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Preventive Tax Policy: Chief Justice Roger J. Traynor's Tax Philosophy

Mirit Eyal-Cohen
University of Alabama - School of Law, meyalcohen@law.ua.edu

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MIRIT EYAL-COHEN*

INTRODUCTION

Roger J. Traynor was appointed to the Supreme Court of California in 1940 and served as its Chief Justice from 1964 to 1970.[1] He is best known today for his judicial innovations in the fields of conflict of laws, product liability, and civil procedure.[2] His decisions on miscegenation, divorce, police searches and product liability were ahead of his time, and guided California's legal system into the future. His most significant opinions included rejecting the legal prohibition of inter-racial marriages, adopting a no-fault divorce, restricting police searches and applying a strict standard of liability in product defect cases.[3]

However, few are aware of Roger J. Traynor's contributions to the field of tax law, where, through academic, administrative, and judicial service, he developed valuable principles that still prevail today. At the University of California at Berkeley, Traynor discovered his passion for tax law, and inspired his students to take this path in their professional careers.[4] As an administrator, Traynor served California's tax system tremendously by shaping some of today's most important local tax acts, which were adopted by other states and countries.[5] Later on, Traynor

* S.J.D. Candidate, University of California, Los Angeles. I would like to thank Julie Makinen, Kirk Stark, Steven Bank, Martin Shapiro, and Ilan Benshalom for their insightful comments on drafts of this Article. I also thank the California Supreme Court Historical Society for choosing this Article as winner of the 2007 Writing Competition. A shorter version of this Article will be published in the 2008 volume of the Society's journal, *California Legal History*, and will appear on the Society's Web site (www.cschs.org). Finally, I am grateful to my family, most especially my husband Tamir for his constant love and support.

1. Adrian A. Kragen, *In Memoriam: Roger J. Traynor: Chief Justice Traynor and the Law of Taxation*, 5 HASTINGS L.J. 801, 802 (1984).

2. *Id.* at 801.

3. BEN FIELD, ACTIVISM IN PURSUIT OF THE PUBLIC INTEREST: THE JURISPRUDENCE OF CHIEF JUSTICE ROGER J. TRAYNOR, at XIV (2003).

4. On his academic interest in tax law, see Elizabeth Roth, *The Two Voices of Roger Traynor*, 27 AM. J. LEGAL HIST. 269, 295 (1983), and James E. Sabine, *Taxation: A Delicately Planned Arrangement of Cargo*, 53 CAL. L. REV. 173 (1965).

5. Kragen, *supra* note 1, at 803.

became an expert consultant to the Treasury and participated in drafting major federal tax legislation. As a California Supreme Court justice, Traynor wrote decisions in the field of state tax law that remain good law, and provide guidance for complicated issues including, for example, computing estate tax marital deductions, and the earnings and profits of corporations. What would be surprising to many people, however, would be to learn of Traynor's partnership and important work with Stanley S. Surrey, one of "our nation's foremost authorities on federal tax law," and "the leading proponent of tax reform" during his life.[6]

Surrey was the ultimate tax professor and a "True Public Servant," as a Harvard law dean and tax professor once said.[7] In 1933, he joined the New Deal administration and established himself as a highly ranked legal counsel at the Treasury Department.[8] In 1951, he joined the Harvard Law School faculty, where he remained an active member for thirty years[9] while continuing to serve as a consultant to the United States Government and as an advisor at the United Nations on international tax projects.[10] However, his best known and most important

6. *See* The Townsend Harris Medal, http://www.ccny.cuny.edu/townsend_harris/awards/s_z.htm (last visited Mar. 17, 2008).

