Current Decisions

CORPORATIONS—STOCKHOLDERS—VOTING RIGHTS OF PERSONAL REPRESENTATIVE OF PROXY-HOLDER.—Pursuant to a separation agreement by which the husband was to pay specified alimony, certain stock in a corporation of which he was president was transferred as security for its payment to a trustee who gave the husband an irrevocable proxy to vote the stock. In case of the husband's death, the dividends on the stock were thereafter to be the sole means of paying the specified maximum alimony, and upon the death of the wife the stock was to revert to the husband's estate. The former contingency having occurred, the court, in *In re Schirmer's Will*,[1] held that the right to vote the stock passed to the personal representative of the deceased husband and not to the trustee.

The right to vote stock is, as a rule, in the owner as disclosed by the books of the corporation.[2] This right passes to the executor or administrator of a deceased stockholder of record without a formal transfer of the shares upon the books[3] and testamentary attempts to deprive the personal representative of it have been held invalid.[4] But the right to vote shares of stock by proxy is usually personal, the relation being merely one of principal and agent[5] and would consequently not pass to the personal representative of a proxy-holder. However, although a proxy was given to the husband in the instant case, his status seems analogous rather to that of a pledgor than to that of an agent and it seems logical that the right of a pledgor to vote, reserved upon transfer of the stock to a pledgee, should pass to the pledgor's estate on his death.[6] While the husband's retention of voting power may have been merely for the purpose of continuing personal control of the corporation, a more logical interpretation would seem to be that his estate was to exercise this power throughout the period of the trust for the protection of the reversion rights. And that the estate was no longer obligated, while dividends on the stock were to be the sole means of payment of the alimony, should not alter the result, since the personal representative and subsequently the heirs would probably not be permitted by the court fla-

[1] 231 App. Div. 625, 248 N. Y. Supp. 497 (1st Dep't 1931).

[2] Kresel v. Goldberg, 111 Conn. 475, 150 Atl. 693 (1930); Barnes v. All-American Investing Co., 120 Misc. 706, 200 N. Y. Supp. 278 (Sup. Ct. 1923). Trustees may therefore vote the shares of stock which they hold. In re Ebbet's Will, 139 Misc. 250, 248 N. Y. Supp. 179 (Surr. Ct. 1931); BALLANTINE, MANUAL OF CORPORATION LAW AND PRACTICE (1930) § 170.

[3] Elevator Supplies Co. v. Wylde, 106 N. J. Eq. 163, 150 Atl. 347 (1930); Townsend v. Winburn, 107 Misc. 443, 177 N. Y. Supp. 757 (Sup. Ct. 1919).

[4] Billings v. Marshall Furnace Co., 210 Mich. 1, 177 N. W. 222 (1920); *cf.* Randall & Sons v. Lucke, 123 Misc. 5, 205 N. Y. Supp. 121 (Sup. Ct. 1924).

[5] See Tompers v. Bank of America, 217 App. Div. 691, 217 N. Y. Supp. 67 (1st Dep't 1926); CUSHING, VOTING TRUSTS (1927) 162.

[6] Voting would be a so-called "power coupled with an interest" which is not revocable at the will of the pledgee nor revoked by the death of either party. See 1 MECHEM, AGENCY (2d ed. 1914) §§ 572, 574, 588; *cf.* Baird v. Barnes, 235 N. W. 122 (S. D. 1931); Jennings v. Gallagher, 152 Atl. 802 (Vt. 1931).

grantly to controvert the agreement by voting for the ultimate enrichment of the estate to the detriment of the *cestui*.[7]

CRIMINAL LAW—INCONSISTENT VERDICTS—A defendant was indicted on three separate counts, for the unlawful possession of intoxicating liquor, for its sale and for the maintenance of a common nuisance. The only evidence offered by the state was the testimony of two Federal agents who had purchased six drinks at the defendant's store. In *Dunn v. United States*,[1] a conviction based upon the verdict of a jury finding the accused guilty of maintaining the nuisance, but acquitting him of possession and sale, was upheld by the United States Supreme Court, one justice dissenting. The majority opinion argued that if each offense had been tried under separate indictments, the same evidence being offered in support of each, an acquittal of one could not have been pleaded as *res adjudicata* of the others[2] and that this rule was equally applicable to offenses charged under separate counts of the same indictment. Mr. Justice Butler, dissenting, argued that the conviction was void because based upon an inconsistent verdict.

An acquittal on one count is at least conclusive with respect to the facts actually at issue thereunder[3] and although the maintenance of a common nuisance as defined by the National Prohibition Act[4] is a separate offense from that of possession or sale, it can only be established by proof of an unauthorized manufacture, sale, possession or barter of intoxicating liquor in the place in question for a substantial period.[5] A habit sufficient to warrant conviction under this section may be inferred from the circumstances surrounding a single sale,[6] but when the existence of the only elements of such a nuisance has, as in the instant case, been expressly negatived by the findings of the jury on other counts, conviction on the nuisance count is hardly logically sustainable.

