, if confident of the possibility of setting off his deposit, may prefer a quick settlement and a probable reduction of ultimate loss and accordingly agree to accept from the principal an amount less than the face of the obligation, but still more than the anticipated dividend. In such an event the principal will in effect pay less of his debt to the insolvent estate than other debtors.

In light of these possibilities most courts, in order to forestall a preference to either the surety or principal, early announced the rule that the surety is not entitled to a set-off if the principal is solvent or the surety is indemnified. This rule is ap-

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2 For a discussion of the major problems having to do with the principal debtor's right to set off his deposit, see 1 Morse, BANKS AND BANKING (6th ed. 1928) § 324; Note (1932) 80 U. PA. L. Rev. 420. Set-offs, formerly cognizable only in equity, have long been available in legal actions by force of statute. WATERMAN, SET-OFF (2d ed. 1872) 11 et seq. Under these statutes “mutual credits” may be set off, but they must be either liquidated, or arise out of contract or judgment. The demands must be due the defendant in his own right against the plaintiff, or his assignor, and must exist and belong to the defendant at the time of the commencement of the action. CLARK, CODE PLEADING (1928) 438. Equitable set-off still exists, and although generally following the statutes, is available for situations not covered by the statutes if special equitable grounds for relief may be shown. Id. Such statutes were not repealed by the pleading codes, and apparently the contract clause of the counterclaim statutes can be used to achieve a set-off. Id. at 445. For an historical account of the development of set-off and counterclaim, see Loyd, The Development of Set-off (1916) 64 U. or PA. L. Rev. 541.

3 This will also occur where the surety is fully indemnified. He will not, however, be credited with interest on his deposit from the date the bank closed its doors. Streeter v. Junker, 230 Ill. App. 366 (1923).

4 In re Middle District Bank, 1 Paige 585 (N. Y. 1829); Lippitt v. Thames Loan & Trust Co., supra note 1; New Farmers' Bank's Trustee v. Young, 100 Ky. 683, 39 S. W. 46 (1897); Davis v. Industrial Mfg. Co., 114 N. C. 321, 19 S. E. 371 (1894); Edmondson v. Thomasson, 112 Va. 326, 71 S. E. 536 (1911) (accommodating indorsers); Knaffle v. Knoxville Banking & Trust Co., 128 Tenn. 181, 159 S. W. 838 (1913) (accommodating maker). None of these cases is articulate as to what degree of insolvency of the principal debtor must be shown. Some of them, concerning instructions to the receiver, direct that he should first attempt to collect from the principal debtor, and that the surety should be allowed a set-off on the balance. Davis
plicable to all types of sureties since all are entitled to reimbursement. In some decisions, however, it has been disregarded, and in New York has been limited in its application. The limitation first appeared in strong dictum in Curtis v. Davidson where the Court of Appeals stated that although an indorser, proceeding by a bill in equity to compel the bank's receiver to set off his deposit, must allege and prove the principal's insolvency, the receiver when suing the indorser on the instrument cannot defeat the set-off without showing that the indorser is certain to be indemnified. Seemingly couched in terms of burden of proof, this dictum has nevertheless led to two recent Appellate Division decisions that an accommodation indorser and a guarantor of notes, when sued by the bank's receiver, may successfully set-off or counterclaim for their deposits even though the respective principals were solvent. Thus in New York the allowance of a set-off in this type of case would now seem to depend upon the origin of the suit—an artificial distinction which may permit the surety to obtain what is generally considered a preference by forcing the

v. Industrial Mfg. Co., and Edmundson v. Thomasson, both supra. No case apparently considers a possible partial reimbursement by the insolvent principal a pro tanto bar to the surety's set-off. For example, in Streeter v. Junker, supra note 3, the set-off of a deposit against a $5,000 note given for accommodation was contested on the ground that the accommodating maker was indemnified together with other creditors, by about $200,000 of frozen assets. Evidence showing that only about $9,400 of this sum had been collected in two years led the court to conclude that the depositor was not sufficiently secured to be denied the set-off. It was further influenced by the fact that the agreement to indemnify would be difficult to prove.

The possibility of contribution from other sureties is considered indemnity that will defeat a proportionate part of the set-off. Thus in Davis v. Industrial Mfg. Co., supra, the receiver was instructed that if the maker of a note was insolvent, one of eight accommodating indorsers was to be permitted to set off his deposit against one-eighth the face amount of the note; but if other indorsers were found to be insolvent, this proportion was to be accordingly increased.

6 It is likewise applicable to indorsers for transfer, and other parties "secondarily liable." Bryant v. Williams, 16 F. (2d) 159 (E. D. N. C. 1926).


7 215 N. Y. 385, 109 N. E. 481 (1915). The case, which came up on a certified question, actually decided that where the receiver sues an indorser of notes, the absence of an allegation of insolvency of the maker in the indorser's answer did not entitle the plaintiff to a judgment on the pleadings.


receiver to bring the action. If preferences upon the liquidation of a bank are undesirable, this result would seem to be a surprising misapplication of the procedural rule of *Curtis v. Davidson.* When the surety sues the receiver, the rule may be justified by the familiar principle that one who seeks equity should show that he is entitled to it,—specifically, that the surety must show that he has no remedy against the principal. On analysis this doctrine seems sound, especially in view of the difficulty of the proof of insolvency. If upon his own suit in equity the surety is allowed a set-off, the bank will be deprived of the benefits of a recovery against the principal. Before this remedy is extinguished, the surety should at least show that if the set-off is denied he will suffer greater loss than other debtor-depositors. On the other hand, when the receiver sues the surety, it would seem that before the set-off is defeated and the surety placed in a less advantageous position than other depositors, it should be incumbent upon the receiver to show good cause for the discrimination, that is, certainty of reimbursement. That this burden is not in fact a harsh one is apparent from the fact that if the maker is actually solvent the receiver may sue him alone and thus avoid the entire question of the surety’s set-off. In any event, other courts have adopted this evidentiary distinction, but none has gone to the extreme of the present and unique New York rule.

With regard to certain types of surety contracts factors other than the insolvency of the principal debtor may affect the allowance of the set-off. Since, in the case of accommodating indorsers and drawers, due proceedings on dishonor are required to fix liability, the set-off has sometimes been disputed on the ground that since the surety’s obligation is contingent, the debts are not mutual. Where the obligation to the bank matures and the liability is fixed before the receivership there is no force in this

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11 Payment of the obligation by the surety, by way of set-off or otherwise, does not discharge the instrument. *NEGOTIABLE INSTRUMENTS LAW,* § 121. But any recovery thereon by the holder enures to the benefit of the surety. In re Garfunkel, 8 F. (2d) 790 (S. D. N. Y. 1924). Although there is no authority on the point, it would seem probable that if the surety is given the set-off, he would be entitled to the full proceeds of a recovery by the receiver against the principal. The insolvent estate would thus lose the difference between the face of the obligation and whatever percentage would be payable on the deposit.