7. Erwin N. Griswold, *In Memoriam: Stanley S. Surrey—A True Public Servant*, 98 HARV. L. REV. 329, 329, 331 (1984).

8. Stanley Surrey worked in the National Recovery Administration in Washington from 1933 to 1935 and at the National Labor Relations Board from 1935 to 1937. Walter Sterling Surrey, *in* STANLEY S. SURREY 1910–1984: PROGRAM OF A MEMORIAL SERVICE HELD OCT. 3, 1984 AT MEMORIAL CHURCH, HARVARD UNIVERSITY (1984) [hereinafter SURREY MEMORIAL SERVICE] (on file with author). In those positions, Surrey found a meaningful outlet to improving government policies. *Id.* The New Deal was also a significant influence on Stanley Surrey. *Id.*

9. At Harvard, even as professor emeritus, Surrey continued to participate in many projects, such as the Income Tax Project of the American Law Institute. Erwin W. Griswold, *in* SURREY MEMORIAL SERVICE, *supra* note 8. He organized the International Program in Taxation at Harvard, produced the World Tax Series, and published various tax books and articles. *Id.* He was the president of the National Tax Association from 1979 to 1980 and through it published major tax articles. *Id.* Surrey wrote twenty books and ninety-seven articles, not including legislative records. James Vorenberg, *in* SURREY MEMORIAL SERVICE, *supra* note 8.

10. Surrey's contribution to the development of international tax systems was vast. He was instrumental in formulating tax treaties between developed and developing countries, and in developing the new tax system that evolved after World War II. For example, he was responsible for the adoption of Resolution A.3, adopted at the Conference of Punta del Este in 1961, by which member governments of the Organization of American States explicitly endorsed a program to reinforce tax systems. Milton Katz, *in* SURREY MEMORIAL SERVICE, *supra* note 8. The Resolution was adopted by "the Pan American Union, the Economic Commission for Latin America, and the Inter-American Development Bank, in cooperation with the Harvard University Law School International Program in Taxation" in August 1961. *Id.* Between 1949 and 1950, Surrey participated in planning and developing a new tax system for Japan, as a member of the American Tax Mission to Japan. Erwin W. Griswold, *in* SURREY MEMORIAL SERVICE, *supra* note 8. Surrey reported his mission was most importantly to devise "a simple and progressive system," which was later acclaimed for "Japan's dazzling economic performance and rapid growth since World War II." *Id.* (quotations omitted); *see also* Erwin N. Griswold, *In Memoriam: Stanley S. Surrey*, 98 HARV. L. REV. 329, 331 (1984). In 1960, he joined his Harvard colleague Oliver Oldman in a research project on the tax system of Argentina. STANLEY S. SURREY & OLIVER OLDMAN, REPORT OF A PRELIMINARY SURVEY OF THE TAX SYSTEM OF

work was formulating the tax expenditure concept. As assistant secretary for tax policy in the Treasury Department, Surrey promoted the legislation establishing today's tax expenditures section of the government's budget.[11] The tax expenditures section enumerates incentives provided through the tax system, thus emphasizing their oversized component of the income tax system. His aim was to raise public awareness of the extent to which the government subsidizes certain activities through the tax code. After his retirement, Surrey continued to update and publish volumes of his famous textbooks on taxation, such as "Federal Income Taxation: Cases and Materials"[12] and "Federal Wealth Transfer Taxation: Cases and Materials,"[13] casebooks that continue to be widely used by tax educators.

Little is known about the strong bond between Traynor and Surrey, who both commenced their careers in the tax law field, and have had an enduring impact on the American tax system. Traynor collaborated with Surrey during President Roosevelt's second term, towards the end of the Great Depression, when the top marginal tax rate climbed back to its World War I-era maximum of 78%.[14] The high marginal tax rates intensified the friction between taxpayers and the government, boosted litigation, and multiplied the number of tax disputes.[15]

At this crucial juncture in the late 1930s, Traynor and Surrey called for a substantial transformation of existing mechanisms for settling tax disputes. During these years, an overload of tax litigation had created inequities that increased the public's discomfort with the tax system.[16] The Bureau of Internal Revenue labored under the burden of individual and corporate tax disputes. When Congress established the U.S. Board of Tax Appeals ("the Board") in the Revenue Act of 1924,[17] it initially considered it a technical, tax expert tribunal within the the Bureau of

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ARGENTINA (1960).

11. *See generally* Stanley Surrey, *Tax Expenditures and the Budget, in* TAX POLICY AND TAX REFORM, 1961–1969: SELECTED SPEECHES AND TESTIMONY (William F. Hellmuth & Oliver Oldman eds., 1973); Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970).