The objection of inconsistency in the verdict has frequently been raised when the findings of a jury have seemed on superficial examination to be repugnant, as for example, where the accused has been acquitted of the possession of intoxicating liquor and convicted of its sale.[7] But no case has been found in which it has prevailed unless, as in the instant case, the offense negatived by acquittal has been a necessary constituent of the offense for which the accused was convicted. Even under these circum-

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[7] Courts of equity have often restrained the holder of the legal title from voting to the prejudice of another who has an interest in the stock. Haskell v. Read, 68 Neb. 107, 93 N. W. 997 (1903); Burke v. Universal Granite Quarries Co., 180 Wis. 520, 193 N. W. 517 (1923); 2 THOMPSON, CORPORATIONS (3d ed. 1927) § 952. And they may compel execution of a proxy to that person. Pennsylvania R. R. v. Pennsylvania Co. for Insurance, 205 Pa. 219, 54 Atl. 783 (1903); 2 THOMPSON, CORPORATIONS, § 978.

[1] 52 Sup. Ct. 189 (U. S. 1932). A conviction of three men for murder was upheld on the authority of this case although the jury specifically exonerated each defendant of having fired the fatal shot. Borum v. United States, 52 Sup. Ct. 205 (U. S. 1932).

[2] *Cf.* Note (1932) 45 HARV. L. REV. 535.

[3] 2 FREEMAN, JUDGMENTS (5th ed. 1925) § 648.

[4] 41 STAT. 314 (1919), 27 U. S. C. § 33 (1926).

[5] United States v. Ward, 6 F. (2d) 182 (C. C. A. 3d, 1925).

[6] Barker v. United States, 289 Fed. 249 (C. C. A. 4th, 1923).

[7] Hesse v. United States, 28 F. (2d) 770 (C. C. A. 9th, 1928); *cf.* Kansas v. Brundiage, 114 Kan. 849, 220 Pac. 1039 (1923) (conviction of burglary, acquittal of larceny); Stockman v. United States, 8 F. (2d) 211 (C. C. A. 9th, 1925) (conviction of possession, acquittal of sale); see Albrecht v. United States, 273 U. S. 1, 11, 47 Sup. Ct. 250, 254 (1927).

stances, however, the prevailing rule in the federal courts [8] and in most state courts [9] under state enforcement acts has been that where a jury convicts upon one count and acquits upon another, the verdict must stand though there be no rational way of reconciling the conflicting conclusions. On the other hand, the courts in the third and ninth circuits have adopted the reasoning of the dissent.[10] The main objection to an inconsistent verdict is that it indicates, on the part of the jury, an inadequate comprehension of the terms of the indictment. It is more probable, however, that the jury is not unconvinced of the defendant's guilt but rather unwilling to convict on several counts where the punishment which may be imposed under each is severe.[11]

LABOR LAW—FREEDOM OF SPEECH—INJUNCTION AGAINST INTERFERENCE WITH "YELLOW DOG" CONTRACT—In the case of *Kraemer Hosiery Co. v. American Federation of Full Fashioned Hosiery Workers* [1] the Supreme Court of Pennsylvania issued a perpetual injunction against an attorney and representative of the union, restraining him not only from picketing and intimidation but also from "sending libelous and scandalous letters, pamphlets or newspapers" for the purpose of inducing employees of the plaintiff to break their "individual contracts" of employment which were in all respects similar to those in the *Hitchman* case.[2] In a strong dissenting opinion, Judge Maxey argued that, since not a single act of violence or intimidation on the part of the defendant was charged and the picketing consisted merely in appearing at the gates of the Kraemer plant and distributing pamphlets to its employees, the injunction in effect violated the defendant's right of free speech.

This directly raises the question whether the Fourteenth Amendment is a protection against abridgements of freedom of speech and press in the field of labor disputes. Although a court of equity will enjoin the publication of a libel where property rights are involved and irreparable injuries threatened, it should be observed that such injunctions have usually been directed against particular statements.[3] This has been true in industrial controversies where publications incident to a strike or boycott have been enjoined.[4] The injunction in the instant case, however, is directed against nothing specific but embraces generally libel and scandal otherwise prohibited by law, and the result is that the defendant is subjected to the addi-

[8] Marshallo v. United States, 298 Fed. 74 (C. C. A. 2d, 1924); Gozner v. United States, 9 F. (2d) 603 (C. C. A. 6th, 1925); Carrignan v. United States, 290 Fed. 189 (C. C. A. 7th, 1923); *cf.* Maceo v. United States, 46 F. (2d) 788 (C. C. A. 5th, 1931) (refusal to pass on objection at all).

[9] Sichick v. State, 89 Ind. App. 132, 166 N. E. 14 (1929); State v. Daly, 77 Mont. 387, 250 Pac. 976 (1926). *Contra:* Kuck v. State, 149 Ga. 191, 99 S. E. 622 (1919) (acquittal of possession, conviction of sale); Davis v. State, 43 Ga. App. 122, 157 S. E. 888 (1931) (acquittal of possession conviction of transportation).