13 *NEGOTIABLE INSTRUMENTS LAW,* §§ 89, 152. This is true also of indorsers for transfer and drawers.
objection. But where the obligation does not mature until after the receivership, the requirement of mutuality has induced the Maryland court in a recent decision to deny the set-off. Most courts have held, however, that the possible discharge of the surety because of an act of the creditor or a failure to fix liability seasonably is insufficient reason for placing the accommodating indorser in a different position from a maker who is in fact the principal debtor. The latter has almost universally been allowed to declare his obligation to the bank presently due and thus avail himself of the set-off. In the converse situation, where the surety’s obligation to the bank is presently due, but the bank’s debt is due in futuro, there is a decided lack of authority. There is conflict, however, as to whether in this situation a maker-principal debtor is entitled to a set-off, and it would seem that in those jurisdictions where the set-off is denied the principal, it would a fortiori be denied to the surety.

Where the depositor seeks the set-off against an obligation not presently due on which he has signed for accommodation in the capacity of a maker, the peculiar difficulties inherent in the case of an accommodating indorser as to the time of maturity of the obligation are not present. Since, under the Negotiable Instruments Law his liability is fixed without notice in the same manner as that of a maker who is in fact a principal debtor, he has likewise been held entitled to declare his debt due immediately.

16 Yardley v. Clothier, supra note 6; Curtis v. Davidson, supra note 7; O’Connor v. Brandt, 32 App. Div. 596, 42 N. Y. Supp. 1079 (3d Dep’t 1897); Davis v. Industrial Mfg. Co., supra note 4. Quaere whether the same result would follow if the condition precedent to the surety’s liability was a suit to judgment of the principal, as in the case of a “guarantor of collection.”
19 §§ 29, 89.
On the other hand, although labeled “primarily liable” by Section 192 of the Negotiable Instruments Law, he has been treated in the same manner as other sureties to the extent of being denied a set-off unless the party accommodated is insolvent, since possible indemnity would create a preference which is generally refused in the case of an accommodating indorser.\textsuperscript{21} The recent case of \textit{Johnston Coffee Co. v. Page} \textsuperscript{22} indicates, however, that a different result may be reached by other courts. In that case it was held that an indorser on a note who was the actual borrower from the bank could not set-off his deposit, although it was conceded that he would have been entitled to the set-off had he appeared on the instrument as maker. The decision was grounded on a literal interpretation of Section 192 of the Negotiable Instruments Law, providing that an indorser is “secondarily liable,” and runs counter to all decided cases, both before \textsuperscript{23} and since \textsuperscript{24} the Negotiable Instruments Law. It would not be surprising to find a court committed to such a construction of Section 192 concluding that the rule making the insolvency of the principal debtor a prerequisite for a set-off to the surety should not apply to an accommodating maker. While there is ample precedent in other types of cases for the literal interpretation of Section 192,\textsuperscript{25} it would seem that when applied to the problem of the surety’s right of set-off, a more equitable result would be reached by interpreting the Negotiable Instruments Law as treating parties in their actual, rather than their apparent capacities.

When an accommodating maker is jointly liable with the accommodated party or with some other surety, a further limitation upon the right to set-off exists in a few jurisdictions which hold that a party jointly liable may not assert a set-off or counterclaim which does not exist in favor of all the joint obligors.\textsuperscript{26} The force of this procedural rule, however, may probably be avoided by a showing that the surety will not be able to obtain reimbursement from his principal;\textsuperscript{27} in any event it would seem probable that the set-off could be obtained by a bill in equity

\textsuperscript{21} Knaffle v. Knoxville Banking & Trust Co., \textit{supra} note 4; see Taylor v. Cox, 40 S. W. (2d) 444, 446 (Ark. 1931).

\textsuperscript{22} \textit{Supra} note 15.


\textsuperscript{25} Cases sustaining such an interpretation are collected in \textsc{Brannan, The Negotiable Instruments Law}, (\textit{4th ed. 1926}) 719 ff. and are adversely criticized by the author.


\textsuperscript{27} Clark v. Sullivan, 2 N. D. 103, 49 N. W. 416 (1891).
containing these allegations. In at least one jurisdiction by force of statute the accommodating maker, whether jointly or jointly and severally liable, is not permitted to set-off or counterclaim for his individual deposit if joined with another party to the instrument. It is generally held, however, that an accommodating maker who is "jointly and severally" liable may avail himself of this privilege whether sued alone or joined.

The various qualifications imposed on the surety's right to set-off his deposit may be entirely avoided, however, where an express agreement between the bank and the surety to charge the obligation to the latter's account can be shown. Such an agreement constitutes a contract to allow a set-off and the obligation may be considered discharged by payment if sufficient funds are still on deposit when it matures. The customary provision of "charge-back" appearing on a bank's deposit slip, however, has been held not sufficient to bring a case within this category, the "charge-back" being construed as a privilege rather than a duty of the bank. Nor has a deposit made by the surety simultaneously with the loan to the principal been construed as such an agreement if the receiver can show that this was merely an inducement for the loan, although such a deposit accompanied by the bank's retention of the certificate of deposit would seem to bring the transaction clearly within the rule.

Even where the surety has no deposit of his own to set off, he may seek to avoid payment of the obligation to the bank by setting off the principal's deposit. Few cases have arisen in which this question has been considered, presumably because the prin-

29 Fidelity & Deposit Co. v. Duke, 293 Fed. 661 (C. C. A. 9th, 1923); American Guild v. Damon, 186 N. Y. 360, 73 N. E. 1081 (1906); Clark, op. cit. supra note 2, at 465.
30 Gooding v. Vaught, 279 S. W. 208 (Mo. App. 1926); Hughes v. Garrett, 150 Ark. 404, 234 S. W. 265 (1921); Richmond Ins. Co. v. Litter, 1 F. (2d) 311 (C. C. A. 8th, 1924); Clark, op. cit. supra note 2 at 465.
32 Bryant v. Williams, supra note 5.
33 Clarkson v. Peurifoy, 142 S. C. 1, 140 S. E. 262 (1927).
34 Ibid.
35 Where the bank is solvent there is a distinct split of authority as to the duty of the bank to apply the principal's deposit to the obligation for the protection of the surety. Seemingly the weight of authority favors the view that the bank is under no such duty. National Mahaiwe Bank v. Peck, 127 Mass. 298 (1879); Camp v. First National Bank, 44 Fla. 497, 33 So. 241
principal will generally hasten to apply for the set-off in payment of the obligation rather than run the risk of suffering a full recovery by the surety who has been forced to pay. In the only decision squarely on the point, *Armstrong v. Warner*, the court held that an accommodating acceptor of a draft could set off the deposit of the drawer-principal debtor who was insolvent. The question may assume greater importance in light of the recent Maryland decision already referred to which denied a set-off to the principal debtor appearing on the instrument as an accommodated indorser. Such a holding would inevitably prompt the surety, if sued, to assert this set-off. Moreover, in another situation, the estate of an insolvent principal debtor would find it to its advantage not to assert its set-off, but rather to receive a comparatively large dividend on its deposit, and on its own liquidation pay a smaller dividend as reimbursement to the surety who has been forced to pay the bank. In light of the present liberal attitude toward set-offs, and since there is no authority to the contrary, it would seem that the courts would, under such circumstances, see their way clear to grant this set-off, perhaps on the theory of either subrogation or exoneration.