12. STANLEY S. SURREY, FEDERAL INCOME TAXATION: CASES AND MATERIALS (1986).

13. STANLEY S. SURREY ET AL., FEDERAL WEALTH TRANSFER TAXATION: CASES AND MATERIALS (1987).

14. In 1918, the top marginal tax rate was 77%, and between 1919 and 1921 it was 73%. In the period following World War I, the maximum rates declined gradually and their lowest level was 24% in 1929. During the Depression period that followed the stock market crash, the top marginal tax rate increased rapidly to 79% in 1936 and continued this trend in the Second World War to a top of 94% in 1945. *See* INTERNAL REVENUE SERVICE, SOI TAX STATS—HISTORICAL TABLE 23 [hereinafter TABLE 23], *available at* http://www.irs.gov/pub/irs-soi/histaba.pdf (last visited Mar. 17, 2008).

15. Roger J. Traynor & Stanley S. Surrey, *New Roads Toward the Settlement of Federal Income, Estate, and Gift Tax Controversies*, 7 LAW & CONTEMP. PROBS. 336, 338 (1940).

16. *Id.*

17. Revenue Act of 1924, Pub. L. No. 68-176 § 900, 43 Stat. 336 (1924).

Internal Revenue, a branch of the Treasury Department, which would later be renamed the Internal Revenue Service.[18] The Board was designed to serve as a professional mediator between taxpayers and the Bureau of Internal Revenue, rather than to function as a court.[19] However, the absence of filing fees prompted taxpayers to take their disputes to the Board.[20] Traynor and Surrey demonstrated that on average, it took the Board three years to issue a decision. Most of the cases involved a relatively small dollar amount and a focus on questions of fact, which for the most part could have been resolved more quickly, and at lower expense, through administrative measures rather than the adversarial judicial procedures of the Board.[21]

Traynor and Surrey criticized this inefficient system of adjudication and proposed ways to minimize litigation through what they called a "preventive tax policy" which was "designed to prevent controversies from arising" and, where they could not be prevented, "to reduce the area in which they occur."[22] Their idea of preventive tax policy entailed reducing the complexity of the tax code and improving the administrative resolution of tax cases, thereby minimizing disputes over tax matters. They called for more flexibility of the tax system by decentralizing the administrative and judicial systems into more divisions and granting them more authority in cases of income, estate, and gift tax.[23] Traynor and Surrey contended that the dispute resolution process had lost its effectiveness and clarity due to complexity added by judicial interpretation. "Too much law,"[24] they said, caused taxpayers to seek out expensive legal advice in order to "thread their way through the complicated maze of tax law."[25] Another aspect of Traynor and Surrey's proposal was to limit appellate reviews and institute a single court of tax appeals in various locations.[26]

Ultimately, Traynor was appointed to the judicial bench, eventually becoming Chief Justice of the Supreme Court of California, while Surrey excelled in Harvard's faculty and in the executive branch as Assistant Legislative Counsel to the United States Treasury. However, when they

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18. T.D. 6038, 1953-2 C.B. 443.

19. Stephen C. Gara, *Challenging the Finality of Tax Court Judgments: When Is Final Not Really Final?*, 20 AKRON TAX J. 35, 38 (2005).

20. Roger J. Traynor, *Administrative and Judicial Procedure for Federal Income, Estate, and Gift Taxes—a Criticism and a Proposal*, 38 COLUM. L. REV. 1393, 1394 (1938).

21. *Id.* at 1394.

22. Traynor & Surrey, *supra* note 15, at 352.

23. *Id.*

24. *Id.* at 351. This exact phrase was also used by Justice Robert H. Jackson. Kirk Stark, *The Unfulfilled Tax Legacy of Justice Robert H. Jackson*, 54 TAX L. REV. 171, 187 (2001). He claimed that the elaborate tax system was "too much law, and too many kinds of law, and from too many sources, for tax administration to be simple, or the law clear." *Id.*

25. Traynor & Surrey, *supra* note 15, at 351.

26. *Id.* at 349.

proposed their preventive tax policy, they were both Treasury consultants. This Article will explore the joint project of these extraordinary men in its historical context and its implementation in Traynor's adjudication of tax disputes. Through legal-historical analysis, this Article also examines the taxpayer-government relationship in view of changes in politics, economics, and culture in the interwar years.