[10] Lambert v. United States, 26 F. (2d) 773 (C. C. A. 9th, 1928); see Hohenadel Brewing Co. v. United States, 295 Fed. 489 (C. C. A. 3d, 1924).

[11] See Boone v. United States, 257 Fed. 963, 968 (C. C. A. 8th, 1919); Steckler v. United States, 7 F. (2d) 59, 60 (C. C. A. 2d, 1925).

[1] 157 Atl. 588 (Pa. 1931).

[2] Hitchman Coal & Coke Co. v. Mitchell, 245 U. S. 229, 38 Sup. Ct. 65 (1917).

[3] *E. g.*, Davis v. New England Railway Publishing Co., 203 Mass. 470, 89 N. E. 565 (1909).

[4] *E. g.*, Robison v. Hotel & Restaurant Employees, Local No. 782, 35 Idaho 418, 207 Pac. 132 (1922); Hughes v. Kansas City Motion Picture Operators, 282 Mo. 304, 221 S. W. 95 (1920).

tional possibility of punishment in contempt proceedings without the right to a jury trial. This is in effect a previous restraint on free speech, similar to that held unconstitutional in the recent case of *Near v. Minnesota*.[5] It has been contended, however,—and the opinion in the *Near* case seems to lend support to this view,—that the constitutional guaranty should not apply to private disputes.[6] To this it may be answered, that the conflict of social and economic interests involved in labor disputes of this kind clothes the controversy with a public interest sufficient to warrant the position taken by the dissenting opinion.

FRAUDULENT CONVEYANCES—UNIFORM ACT—EFFECT ON HYPOTHECATION OF INTANGIBLES—A bank accepted accounts receivable as security for loans made under an agreement whereby the borrowing company was to hold in trust for the bank any returned goods covered by the assigned accounts or the proceeds thereof if sold. Goods were subsequently returned, but the bank neither made a demand for an accounting nor inquiry as to the disposition of the goods. The pledgor having become bankrupt, its trustee in bankruptcy sought to set aside the assignments as a fraudulent conveyance and to recover the proceeds. In *Lee v. State Bank & Trust Co.*[1] the Circuit Court of Appeals for the Second Circuit found that, contrary to the terms of the loan contract, both the real agreement and the acts of the parties were designed to reserve to the pledgor dominion over the returned goods and consequently held that the entire transaction was void as against creditors of the bankrupt.

A chattel mortgage under which the mortgagor, by express agreement and not by mere acquiescence of the mortgagee,[2] retains control over the disposition of the goods is invalid,[3] except where the mortgagor is merely the agent of the mortgagee to sell the goods and pay over the proceeds or substitute other goods therefor.[4] The rule was said to rest upon ostensible ownership and on that theory has been held inapplicable to the hypothecation of intangibles.[5] The Supreme Court, however, in *Benedict v. Ratner*[6] denied the ostensible ownership basis of the doctrine and held that the reservation of dominion inconsistent with the effective disposition of title and creation of a lien conclusively imputed fraud and thus that the rule could properly be applied to intangibles. It has been repeatedly contended that the Uniform Fraudulent Conveyance Act, by specifying those convey-

[5] 283 U. S. 697, 51 Sup. Ct. 625 (1931), discussed by Shulman, *The Supreme Court's Attitude Toward Liberty of Contract and Freedom of Speech* (1931) 41 YALE L. J. 262.

[6] See Note (1931) 31 COL. L. REV. 1148, 1155.

[1] 54 F. (2d) 518 (C. C. A. 2d, 1931). For a former appeal of the case see 38 F. (2d) 45 (C. C. A. 2d, 1930).

[2] Brown v. Leo, 12 F. (2d) 350 (C. C. A. 2d, 1926). Such agreement may be *dehors* the contract. Potts v. Hart, 99 N. Y. 168, 1 N. E. 605 (1885).

[3] Arbury v. Kocher, 18 F. (2d) 588 (W. D. N. Y. 1927); Wood v. Lowry, 17 Wend. 492 (N. Y. 1837). *Contra:* Harding v. Federal National Bank, 31 F. (2d) 914 (C. C. A. 1st, 1929).

[4] Greey v. Dockendorff, 231 U. S. 513, 34 Sup. Ct. 166 (1913); Hickock v. Cowperthwait, 210 N. Y. 137, 103 N. E. 1111 (1913). This exception applies to the hypothecation of intangibles also. Young v. Upson, 115 Fed. 192 (S. D. N. Y. 1902). In re Bernard & Katz, 38 F. (2d) 40. (C. C. A. 2d, 1930).

[5] In re Michigan Furniture Co., 249 Fed. 978 (S. D. N. Y. 1918); Stackhouse v. Holden, 66 App. Div. 423, 73 N. Y. Supp. 203 (4th Dep't 1901).