**COMPETITION AND MONOPOLY UNDER THE AGRICULTURAL MARKETING ACT**

In 1929 the Agricultural Marketing Act established the Federal Farm Board, placed at its disposal five hundred million dollars, and assigned to it the task of rehabilitating agriculture. The control of production and the curbing of speculation were the primary objectives. The centralization of marketing facilities was the program adopted. To these ends the Farm Board is attempting to establish a hierarchy of local and regional cooper-

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36 49 Oh. St. 376, 31 N. E. 877 (1892); see Fidelity & Deposit Co. v. Duke, *supra* note 29 (surety on bond to bank for cashier—depositor's dishonesty); Streeter v. Junker, *supra* note 3. In Allen v. Abramson, 246 Mass. 321, 139 N. E. 648 (1923) the plaintiff, an accommodating indorser was denied the right to set-off the maker's deposit against a note held by the insolvent bank where the bank held other notes of the insolvent maker which were unsecured.

37 See Funk & Son v. Young, 138 Ark. 38, 44, 210 S. W. 143 (1919).


atives supervised by national associations. Only cooperatives are eligible for the government subsidy and submission to government domination is the price exacted. But not all of the cooperatives have been willing to sacrifice their independence for the advantages proffered. To these recalcitrants, and to the non-cooperative marketing agencies who are expressly barred from federal aid, the spectre of government monopoly forbodes ultimate extinction.

The first legal skirmish in the inevitable conflict between the independents and Farm Board cooperatives recently developed from a situation at the National Stockyards of East St. Louis. The National Order Buying Company, a subsidiary of the Producers Commission Company, was organized to buy from its parent and other commission agents livestock for resale to non-resident packers. Both of these organizations were cooperatives under the supervision of the National Livestock Marketing Association, which in turn was directly controlled by the Farm Board. Subsidized by loans granted by the Board at low rates of interest, they were in a strategic position to carry on business on both sides of the market at prices which their competitors could not meet. The independent members of the market were aware of the danger; almost without exception, they refused to do business with the Producers Commission Company or its subsidiary.

Pursuant to the authority vested in him by the Packers and Stockyards Act, the Secretary of Agriculture investigated this boycott and found it to be violative of the Act, which provides

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3 See McKelvie, Agricultural Problems and the Federal Farm Board (1930) 9 NEW. L. BULL. 65, 70.
4 Loans are only made to the “Nationals” which pass the money along to their members. Ibid.
5 Farmers Livestock Commission Company v. United States, Brief of Plaintiff (Farmers Livestock Commission Co.), p. 10 and 11.
6 It is interesting to note that a strikingly similar English “Agricultural Marketing” law attempting the establishment of a government regulated and subsidized monopoly, has been passed by Parliament in order to effect an increase rather than a decrease in agricultural production. See Marketing Agricultural Produce (1931) 75 SOL. J. 622.
7 The two Farm Board Cooperatives here involved are part of a system of 8 commission and 8 order buying associations operating at the larger terminal markets. The commission companies are members of the order buying organizations. They control their activities at the market where they do business, taking all profits and paying all losses accruing thereat. Farmers Livestock Commission Company v. United States, Record, at 146, 224-228.
8 Loans from the revolving fund bear interest at a rate equal to the lowest yield of any government obligation issued subsequent to April 6, 1917. In no case can the rate exceed 4%. 46 STAT. 14 (1929), 7 U. S. C. A. (Pocket Part) § 528 (a) (1931).
that stockyard agencies must "furnish upon reasonable request, without discrimination, reasonable stockyard services." An order issued prohibiting the continuance of the boycott and suspending the registration of the parties to it. In proceedings to enjoin the enforcement of this order, the Federal District Court in Farmers' Livestock Commission Co. v. United States, affirmed the action taken by the Secretary.

The court found sufficient evidence of a concerted boycott to sustain the Secretary's order and cited anti-trust cases to support its holding. But if the case must turn upon the existence of a combination in restraint of trade, the decision is difficult to justify. In the absence of any direct evidence of an agreement the court was forced to infer the existence of a combination from "unanimity of action, simultaneousness of time, identity of motive, and completeness of result." Doubtless by their very nature conspiracies are seldom capable of proof by direct evidence but must often be inferred from things done. Indeed the necessity of express agreement has been denied. But mere simultaneity of action which is entirely explainable in terms of the individual and independent motives of the actors has never yet been held to constitute a conspiracy. In the instant case each individual participant might well have been actuated by a desire to prevent his own financial ruin at the hands of the attempted Farm Board monopoly. The urgencies of the particular situation would seem to constitute adequate refutation of a combination inferred solely from chronological concurrence. Nor can the fact that the activities of the boycotters in the instant case might have been subversive of legislative policy make up for the total lack of proven concerted action.

However, if Congress had the power to provide in the Packers and Stockyards Act that market agencies must "furnish upon reasonable request, without discrimination, reasonable