The tax policy community continues to debate questions concerning the scope and nature of tax law, and the role of the judiciary and administrative agencies in its development.[27] Thus, it is important to study the objectives of the individuals who helped to shape tax laws in order to continue this legislative chain of intent. Traynor and Surrey's idea of preventive tax policy was instrumental in shaping our current tax system. The introduction of a closing agreement for a future transaction, and today's private letter ruling, originated as a result of their proposal. Their suggestion to create a single court of tax appeals continues to be deliberated. Their philosophy can serve today as a valuable guide for reducing the complexity and vagueness inherent in our tax system, and for improving the relationship between taxpayers and the government.

Following this brief introduction, Parts II and III provide a historical overview of the development of the tax system between 1913 and 1940 and detail the administrative and judicial problems at that time, as a background for Traynor and Surrey's work. Part IV tells the story of Traynor's tax education and how he met Surrey, along with an outline of their proposal to improve the interwar tax system. Part V describes the success of implementing preventive tax policy in the U.S. tax system, specifically in Traynor's decisions. Finally, Part VI summarizes the importance of preventive tax policy at a turning point in history and Traynor and Surrey's effect on today's tax system.

I. THE INCOME TAX SYSTEM IN THE INTERWAR PERIOD

Taxing the income of individuals by the United States government began during the Civil War,[28] and the income tax appeared intermittently in various forms until it was constitutionalized in 1913.[29] That year, the remaining three states ratified the Sixteenth Amendment,[30] which

27. *See, e.g.*, Francis M. Allegra, *Section 482: Mapping the Contours of the Abuse of Discretion Standard of Judicial Review*, 13 VA. TAX REV. 423, 453 (1994) (discussing the role of the judiciary in the development of tax law); Jennifer C. Root, *The Commissioner's Clear Reflection of Income Power Under 446(B) and the Abuse of Discretion Standard of Review: Where Has the Rule of Law Gone, and Can We Get It Back?*, 15 AKRON TAX J. 69, 74–76 (2000) (describing the role of administrative agencies and the IRS in the development of tax law).

28. *See, e.g.*, Revenue Act of 1862, ch. 119, 12 Stat. 432 (1862).

29. Revenue Act of 1913, ch. 16, § 2, 38 Stat. 166–67 (1913).

30. JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 79 (1985); *see also* Erik M. Jensen, *The Taxing Power, the Sixteenth Amendment, and the Meaning of "Incomes,"* 33 ARIZ. ST. L.J. 1057, 1073–77 (2001) (discussing the ratification process).

authorized Congress to impose taxes on income without apportionment by population, and from then on a federal income tax system became a permanent statutory reality. The first income tax bill was modest, imposing graduated rates with a maximum rate of 7% and large exemptions.[31] The campaign for introducing the income tax was led mainly by the states, which struggled to raise revenue and endured heavy federal tariffs and excise taxes.[32] State representatives argued for an income tax by emphasizing that it would be a progressive tax; that is, it would tax people according to their ability to pay. However, while progressive ideas of redistributing wealth and promoting equality were part of the public debate, congressional debates focused on the income tax as a suitable device to raise the revenue necessary anticipated for the forthcoming war.[33]

Until 1916, moderate tax rates and large exemptions resulted in little added revenue for the Treasury, and the new income tax remained a marginal source of income for the federal government.[34] Excise taxes and tariffs accounted for 90% of federal government receipts; thus the new income tax affected few people.[35] However, the U.S. decision to enter World War I in April, 1917, resulted in higher defense expenses, and the government turned to the income tax knowing it would generate immediate revenue needed to fund defense costs.[36]