[6] 268 U. S. 353, 45 Sup. Ct. 566 (1925). Subsequent creditors may attack the conveyance as fraudulent. Eastern Sash & Door Co. v. Meister, 99 N. J. Eq. 819, 134 Atl. 619 (1926).

ances which are fraudulent without regard to intent,[7] excluded by implication assignments of accounts with dominion reserved to the assignor and thus abolished the rule of the *Benedict* case. While this argument accords with the intention of the framers of the Act,[8] and has been adopted in New York by two federal district courts,[9] nevertheless the instant decision in rejecting it is supported by the predominant authority.[10] It is significant, however, that the Uniform Chattel and Mortgage Act, not yet adopted in any state, upholds as a mortgage an instrument which allows the borrower freely to dispose of hypothecated goods or accounts.[11] This, it seems, would effectively alter the *Benedict* rule.

INCOME TAXATION—ASSIGNMENT OF PARTNERSHIP PROFITS—In *Burnet v. Leininger*[1] the petitioner had in 1920 constituted his wife an equal partner in his one-half interest in a partnership, his wife to share equally in the profits and contribute equally to the losses. The fact of this assignment was communicated to the representative of the other partners but the assent of the partnership, required by the local law for the admission of a new partner, was not shown. Furthermore, no change was made on the partnership accounts, one-half of the profits being returned to the petitioner and by him deposited in a bank account owned jointly with his wife. The petitioner's wife took no part in the partnership business nor did she contribute to the partnership capital. The petitioner returned only one-half of his share in the firm profits as income for the years 1920 to 1923, his wife returning the other half. The Commissioner, however, assessed the petitioner's entire share of the profits to him, contending that he was taxable as if the marital agreement had not taken place. The Board of Tax Appeals upheld the Commissioner, stressing the failure of the partnership to record a change in the distribution of the profits, but the Circuit Court of Appeals reversed this decision on the ground that regardless of whether the petitioner's wife had become a partner by virtue of the agreement, she had acquired a vested interest in partnership profits for which her husband could not be taxed. On *certiorari*, Mr. Chief Justice Hughes sustained the holding of the Board of Tax Appeals, devoting his opinion chiefly

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[7] 9 Uniform Laws Annotated (1932) 174-179; Uniform Fraudulent Conveyance Act §§ 4-8.

[8] See Report of the Proceedings of the Twenty-seventh Annual Meeting of the National Conference of Commissioners on Uniform State Laws (1917) 250-251, 255.

[9] American Steamship Co. v. Wickwire Spencer Steel Co., 42 F. (2d) 886 (W. D. N. Y. 1930), *aff'd*, 49 F. (2d) 766, (C. C. A. 2d, 1931); Comment (1930) 30 COL. L. REV. 1013. Another unreported decision by Judge Knox in the New York District Court followed this case. See the instant decision, *supra* note 1, at 520.

[10] In re Edelstein, 18 F. (2d) 963 (S. D. N. Y. 1926); In re M. G. Hoey & Co., 19 F. (2d) 764 (C. C. A. 2d, 1927); In re Monumental Shoe Co., 14 F. (2d) 549 (D. Md. 1926); In re Lambert v. Braceland Co., 29 F. (2d) 758 (E. D. Pa. 1928); Blue v. Herkimer National Bank, 30 F. (2d) 256 (C. C. A. 2d, 1929); In re Almond-Jones Co., 13 F. (2d) 152 (D. Md. 1926). In these cases, although the jurisdiction had adopted the Uniform Fraudulent Conveyance Act it was not mentioned. Nor does the Act change the rule as to a mortgage on a stock of goods. In re Frey, 15 F. (2d) 871 (D. Minn. 1926); In re Hanover Milling Co., 31 F. (2d) 442 (D. Minn. 1929); McHenry v. Heiderick, 134 Misc. 546, 236 N. Y. Supp. 1 (Sup. Ct. Madison County, 1929).

[11] 9 Uniform Laws Annotated (Supp. 1930) 79; Uniform Chattel Mortgage Act § 18.

[1] U. S. Daily, March 16, 1932.

to showing that since the wife had not become partner, her share in the partnership income was only "derivative."

The Revenue Acts of 1918 and 1921 provide that "the individuals carrying on the business of a partnership shall be liable for income tax only in their individual capacity," the net income of each partner being determined by his distributive share of the partnership income, whether distributed or not.[2] The Supreme Court in the principal case construed this provision to tax the distributive share of each partner regardless of the "beneficial" ownership of such share.[3] Under such an interpretation, a determination of the partners of a firm will automatically serve as a determination of who is to be taxed for partnership profits, state law usually serving as the criterion.[4] But it has been argued with equal plausibility that these provisions of the Revenue Act were intended merely to ensure the taxation of undivided partnership profits not withdrawn from the business and do not purport "to fix any policy as to who is to be deemed to receive the income."[5] Either proceeding upon this latter assumption, or ignoring the issue, most of the cases dealing with the allocation of income tax as between assignor and assignee of partnership interests have discussed the problem in the light of general principles of income taxation. For example, an assignment of unearned income to arise in the future does not, standing alone, relieve the assignor from the burden of taxation,[6] nor does it seem to be material that the assignment was for a consideration[7] and irrevocable.[8] Hence to avoid taxation, a partner must transfer a "share" in the partnership as well as profits earned upon such share,[9] a distinction particularly difficult of application because of the peculiar and ill-defined nature of partnership interests.[10] The Board of Tax Appeals, in upholding the Commissioner of Internal Revenue, has in general discountenanced inter-family assignments, usually without attempting fine distinctions, and sometimes being content to look merely to the partnership