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10 42 STAT. 164 (1921), 7 U. S. C. A. § 205 (1926).
11 54 F. (2d) 375 (E.D. Ill. 1931).
13 Allen v. U. S., 4 F. (2d) 688, 691 (C. C. A. 7th, 1924). It was here stated: "A new tacit understanding between conspirators to work to a common purpose is all that is essential to a guilty actionable combination."
14 Judicial sanction has been accorded concerted activities coming within the definition of conspiracy when the effect has not been detrimental to trade or commerce. United States v. United States Steel Corp., 251 U. S. 417, 36 Sup. Ct. 408 (1930). But the converse of this proposition does not hold. The inference from judicial language on the subject is that evil effects cannot supply the need for the intent and form of a conspiracy. See Maple Flooring Association v. United States, 263 U. S. 563, 577, 46 Sup. Ct. 576, 583 (1925); United States v. American Linseed Oil Company, 262 U. S. 371, 390; 43 Sup. Ct. 607, 611 (1923).
stockyard services,” the necessity for finding a combination in restraint of trade is eliminated. Of course, the mere fact that, by repeated judicial utterance, the stockyards have been invested with a public interest will not, of itself, justify interference with the right of each trader to deal or refuse to deal with others as he sees fit. It is elementary that different types of businesses sustain and justify different degrees of regulation. Indeed an Illinois state court has declared that the public character of a live stock exchange does not operate to deprive its members of the privilege of accepting or rejecting customers. And the Supreme Court has withheld from the state legislatures the power of subjecting private carriers to common-carrier regulation, though, by their use of the road they exercise a privilege which might be conditioned or withheld. Nevertheless, the language used by federal courts in passing upon the validity of the Packers and Stockyards Act, indicates an attitude entirely favorable towards the provision under discussion. Thus in Stafford v. Wallace, the Supreme Court apparently considered it no bar to the constitutionality of the Act that it “treats the various stockyards of the country as great national public utilities...” And in United States v. American Livestock Commission Company, though a conspiracy had been shown, Mr. Justice Holmes seemed to disregard it when he said “it does not need argument to show that a boycott of a dealer in a stockyard may be an unfair practice under the Act.” It would

15 Supra note 10.
17 Only businesses within the class of public utilities are properly subject to this requirement. 1 WYMAN, PUBLIC SERVICE CORPORATIONS (1st ed. 1911) 2. The distinction between a business affected with the public interest and a public utility is pointed out in Cotting v. Kansas City Stockyards, 183 U. S. 79, 22 Sup. Ct. 30 (1899).
18 See Wolff Packing Co. v. Court of Industrial Relations, 262 U. S. 522, 539, 43 Sup. Ct. 630, 634 (1923).
19 American Livestock Commission Co. v. Chicago Livestock Exchange, 143 Ill. 210, 22 N. E. 274 (1892).
21 Supra note 16, at 516, 42 Sup. Ct. at 402. Likewise the District Court opinion in Tagg Bros. & Moorhead v. U. S., 29 F. (2d) 750, 752 (D. Neb. 1928), states that if the public stockyard itself performed the marketing function, there would be no question of public use and the obligation to serve all comers. And the assignment of this task to agencies does not alter the gist of the business. The Supreme Court opinion, supra note 16, did not mention this point.
23 Supra note 22, at 437, 49 Sup. Ct. at 426.
seem therefore that in the future the independent market agencies may be compelled to deal with Farm Board cooperatives; in other words, to become instrumentalities for their own destruction.

With the avenues of self-help through boycott thus definitely closed, the chief hope remaining to the independents would seem to be a direct attack on the constitutionality of the Agricultural Marketing Act. Authority in Congress to enact the Act can only be derived from its power to regulate interstate commerce. On this basis the validity of the Packers and Stockyards Act was upheld in \textit{Stafford v. Wallace}.\textsuperscript{24} However, the object to be secured by the statute there involved was, "the free and unburdened flow of livestock from the ranges and farms of the West and Southwest through the great stockyards ... to the consuming cities of the country in the Middle West and East. ..."\textsuperscript{25} It is doubtful whether legislation having for its purpose the reduction of speculation, and the prevention of surpluses bears a similarly close relationship to interstate commerce. It is more nearly analogous to the child labor statute which was invalidated in \textit{Hammer v. Dagenhart}\textsuperscript{26} despite the government's attempt to bring it within the commerce clause on the ground that goods made with child labor unfairly competed with that emanating from states where such labor was not permitted. Likewise, numerous Supreme Court decisions excluding the processes of mining and manufacture from the operation of the commerce power\textsuperscript{27} would seem to cast serious doubt on the validity of this legislation. On the other hand, the fact that the Act affects the marketing rather than the producing end of the agricultural industries, would tend to take it out of the rule established by these cases.

Additional constitutional difficulties are encountered with respect to the $500,000,000 "revolving fund" which has been placed at the disposition of the Farm Board. Out of this fund, the Board is empowered to make loans to cooperative associations for the purpose of assisting in the effective merchandising of their commodities, the extension of their membership, and the acquisition of marketing facilities.\textsuperscript{28} Though it cannot be

\textsuperscript{24} \textit{Supra} note 16.
\textsuperscript{25} \textit{Supra} note 16, at 514, 42 Sup. Ct. at 401.
\textsuperscript{26} 247 U. S. 251, 38 Sup. Ct. 529 (1918).
\textsuperscript{28} 46 STAT. 14 (1929), 7 U. S. C. A. (Pocket Part) § 527 (1931). The Board is also authorized to make loans to stabilization corporations to meet carrying and handling charges incidental to the control of surpluses.
doubted that the resuscitation of the agricultural industries
would have a beneficial effect on the country as a whole, a seri-
sous question arises as to whether these loans do not constitute
appropriations of public moneys for private purposes.\textsuperscript{20} True,
there are recent cases upholding taxes levied to provide relief
for a class affected by disaster.\textsuperscript{21} But despite the insistent com-
plaints of the western farmer, it would be difficult to bring him
within the class of drought and flood sufferers.\textsuperscript{31} Certainly the
use of the revolving fund by stabilization corporations to control
surpluses, and by the Board to peg the price of grain, can hardly
be justified as donations to charity. Furthermore, if these dif-
ficulties were surmounted, a question would remain as to the
propriety of restricting the privilege of borrowing to cooper-
avtives.\textsuperscript{32} Under \textit{Frost v. Corporation Commission of Oklahoma},\textsuperscript{33}
this might be construed as an unfair discrimination,—at least,
in favor of capital stock cooperatives.

Subject as it is to these technical objections, the Agricultural
Marketing Act would seem at first blush to have little chance
of finding favor with the Court. The Act does more than pro-
vide for public utility regulation of stockyards, grain elevators
and produce exchanges. It provides in effect for their ultimate
financing, management and control as part of the business of the
federal government. Nevertheless, it is probable that the Act
will pass muster. The Court has already sustained modest ven-
tures into state socialism where the need was less acute.\textsuperscript{34} And
in the near future more of the justices may be convinced that
"there must be power in the states and nation to remold, through

\textsuperscript{20} A recent advisory opinion of the highest court in South Dakota de-
cided that a tax to provide "feed loans" for necessitous stock raisers was
not for a public purpose. Opinion of the Judges, 6 U. S. Daily, Feb. 13,
1932, at 2820. See further, Allen v. Inhabitants of Jay, 60 Me. 124 (1872);
Loan Association v. Topeka, 20 Wall. 655 (U. S. 1874). See Note (1932)
41 YALE L. J. 779.

\textsuperscript{21} State ex rel. Cryderman v. Wienrich, 54 Mont. 390, 170 Pac. 942
(1918); State v. Nelson County, 1 N. D. 88, 45 N. W. 33 (1890).