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[2] 40 STAT. 1070 (1918), 42 STAT 245 (1921), 26 U. S. C. § 218a (1926).

[3] *Cf.* Harris v. Commissioner, 39 F. (2d) 546, 547 (C. C. A. 2d, 1930); Mitchell v. Bowers, 9 F. (2d) 414, 415 (S. D. N. Y. 1925), *aff'd* on another ground, 15 F. (2d) 287 (C. C. A. 2d, 1926), *cert. den.* 273 U. S. 759 (1926).

[4] But *cf.* Pugh v. United States, 48 F. (2d) 600 (S. D. W. Va. 1931) (wife held partner in equity though spouses prohibited from becoming partners). For effect of the Uniform Partnership Act, compare Parshall v. Commissioner, 7 B. T. A. 318 (1927) with Colbert v. Commissioner, 12 B. T. A. 565 (1928).

[5] Leininger v. Commissioner, 51 F. (2d) 7, 8 (C. C. A. 6th, 1931). See dissents in Battleson v. Commissioner, 22 B. T. A. 455, 464 (1931) substantially on the ground that an individual cannot be taxed for income enjoyed by another. *Cf.* O'Malley-Keyes v. Eaton, 24 F. (2d) 436, 437 (D. Conn. 1928).

[6] Bing v. Bowers, 22 F. (2d) 450 (S. D. N. Y. 1927), *aff'd.* 26 F. (2d) 1017 (C. C. A. 2d, 1928); see S. M. 2763. 111-2, Cum. Bull. 53 (1924). Compare Lucas v. Earle, 281 U. S. 111, 50 Sup. Ct. 241 (1930) with Hall v. Burnet, U. S. Daily, Nov. 18, 1931, at 193. But *cf.* Young v. Guichtel, 28 F. (2d) 789 (D. N. J. 1928).

[7] Larsen v. Burnet, 50 F. (2d) 308 (Ct. of App. D. C. 1931) (community property); Olds v. Commissioner, 15 B. T. A. 560 (1929) ("sale of interest"). See Note 43 HARV. L. REV. 1282.

[8] See Comment (1929) 38 YALE L. J. 1123; Note (1931) 40 YALE L. J. 663.

[9] See *Acquiescences and Non-Acquiescences of Commissioners* (1931) INTERNAL REVENUE CUMULATIVE BULLETIN X-1. Compare Van Brunt v. Commissioner, 11 B. T. A. 406 (1928) with Leydig v. Commissioner, 43 F. (2d) 494 (C. C. A. 10th, 1930).

[10] See Commissioners' note to §§ 23-25 of the Uniform Partnership Act, Part 5.

books to discover whom the firm considers entitled to profits.[11] The few federal court cases have adopted different courses of reasoning, the most popular being that an assignment of income to arise in the future "has no immediate effect." [12] Although the tests thus adopted are not fundamentally repugnant, the difficulty of applying them, together with a consistent failure precisely to define the nature of the interest subject to taxation, have led to holdings difficult, if not impossible, to reconcile.

INCOME TAXATION—INTERSTATE ALLOCATION—INTERCORPORATE CONTRACTS—A Wisconsin corporation contracted with its foreign parent sales corporation which did no business in Wisconsin to manufacture soap on a "cost plus" basis. In assessing the corporation for income tax purposes, the state tax officials disregarded the contract and this action was approved by the district court,[1] which set forth collateral facts to show that the cost plus were in fact mere bookkeeping devices [2] and held them to constitute a fraud on the income tax laws. On appeal, the Circuit Court of Appeals for the Seventh Circuit in *Palmolive Co. v. Conway*,[3] emphasizing the peculiar value of the Wisconsin factory to this particular enterprise, affirmed the district court after a careful analysis of the cost basis of the contracts involved. It pointed out that the failure to include in this basis items such as management, general overhead including rent and depreciation, interest on funds supplied by the parent, and a fair middleman's profit on raw materials furnished by the parent, resulted in a great understatement of the actual manufacturing cost.

Disregard of intercorporate contracts [4] in determining the taxable income of the local subsidiary has been countenanced when a minority stockholder of the subsidiary could validly have objected to the contract,[5] and when the contract operated as a device to distribute untaxed corporate profits to the parent shareholder.[6] If the contract has properly been disregarded, the taxing state even when using a statutory allocation fraction is limited in its assessments to a share of total income, wherever earned, which in "appropriate proportion" reflects the business transacted in the

[11] *Cf.* Battleson v. Commissioner, *supra* note 5. But *cf.* Kier v. Commissioner, 15 B. T. A. 1114 (1929) (contribution to capital).

[12] See Harris v. Commissioner, *supra* note 3, at 547. But *cf.* Copland v. Commissioner, 41 F. (2d) 501 (C. C. A. 7th, 1930) (joint venture).

[1] 43 F. (2d) 226 (W. D. Wis. 1930).

[2] The court points to (1) inconsistencies in the interest and by-product accounts between subsidiary and parent; (2) the fact that the subsidiary sold directly to Wisconsin wholesalers for $9.24 per gross whereas it received but $3.52 from the parent; and (3) a drop-off of over 90% in gross profit as between years before and years after the contracts with the parent were entered into.

[3] U. S. Daily, Feb. 20, 1932, at 4 (C. C. A. 7th, 1932).

[4] Magill, *Allocation of Income by Corporate Contract* (1931) 44 HARV. L. REV. 935; Breckenridge, *Tax Escape by Manipulation of Holding Company* (1931) 9 N. C. L. REV. 189; Rottschaefer, *State Jurisdiction of Income for Tax Purposes* (1931) 44 HARV. L. REV. 1075, 1085; Huston, *Allocation of Corporate Net Income for Purposes of Taxation* (1932) 26 ILL. L. REV. 725, 751; Comment (1931) 40 YALE L. J. 1273, 1280; Note (1931) 31 COL. L. REV. 719; Jones, *Present Problems of the Consolidated Return* (1929) NATIONAL TAX ASSOCIATION PROCEEDINGS, 414, 420.

[5] Cliffs Chem. Co. v. Tax Commission, 193 Wis. 295, 301, 214 N. W. 447 (1927), dismissed for want of substantial federal question, 277 U. S. 574, 48 Sup. Ct. 435 (1927).

[6] Magill, *op. cit. supra* note 1, at 937; Buick Motor Co. v. City of Milwaukee, 48 F. (2d) 801, 803 (C. C. A. 7th, 1931) affirming 43 F. (2d) 385 (E. D. Wis. 1930), *cert. den.* 52 Sup. Ct. 34 (Oct. 26, 1931).

state.[7] In not mentioning these established criteria and resting its decision on an accounting basis, the court in the instant case seems to imply that, given an intercorporate contract which pays to a local subsidiary the "fair" cost of its services plus even a comparatively small profit, income tax officials will be required to base their estimate of the subsidiary's state income on the contract and on the separate accounting systems of the corporate organization, rather than on a statutory allocation fraction or empirical estimates.[8] It remains to be seen whether the courts will be even more ready in such a case to find the contract fair and to require the use of the organization's separate accounting than they have been in the case of a single departmentalized corporation in which one department sells to another.[9]

INCOME TAXATION—INCOME FROM TRUST ESTATE BEFORE DISTRIBUTION TO BENEFICIARIES—Under the Federal Revenue Acts trustees are charged with the duty of paying a tax on income derived from the trust estate which is properly accumulated or held for future distribution under the terms of the trust.[1] But as to income which is to be distributed currently to the beneficiaries a deduction is allowed, the amount of which "shall be included in computing the net income of the beneficiaries whether distributed to them or not."[2] In the recent case of *Columbia & Fidelity Trust Co. v. Lucas*,[3] the trustee sought a refund of taxes paid under these provisions on the ground that a court of the state which controlled the administration of the trust had since construed the terms of the will creating it as requiring the net income received each year to be divided initially into three equal parts, one for each beneficiary, and the balances, remaining each year after the beneficiaries had received what the trustee in his discretion distributed to them, to be carried on separate trust accounts for the benefit of the beneficiaries until the main trust should be finally terminated. The court, however, after dismissing the contention that it was bound by the state court's construction, went on to construe the will to require that the balances should be held as part of the main trust and not separately, and accordingly decided that the trustee was the proper person to pay the tax on the amount of such balances.

For the purpose of determining whether the trustee or the beneficiary is liable to the tax the term "distributed" as used in the revenue act has been interpreted not necessarily to refer to the actual passing of the income

[7] The court in the instant case felt obliged to distinguish away the case of Hans Rees & Sons v. North Carolina, 283 U. S. 123, 51 Sup. Ct. 385 (1931), where the question was solely one of allocation and not at all one of attempted tax avoidance through intercorporate contract. From the district court's opinion it appears that the mode of allocation used was quite fair granted that the contracts could be disregarded. See Palmolive Co. v. Conway, *supra* note 1, at 231.

[8] "A stipulated percentage of profit upon manufacturing cost might in many cases be fair enough if all cost factors were included." U. S. Daily, Feb. 20, 1932, at 4.