\textsuperscript{31} And in Cobb v. Parnell, 183 Ark. 429, 36 S. W. (2d) 388 (1931), a
case upholding the validity of a tax to alleviate group distress, it was
stated on page 445, 36 S. W. (2d) at 394, "The doctrine announced in this
case has no application except in cases where the calamity is certain and
irremediable in its nature and general in its scope."

\textsuperscript{32} Cf. Connolly v. Union Sewer Pipe Co., 184 U. S. 540, 22 Sup. Ct. 431
(1902); Liberty Warehouse Co. v. Burley Tobacco Growers Cooperative

\textsuperscript{33} 278 U. S. 515, 49 Sup. Ct. 235 (1929); see Comment (1930) 40 YALE
L. J. 282.

\textsuperscript{34} Green v. Frazier, 253 U. S. 233, 40 Sup. Ct. 499 (1920). This decision
permitted the state of North Dakota to engage in the business of manu-
facturing and marketing farm products.
If such be the attitude, technical grounds will not be wanting. Perhaps the Act could be squeezed by as emergency legislation. More likely, however, its constitutionality need not be directly faced. Certainly, after the decision in Massachusetts v. Mellon, a taxpayer may not invoke the power of the court in this respect. Similarly market agencies not qualified to receive benefits under the Act, and which are therefore being forced out of business, would seem to be precluded. Like the statute involved in Massachusetts v. Mellon, the Agricultural Marketing Act does not invade the rights of such parties, "but simply extends an option which (they) are free to accept or reject." 

THE PROVABILITY AGAINST INSOLVENT ESTATES OF LANDLORDS' CLAIMS FOR FUTURE RENT

The legal status of a lessor's claim for future rent or damages when the lessee's estate passes into some form of administration for the benefit of creditors will depend first on the type of administration employed and second on the presence or absence of certain specific lease provisions which have been designed for such contingency. Under any circumstances when the administrator of the estate rejects the lease and opens the lessee's assets to complete consumption by creditors the lessor would seem to have suffered damage for which he should be compensated at the time. Mere continuing personal liability of the lessee is not only valueless to the lessor but defeats the recognized purpose of the debtor to make a fresh start unencumbered by previously incurred obligations to pay money in the future.

It is the object of the ensuing discussion to indicate to what extent the conflicting interests of lessor, lessee and creditors are satisfied or ignored in special factual situations.

I. Bankruptcy

It is the established rule that, in the absence of specific lease provisions, a claim for rent accruing subsequent to the filing of the petition in bankruptcy is not provable. This follows from the

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38 Supra note 37, at 480, 43 Sup. Ct. at 598.
common law dogma that a lease is not an executory contract but an estate, and rent is not “owed” until the day it is payable. Nor is bankruptcy a breach of the lease giving rise to a claim for damages. The result is satisfactory only to creditors of the lessee other than the lessor, since unless the trustee adopts the lease the debtor remains obligated while the lessor is for all practical purposes remediless. Certain devices designed to ameliorate this situation have, however, been sanctioned by the courts. Thus where a lease was given for a lump sum paid at the time of its execution, a provision which provided that the lease should terminate upon bankruptcy of the lessee was held valid over the objection that it entailed a forfeiture since it was clearly to the reasonable interest of the lessor that the premises be in the hands of a solvent lessee. But the apparent generality of this reasoning does not save from the inhibitions of forfeiture a provision terminating the lease on bankruptcy with acceleration of all future rent. While both of these cases have a similar practical aspect, neither seems wholly desirable, in that the former may result in unjust enrichment of the lessor, while the latter denies him any compensation at all. Nor would the objection of forfeiture under the latter provision be met by proof of the stipulated rental less the amount received on reletting in mitigation of damages, since the claim is thereby rendered contingent. A third device involves a deposit by the lessee as security for faithful performance of covenants. If the lease so provides, but not otherwise, the lessor may retain the deposit upon the bankruptcy of his tenant until the latter has fulfilled all covenants including the covenant

2 See cases cited supra note 1. Bankruptcy amounts to an anticipatory breach of an ordinary executory contract and any resultant damage is provable. Central Trust Co. v. Chicago Auditorium Ass'n, 240 U. S. 531, 36 Sup. Ct. 412 (1916). This rule was applied to a lease in an excellent opinion in In re Bissinger Co., 5 F. (2d) 106 (N. D. Ohio 1925), rev'd, Wells v. Twenty First St. Realty Co., supra note 1.

3 In re Service Appliance Co., 39 F. (2d) 632 (N. D. N. Y. 1930); In re McAllister-Mahler Co., 46 F. (2d) 91 (S. D. Ohio 1930).

4 On adoption by the trustee consult GILBERT'S COLLIER ON BANKRUPTCY (2d ed. 1931) 1226. On the lessor's right to compensation for occupation by the trustee see (1929) 23 ILL. L. REV. 609.

5 See cases cited supra note 1.


8 A provision for damages equal to the true loss of rent is contingent and not provable. Re Roth and Appel, supra note 1; In re Ells, 73 Fed. 967 (D. Mass. 1900).

9 In re Homann, 45 F. (2d) 481 (C. C. A. 2d, 1930).

10 In re Schiff, 295 Fed. 575 (S. D. N. Y. 1923); Carstens v. McLean, 7 F. (2d) 322 (C. C. A. 9th, 1925).
to pay rent to the end of the term. But if the lease also contains a provision terminating it on bankruptcy, the retention of the deposit may, insofar as it covers future rent, be deemed a forfeiture unless, perhaps, the lessor is expressly obligated to turn over to the lessee's estate whatever is received in mitigation of damages.\textsuperscript{11}

In some states there are statutes which give the lessor a lien on the tenants' goods to secure rent accruing for a specific time after the filing of the petition. Such a lien has occasionally been held unenforceable in bankruptcy because not sustained by a provable claim.\textsuperscript{12} By the majority view, however, statutory liens are effective \textsuperscript{13} either on the theory that they make the landlord's claims for unaccrued rent a "provable claim" against the assets covered by the lien,\textsuperscript{14} or on the more consistent ground that a valid lien will be enforced regardless of the provability of the debt it secures.\textsuperscript{15} And because the majority result avoids the effect of the common law dogma as to rent and secures to the lessor some compensation for the loss of his bargain, it is much to be preferred. It is, however, an open question whether a non-statutory lien incorporated in the lease will be allowed in bankruptcy. If it is recorded under the appropriate statute there would seem to be no apparent objections.