[9] See Standard Oil Co. v. Thoresen, 29 F. (2d) 708 (C. C. A. 8th, 1928) and Standard Oil Co. v. Tax Commission, 197 Wis. 630, 223 N. W. 85 (1929) for departmentalization cases where officials were required to abide by the company's separate accounting. But see Kresge Co. v. Bennett, 51 F. (2d) 353 (S. D. N. Y. 1931) where under the circumstances the court said that separate accounting would not fairly reflect the state income by which to measure a New York "franchise" tax.

[1] 26 U. S. C. § 960 (a) and (b) (1928).

[2] 26 U. S. C. § 960 b (2) (1928).

[3] 52 F. (2d) 298 (W. D. Ky. 1931).

into the uncontrolled possession of the beneficiary, but rather to its separation and segregation from the trust estate so that it no longer forms any part thereof.[4] Thus in *Willcuts v. Ordway*[5] a trustee was held not taxable as to a portion of the income which was not actually handed over to the beneficiaries but was invested, according to the testator's directions in securities which were segregated from the *corpus* and held in a separate repository, and recorded on separate books. On the other hand, the income has been held taxable to the trustee where, although separate accounts were kept, the beneficiaries were entitled to the accumulated income only in the event that the discretion of the trustee to make an unequal distribution thereof was not exercised before they reached their majority.[6] It seems clear that under the state court's construction of the trust in the instant case the income had been distributed within the rule laid down by the *Ordway* case. And in view of the fact that the trustee was bound to administer the trust in accordance with the state court's decree, it may reasonably be argued that the federal court, even in the absence of any compelling precedent should have adopted it for the purpose of determining the incidence of the tax.[7] It should be noted, however, that in cases of this kind the income thus segregated and accumulated is withheld from the beneficiary, and the courts might well have taken the position that the beneficiary should not be taxed except as to that portion of the income to which he is beneficially entitled during any taxable year. Distribution in this latter sense would seem to be more nearly in harmony with the purpose of the statute, *viz.*, to let the tax follow the income.

PUBLIC UTILITIES—RATE REGULATION—INTERCORPORATE CONTRACTS—A corporation operating a natural gas distributing system in Kansas filed with the state Public Service Commission an application for an increase in rates. By far the largest item of operating expense shown by the petition was the cost of gas purchased from an interstate pipe line company which owned all the capital stock of the applicant. The commission insisted that, in order to determine the reasonableness of the requested increase, inquiry must be made into the propriety of the rate charged by the holding company and upon the applicant's refusal to make any showing in this regard, dismissed the petition. A bill to enjoin the enforcement of the existing rate schedule was thereupon brought by the applicant before a statutory three judge court. It was there dismissed on the ground that until the applicant had produced the required evidence, it had not exhausted its remedy before the commission. In affirming the judgment of dismissal in *Western Distributing Co. v. Public Service Commission of Kansas*,[1] the United States Supreme Court brushed aside the objection that it imposed

[4] Willcuts v. Ordway, 19 F. (2d) 917, 918 (C. C. A. 8th, 1927).

[5] *Ibid.*

[6] Henn v. Commissioner, 8 B. T. A. 190 (1927); *Cf.* Sears, Roebuck & Co., Employees' Savings & Profit Sharing Pension Fund v. Commissioner, 17 B. T. A. 22 (1929).

[7] The Board of Tax Appeals had shown a tendency to adopt the state court's construction, Appeal of Catherine Erswell, 1 B. T. A. 1254 (1925); and to give weight to the manner in which the trustee has actually handled the income as well as to the bare language of the trust instrument. See Appeal of Grace Scripps Clark, 1 B. T. A. 491, 496-7 (1925). It is significant, however, that, in the instant case, not only had the trustee paid the tax over a period of ten years but also the state court's construction had not been contested, but had been agreed upon by the only parties interested in the estate. But see Brenneman v. Commissioner, 10 B. T. A. 544, 552 (1928).

[1] 52 Sup. Ct. 283 (1932).

a burden on interstate commerce and stated that in view of the relationship of the two corporations the state authority was entitled to fuller evidence of the reasonableness of the charges than would be required were the parties dealing at arms' length.

Prior to the decision of the Supreme Court in *Smith v. Illinois Bell Telephone Co.*[2] it was apparently established that the existence of a parent-subsidiary relationship between two corporations was not material to a determination of the reasonableness of charges made by one to the other in the absence of a clear showing of bad faith.[3] But in the *Smith* case, which involved charges made by a subsidiary supply company to a utility owned by the same parent, it was held that their reasonableness was not established in the absence of findings of the cost to the supply company of the specific services rendered. The Court neglected, however, to give any indication of how the data necessary to support such findings was to be obtained. The instant case, in placing upon the applicant for a rate increase the burden of producing the evidence necessary to establish the reasonableness of an intercorporate charge, indicates how the rule of the *Smith* case may be made effective and lends countenance to a practice already adopted by at least a few of the state commissions.[4] It remains to be seen whether a commission will also be able to place the burden of proof on a utility in the converse situation where it attempts to lower the utility's rates on its own motion. The Wisconsin commission had dared to do so long before the *Smith* case.[5] In view of the emphasis placed by the Court in the instant case upon the danger inherent in a close interrelationship of supply and distributing companies that charges, ultimately the basis of a retail rate, will be arbitrarily established without any reference to the true value of the services rendered, it is predicted that such an extension of the rule would be successful.

SURETYSHIP—SURETY'S DEFENSES—CHANGE IN PRINCIPAL DEBTOR—In the recent case of *Walter & Co. v. Zuckerman*[1] the defendant guaranteed payment for goods sold on credit by the plaintiff. The buyer subsequently incorporated his business, taking all the shares except those necessary to qualify directors. The plaintiff, who had notice of the change, sued the surety for the price of goods sold after incorporation. A judgment for the defendant was reversed on the ground that, to prevent injustice, the corporation and individual buyer should be considered as one.[2]

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[2] 282 U. S. 133, 51 Sup. Ct. 15 (1930). See Comment (1931) 40 YALE L. J. 809.

[3] Houston v. Southwestern Bell Telephone Co., 259 U. S. 318, 42 Sup. Ct. 486 (1921); Southwestern Bell Telephone Co. v. Public Service Commission, 262 U. S. 276, 43 Sup. Ct. 544 (1923). See Lilienthal, *The Regulation of Public Utility Holding Companies* (1929) 29 COL. L. REV. 404, 412 ff.

[4] Re New York Telephone Co., P. U. R. 1925C 767 (N. J. Board of Pub. Serv. Comm. 1924); Re Wisconsin Telephone Co., P. U. R. 1925D 661 (Wis. Ry. Comm. 1925); Re Point Pleasant Natural Gas Co., P. U. R. 1927B 805 (W. Va. Pub. Serv. Comm. 1927); Re Cumberland & Allegheny Gas Co., P. U. R. 1928B 20 (W. Va. Pub. Serv. Comm. 1927). See Comment (1931) 40 YALE L. J. 1088.

[5] Re Wisconsin Fuel & Light Co., P. U. R. 1927E 212 (Wis. Ry. Comm.); Re Wisconsin Public Utility Co., P. U. R. 1930A 119 (Wis. Ry. Comm. 1929).

[1] 6 Pac. (2d) 251 (Cal. 1931).

[2] *Cf.* Standard Plumbing Supply Co. v. Messamina La Conte, 178 N. E. 611 (Mass. 1931); *cf.* Marshall-Wells Co. v. Kramlich, 46 Idaho 355, 267 Pac. 611 (1928) (debtor partnership represented itself to be a corporation

The rule that a change in the personnel of the principal debtor to whom credit is extended under a continuing guarantee releases the non-consenting surety-guarantor as to credit subsequently extended,[3] has quite consistently been applied to changes in the membership of a partnership.[4] The basis of these decisions is said to be the reliance which the surety places in the responsibility of the individual members at the time the obligation is assumed.[5] The surety is not released, however, by a merely formal change in the principal's business, as for example a change in the name,[6] or a statutory extension of its limited existence.[7] The holding in the instant case, where corporation and stockholders are practically indistinguishable, could not be in any way prejudicial to the surety, provided the courts will in like fashion refuse to distinguish them in case of a suit for reimbursement. It may be noted, however, that the incorporation of the creditor has been held to release the guarantor,[8] although a change in the personnel of either debtor or creditor has usually been given identical treatment.[9]

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and guarantor, a partner, held estopped to plead the subsequent incorporation as discharge).

[3] See Note (1929) 29 COL. L. REV. 97 and cases therein cited.

[4] Where a new partner comes in, see Dupee v. Blake, 148 Ill. 453, 35 N. E. 867 (1893); Spokane Union Stockyards Co. v. Md. Casualty Co., 105 Wash. 306, 178 Pac. 3 (1919). But *cf.* Gilbert v. State Insurance Co., 31 Kan. App. 1, 44 Pac. 442 (1896) (in a suit on a fidelity bond new partner was held to have had nothing to do with the agent's service of his employer). Where there is withdrawal of a partner see Byers v. Heckman Grain Co., 112 Iowa 451, 84 N. W. 500 (1900).

[5] *Cf.* the unique holding in Richardson v. County of Steuben, 226 N. Y. 413, 122 N. E. 449 (1919) that the issue is whether the guarantor intended the withdrawal of a partner to affect his liability.

[6] Scovill Mfg. Co. v. Cassidy, 275 Ill. 462, 114 N. E. 181 (1916). *Cf.* Rouss v. King, 74 S. C. 251, 54 S. E. 615 (1906).

[7] People v. Backus, 117 N. Y. 196, 22 N. E. 759 (1889).

[8] John Wanamaker v. Shoemaker, 70 Pa. Super. Ct. 473 (1918) (incorporation of partnership).

[9] See Comment (1909) 57 U. PA. L. REV. 327 and cases therein cited; Note (1929) 29 COL. L. REV. 97.