II. Equity Receiverships

While the decided cases in receivership proceedings show a distinct analogy to their counterparts in bankruptcy, there are essential differences, in that since the provisions of the Bankruptcy Act with regard to the provability of claims are inapplicable, the courts need be guided only by "general equitable principles."\textsuperscript{16} Furthermore, these cases admit of an inner classification into those in which the receivership is designed to effect a winding up of the business and those in which it is a temporary device contemplating the ultimate return of the business to its

\textsuperscript{11} Cf. In re Barnett, 12 F. (2d) 73 (C. C. A. 2d, 1926).
\textsuperscript{12} In re L. & H. Katz, 6 F. (2d) 581 (S. D. Miss. 1928).
\textsuperscript{13} See Note (1923) 22 A. L. R. 1308; Note (1926) 45 A. L. R. 718; Goodman, Rent as a Priority Claim in Bankruptcy (1916) 3 Va. L. Rev. 386.
\textsuperscript{14} In re Scruggs, 205 Fed. 673 (S. D. Ala. 1913); Lontos v. Coppard, 246 Fed. 803 (C. C. A. 5th, 1917); cf. Re Keith-Gara Co., 203 Fed. 556 (E. D. Pa. 1913); aff'd, 213 Fed. 450 (C. C. A. 3d, 1914) (no statutory lien, but priority under state law).
\textsuperscript{15} Britton v. Western Iowa Co., 9 F. (2d) 488 (C. C. A. 8th, 1925).
\textsuperscript{16} Quincy etc. R. R. v. Humphreys, 145 U. S. 82, 12 Sup. Ct. 787 (1892). Moreover there may be some distinction on the grounds that the bankruptcy trustee has title (supra note 4) while property in receivership is in \textit{custodia legis} [Note (1908) 8 Col. L. Rev. 213]. Furthermore specific state statutes may alter the general rules of equity receiverships.
owners as a going concern. In the absence of lease provisions expressly contemplating a receivership, the distinction appears material to a determination of whether the appointment of a receiver constitutes an anticipatory breach of the lease contract with a resultant right to damages. Receivership as a device for the dissolution of a corporation would seem more clearly to constitute such a breach since in this case even the shadowy personal liability of the lessee is wiped out. And it has been so held, although the lessor’s claim has also been denied in this situation on the ground that he might have, but did not, provide for such contingency in the lease.

Where a temporary receivership is involved, on the other hand, the problem does not normally arise, since the receiver will in most cases find it more advantageous to adopt the existing lease than to procure another, leaving the lessee still bound on his original undertaking. But if he choose to reject the lease, it is probable that the rejection would not be considered a breach giving rise to a claim against the receiver in view of the fact that the return of the business to the lessee will presumably leave him with assets from which he can satisfy his continuing obligation. Hence in these cases the court’s inquiry is likely to be limited to a consideration of claims arising under specific lease provisions, the question of primary importance being whether they must be such as are “absolutely owing” at the time of the appointment of the receiver.

An affirmative answer has been given by a few of the lower federal courts, but when presented to the United States Supreme Court the issue has never been directly met. In *William Filene Sons v. Weed* the lease provided, *inter alia*, for damages upon termination of the lease by bankruptcy or the appointment of a receiver not discharged within ninety days. The damages were based upon the difference between the rent reserved and the rental value at the time of termination, less specified yearly payments which the lessee was required to make by other terms of the lease. The claim was allowed, but the court was at pains to point out that it was not a claim for future rent, but “a personal

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21 In the case of dissolution of a partnership different considerations might apply because of continuing personal liability.
22 Kalkhoff v. Nelson, 60 Minn. 284, 62 N. W. 352 (1895).
24 See 1 CLARK ON RECEIVERS (2d ed. 1929) § 442.
26 245 U. S. 597, 38 Sup. Ct. 211 (1918). While this opinion undoubtedly favors allowance of unmatured claims it is questionable whether it also favors contingent claims as suggested in Comment (1919) 23 YALE L. J. 673. For the distinction in bankruptcy see GILBERT’S COLLIER, 984 et. seq.
covenant that liquidated the damages on a basis that was familiar and fair." 23 And in the companion case of Gardiner v. Butler & Co. 24 a claim by the lessor for "loss of bargain" was disallowed, but for the stated reason that in the absence of express contract a lessor who has terminated a lease and evicted the tenant has no further claim against the lessee. There are, however, a number of cases allowing claims that were not "owing" when the receiver was appointed. Thus where the receiver had vacated the premises, the lessor was allowed to prove for future rent less that received on reletting under a lease provision allowing him such damages if the premises became vacant. 25 Likewise a claim for the entire future rent was allowed by virtue of a clause accelerating the rent on assignment without consent, although this decision that receivership is an assignment is open to question. 26 It is therefore desirable carefully to designate in the lease each contingency, including receivership, that will bring the damage claim into operation. Here again, as in bankruptcy, the deposit 27 and contractual lien 28 devices seem valid. As a group the receivership cases obtain a result more liberal than in bankruptcy in two significant respects. First, the claim may be sustained although not absolutely owing when the receiver is appointed and, second, a provision for termination plus unliquidated damages is apparently sustained in receivership although unquestionably bad in bankruptcy.

III. Assignments

The usual provision in general statutory assignments 29 that provable claims shall include "debts due or to come due" 30 is not helpful to the present inquiry since it does not settle the status of rent or damages arising from an assignment by the lessee. Nevertheless, some courts, in terms of legislative purpose, have taken the broad view that if the assignee rejects the lease the lessors

23 245 U. S. at 602, 38 Sup. Ct. at 214.
24 245 U. S. 603, 38 Sup. Ct. 214 (1918).
29 Note that the modern statute (e.g. Mich. Comp. Laws (1929) §§15352-15364) is not an insolvency law. For an example of the latter, see Conn. Gen. Stat. (1930) §§4839 et seq.
may prove for future rent less that obtained on reletting. This result appears desirable, but it admittedly disregards the common law theory of rent in setting up a criterion which requires only that the claim be capable of liquidation in time to avoid delay in administering the estate. Where specific lease provisions are involved it seems that here, as in receivership and bankruptcy cases, a provision for liquidated damages if the lessee makes an assignment for the benefit of creditors will be valid. Moreover, some cases have allowed a claim for unliquidated damages under a loose lease provision obligating the lessee to pay damages if the term becomes vacant or is assigned by operation of the law or otherwise. But in some jurisdictions, when the lessor has entered and relet the premises, the courts have invoked the rule that the lessor can wait until the end of the term and sue for the entire rent and hold the claim to be non-provable since it was contingent upon the amount received on reletting. Finally, it would seem that the deposit and lien devices are perfectly valid as applied to assignments.

Summary

Whenever practical the lease should provide for termination and liquidated damages payable on filing a petition in bankruptcy, the appointment of a receiver, or the making of an assignment. This will uniformly be sustained unless so unreasonable as to amount to a forfeiture. If, however, the lessor's bargain is unusually good, and especially if the lease is for a long term, it will be difficult to fix the amount of damages payable. In all three situations, though in varying degree, if the lease provision is merely for unliquidated damages there is a danger that the claim will be disallowed as contingent. And even if this objection is met the lessor should present facts indicating that liquidation of damages may be speedily effected. Moreover, provisions making assignment of the term the contingency for damage payment are open to the argument that neither type of receiver nor the assignee for the benefit of creditors is an assignee of the term.

32 In re Reading Iron Works, 150 Pa. St. 369, 24 Atl. 617 (1899); Smith v. Goodman, 149 Ill. 75 (1893); Baker v. Herrlinger, 16 Ohio App. 233 (1922). Note that in bankruptcy the federal court interprets Ohio law to reach the opposite result. Wells v. Twenty-First St. Realty Co., supra note 1.
33 In the Matter of the Assignment of Adams, 67 How. Pr. 234 (N. Y. 1884); Matter of Hevenor, 144 N. Y. 271, 39 N. E. 393 (1895).
34 Rice v. Harris, 76 Miss. 422 (1898).
35 Bankruptcy: GILBRETH'S COLIER 1224; Receivership: CLARK ON RECEIVERS, §§ 442, 445.
36 Whether an assignment for the benefit of creditors is an assignment of the lease would seem to depend on the specific terms of the assignment.
And since vacancy may not occur until after the petition or appointment of the receiver or assignee it is not desirable to designate it as the contingency. Likewise the recorded contractual lien to secure future rent is at least doubtful although the chances of its validity appear fair. The deposit device with appropriate provisions will be sustained. Lastly, in connection with any provision involving termination of the lease on contingency the specific wording of the lease and conduct of the lessor must carefully avoid the possibility of inference that the lessor has accepted a surrender of the lease, thus foreclosing any further rights thereunder. 37

INCOME TAX DEDUCTIONS FOR NET LOSSES OF PREVIOUS YEARS

The prospect of large losses in the immediate post-war years to industries which had flourished under war time conditions was the prime motive underlying the provision of the Revenue Act of 1918 1 which allowed the deduction of net losses sustained in 1919 in recomputing taxable income for 1918 and, if the loss was greater than the income for 1918, the further deduction of the difference from the 1920 income. 2 This provision marked a departure from the policy of ignoring greatly fluctuating returns and for the first time made it possible to average net losses with high returns of prosperous years in order to determine net income over a period longer than a year. 3 Subsequent tax statutes, 4 while eliminating the clause providing for a deduction from the income of a previous year, have continued the policy of breaking through the rigid annual divisions by allowing the deduction from present income returns of net losses incurred in a previous

37 In re Frey, 26 F. (2d) 472 (E. D. Pa. 1928); see cases collected in In re Barnett, supra note 11, at 79. Receivership: People v. St. Nicholas Bank of N. Y., supra note 25; Woodland v. Wise, 112 Md. 35, 76 Atl. 502 (1910). Moreover, the lessor must avoid the effect of having evicted the tenant. Gardiner v. Butler & Co., supra note 24. And the same consideration would seem to apply to an assignment for the benefit of creditors.

1 § 204

2 See Appeal of Butler's Warehouses, Inc., 1 B. T. A. 851, 854 (1925); Ralls, Net Losses Under the Various Revenue Acts (1926) 4 N. I. T. M. 93. The provision was designed to tide over the expected slump of 1919 and to prepare for normal conditions in 1920.

3 Under previous English practice taxable income was computed upon an average of three years but this practice was later discontinued. See Ralls, op. cit. supra note 2, at 93. The provision in the 1918 act was the first approach to that system in this country.

4 Revenue Act of 1931, § 204; Revenue Act of 1924, § 206; Revenue Act of 1926, § 206; Revenue Act of 1928, § 117.
Large business losses in 1931 in connection with the present pressing need for increased revenue make it unlikely that the net loss provision will remain unchanged in the 1932 tax bill now before Congress. But even if its omission from the next bill should be justified by the needs of the present year, the policy of the provision is sound and should be followed when the demand for increased revenue is less acute.

Although the 1918 Act contemplated the deductions of only those net losses incurred in the "operation of a trade or business," under the 1924 and subsequent Acts, in computing the net loss to be carried forward, deductions of losses not attributable to the operation of a trade or business are allowed, but only to the extent of the gross income which is not derived from such trade or business. In the case of corporations any net loss has been presumed to result from the operation of business, but in the case of individual taxpayers considerable litigation has involved the determination as to whether a particular loss resulted from doing business. But a recent provision allowing deductions for losses incurred in any venture engaged in for profit would seem to embrace those isolated transactions previously so much in dispute and thus practically to eliminate litigation on this point.

The reason for allowing the deduction from the taxable income of 1918 was the high war profit taxes of that year. With the lowering of the war time level the deduction from the next taxable year had the desired result.

Since this issue of the Journal went to press, the House of Representatives passed a bill suspending the net loss provision until 1934.

Operation has been construed in its popular rather than its technical sense. For a full discussion of this construction see Ralls, op. cit. supra note 2, at 93, 94.

The Act of 1918 also allowed the deduction of losses incurred "in the sale of capital acquired after April 6, 1917 and used for the production of articles contributing to the prosecution of the present war" § 204(a). This has been omitted from the later acts.

Act of 1924, § 206 (a) (1). 206 § (a) also includes other rules for calculating a deductible net loss such as the deduction of capital loss. This section in effect provides for a method of computing the deductible loss which would be different if determined by the rules applied to the regular return.

There are no cases reported disallowing a deduction by a corporation because the loss was not sustained in a trade or business. See Appeal of Philip Kobbe Co., Inc., 4 B. T. A. 663 (1928), where a deduction was allowed which, under existing decisions, would not have been allowed an individual. Under the more recent statutes the deductions have been allowed to partnerships and trusts.

Revenue Act of 1928, § 23 (e).

Most of the cases concerning the determination of whether a particular loss was incurred in a trade or business involve investments or isolated transactions. Washburn v. Commissioner, 51 F. (2d) 949 (C. C. A. 8th, 1931); Goldberg v. Commissioner, 36 F. (2d) 551 (Ct. App. D. C.
Equally productive of litigation, however, and as yet unillumined by specific legislative provision, is the question of the effect of a change in the status of the taxpayer upon the right to a deduction. The problem arises most frequently upon affiliation of corporate taxpayers. The court of Claims in \textit{Swift & Co. v. United States}\textsuperscript{12} ruled that an affiliated group should be treated as a tax unit for purposes of computation, even when the group had experienced various additions and subtractions in membership during the taxable years. In that case the group was allowed to file a single return, including the income and losses of its shifting members during the periods of their affiliation, while the individual members were instructed to file separate returns for the time when they were unaffiliated. Subsequently, in \textit{Sweets Company of America v. Commissioner},\textsuperscript{13} a federal circuit court adopted the rule of the \textit{Swift} case and held that the addition or subtraction of a unit did not deprive an affiliated group of the privilege of deducting net losses sustained in a prior year.

A net loss sustained by a corporation in a year prior to affiliation may be deducted from the gross income of the group in the following year,\textsuperscript{14} but only to the extent of the net income of the corporation for the first year of affiliation.\textsuperscript{15} A contrary rule,
though adopted by the Board of Tax Appeals in several early decisions, would open the way to widespread acquisition and affiliations of corporations sustaining large net losses solely for purposes of consolidated tax returns. Indeed, it seems that the same result might be reached despite the majority rule through manipulation of the earnings of the units of the affiliated group in such a way that the newly acquired corporation would show a net income sufficient for it to take advantage of its prior net losses.

In the converse situation, where the affiliated group sustains a net loss and in the following year one or more members leave the group, the corporation leaving is permitted to deduct that part of the net loss created by it while a member of the group. This amount is subtracted from the net loss which the group is allowed to deduct. Moreover, when one of the tax units is dissolved the part of the net loss caused by that unit is not deductible from the affiliated return if the assets of the unit have been disposed of, and it seems likely that the same result would follow even if the assets were absorbed by another member of the affiliated group.

In these cases the affiliated member has been treated as a tax unit unaffected by its membership in the group, except for computation purposes during the period of affiliation, the rationale being that the unit is entitled to its deductions for net losses as though it had never been a member of the group. Where, however, the affiliated group remains unchanged for more than two years the deduction of the past net loss is allowed regardless of whether the unit sustaining the net loss has any present income. This is in accord with the policy of the joint return, since the ultimate taxpayer is the same so long as the affiliated group is unchanged.

It is interesting to observe the result reached by the Board of Tax Appeals in the analogous situation involving a joint return taxpayer sustaining the loss the benefit of it and also upon the provision preventing a loss from being carried forward where its deduction would create a loss.


17 Farmers & Merchant's Bank v. Commissioner, 21 B. T. A. 1383 (1931). It has been held that a corporation making a separate return could not deduct a net loss attributable to its operation while affiliated in the absence of a showing of a net loss for the affiliated group. Appeal of Owensboro Conserve Co., 8 B. T. A. 615 (1927).

18 Sklar Mfg. Co. v. Commissioner, 22 B. T. A. 1326 (1931); Alabama By-Products Co. v. Commissioner, 16 B. T. A. 1073 (1929).

19 Brighton Corp. v. Commissioner, 16 B. T. A. 945 (1929).

20 American Steel Co. v. Commissioner, 7 B. T. A. 641 (1927).
of a husband and wife, a result which seems inharmonious with the more realistic treatment of affiliated corporation returns. A husband with a large business loss and his wife, who had considerable non-taxable income, filed a joint return showing only a small net loss. The following year he filed a separate return. It was held that since he had chosen to file a joint return the preceding year, he would have to deduct his wife's non-taxable income from his previous business loss in determining his deductible net loss.\(^2\) The wife's income being non-taxable, however, she would have paid no tax and the husband would have had the advantage of his total business loss had they filed a separate return for both years. In view of the fact that the joint return was optional, it seems extreme to penalize the husband for his election.

With respect to other changes of the taxpayer the emphasis has been placed on form rather than the actual identity of the changed taxpayer. Almost any change in the corporate organization is said to create a new taxpayer. A Massachusetts corporation, organized to take over the assets of a Massachusetts trust which had sustained large net losses, was not allowed to deduct the losses of the trust, although the same individuals were stockholders and cestuis.\(^2\) A similar rule was applied where a partnership incorporated for one year during which time it suffered heavy losses. At the end of the year the corporation was dissolved and the assets turned over to the two partners who had owned the entire stock of the corporation. It was held that the partnership could not take advantage of the net loss of the corporation.\(^2\) In both these situations there has been a formal change sufficient to induce the Board of Tax Appeals and the courts to regard the new entity as a new taxpayer. Yet, there being no change in the ultimate taxpayer, a less legalistic holding would have allowed the deduction.

Moreover one corporation taking over all the assets and liabilities of another has not been allowed to deduct the net losses incurred by the old corporation in the past year.\(^2\) Where the stockholders of the new corporation are not the same, the two are obviously different taxpayers and the holding is justified. But the same rule has been applied to two corporations of the same state when the only difference was a lower capitalization in the old corporation and where the stock was held in the same

\(^{22}\) West Point Marion Coal Co. v. Commissioner, 19 B. T. A. 945 (1930).
\(^{23}\) Trusts have been allowed to take advantage of the deduction under the more recent statutes.
\(^{24}\) Phillip C. Donner v. Commissioner, 16 B. T. A. 758 (1929).
proportions by the same interests. Still more striking illustrations of a rigid construction of the Revenue Act may be found. For example, upon the merger of the members of an affiliated group into a single corporation, the latter has not been allowed a deduction for the net losses of the affiliated group incurred in the preceding year although no change in ownership of stock was shown. Where one man owned 95% of the stock of two unincorporated associations and later split them into three, the net losses sustained by the two were not deductible in the return of the three even though both had been affiliated. Finally it has been ruled that the net loss of a testator may not be deducted from the income of his estate. These holdings quite clearly ignore the actual identity of the two taxpayers.

When new individuals are substituted for those who bear the ultimate burden of a tax on the corporation sustaining a net loss a change in status would warrant a holding that the changed taxpayer was a new and separate unit not entitled to all the tax privileges of the old taxpayer. But where there has been no change in the underlying taxpayer such a holding would seem undesirable. In a few decisions a more realistic treatment of changes in form may be found. Where, for example, a corporation lost its charter, it was held that a corporation with a similar charter taking over its assets might deduct the net loss of the old corporation. And in Western Maryland Ry. v. Commissioner a new corporate organization was ignored in allowing deductions for the amortization of the discount on bonds sold by a predecessor corporation. Although this case did not involve the deduction of past net losses, the reasoning of the court might well be applied to the problem herein considered.

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25 Standard Silica Co. v. Commissioner, 22 B. T. A. 97 (1931). A dissent points out that under the state law the new corporation stands in the same place as its predecessor and that it would have been liable for any tax deficiency of the old organization.

26 Industrial Cotton Mills Co. v. Commissioner, 22 B. T. A. 648 (1931). The merger was not complete till the middle of the year and the deduction was allowed for that part of the year prior to the merger.


29 Appeal of the Suburban Investment Co. v. Commissioner, 1 B. T. A. 1121 (1925).

30 33 F. (2d) 695 (C. C. A. 4th, 1929) This case has been cited in a dissenting opinion in the Board of Tax Appeals, supra note 25, at 103.