The collective political agreement in Congress to enter the war reflected the unified political atmosphere of the period, which gave rise to bipartisan support for increasing the income tax burden.[37] For the first time, American armed forces were sent to fight on European soil. The public mood seemed to be that it was the patriotic duty of the homeland to make financial sacrifices to support the troops at the battlefront.[38] In 1916, income and corporate taxes accounted for 16% of government revenue; by 1920 the figure had grown to 58.6%.[39] In just a few short years the maximum individual tax rate reached 77%.[40] The government raised $13.5 billion between 1917 and 1920, primarily from progressive taxes on individual incomes and corporate profits, and reduced its heavy

31. Revenue Act of 1913, § 2, 38 Stat. 166–67.

32. ELLIOT W. BROWNLEE, FEDERAL TAXATION IN AMERICA: A SHORT HISTORY 40–45 (1996).

33. WITTE, *supra* note 30, at 83.

34. U.S. Dep't of the Treasury, Fact Sheet on the History of the U.S. Tax System, http://www.treas.gov/education/fact-sheets/taxes/ustax.shtml (last visited Mar. 17, 2008).

35. *Id.*

36. *See* BROWNLEE, *supra* note 32, at 58–78; *see also* JOHN STEELE GORDON, HAMILTON'S BLESSING: THE EXTRAORDINARY LIFE OF OUR NATIONAL DEBT 104 (1997).

37. *Id.*

38. *See* DAVID M. KENNEDY, OVER HERE: THE FIRST WORLD WAR AND AMERICAN SOCIETY (1980) (providing a detailed study of the American home front and society on the eve of the war).

39. WITTE, *supra* note 30.

40. TABLE 23, *supra* note 14.

reliance on import duties.[41] Scholar John F. Witte aptly summed up the atmosphere of the period when he said: "[T]he need for revenue ruled the discussion over progressive arguments."[42]

Once the war was over and the government had paid for much of those costs, there was a general desire for isolationism and steady healing.[43] Revisions to the income tax rate were no exception, and the Republicans who regained power in the 1920s called for a "return to tax normalcy."[44] The maximum individual tax rate dropped from 77% in 1918 to 24% in 1929.[45] Attempts to increase the tax burden on individuals and corporations with the explicit purpose of taxing accumulation of wealth encountered heavy resistance in Congress.[46] At that time, debates on tax policy issues crossed party lines and created voting abnormalities when Congress discussed new tax legislation.[47]

From then on, tax policy became a major issue in public and political discourse.[48] Tax legislation became more frequent, contributing to the development of the tax code as well as the growing complexity of the tax system. For example, taxation of businesses varied according to the size of the entity and the nature of the organization.[49] Special deductions, credits, and other provisions made the tax code denser.[50] Taxes on individuals varied depending on the amount of their income, their type of income, and the source of their income. At the same time, politicians and scholars began to criticize the complexity of the tax code.[51] Writing about

41. BROWNLEE, *supra* note 32, at 44. *See generally* WITTE, *supra* note 30, at 110; Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 BUFF. L. REV. 685 (1989) (discussing the transformation of the tax system from a "class tax" to a "mass tax").

42. WITTE, *supra* note 30, at 83.

43. President Harding recorded several speeches to the nation calling for a return to normalcy: "America's present need is not heroics but healing; not nostrums but normalcy; not revolution but restoration . . . not surgery but serenity." Warren G. Harding, U.S. President, Readjustment (May 14th, 1920), *available at* http://lcweb2.loc.gov/ammem/index.html (search "all collections" for "readjustment"; then follow "4. Readjustment" hyperlink under "Item Titles").

44. WITTE, *supra* note 30, at 89.

45. TABLE 23, *supra* note 14.

46. WITTE, *supra* note 30, at 101.

47. Opposition toward Roosevelt's initiatives from members of his own Democratic party is an example of such abnormalities. *Id.* at 102–04.

48. "Although government officials of earlier historical periods were aware that taxation affected matters such as capital investments and regional industry, they did not deliberately manipulate taxation to help manage the national economy." JULIAN E. ZELIZER, TAXING AMERICA: WILBUR D. MILLS, CONGRESS AND THE STATE, 1945-1957, at 12-14 (1998). For a detailed description of the postwar tax policy, see WITTE, *supra* note 30.

49. WITTE, *supra* note 30, at 108.

50. Sheldon D. Pollack, *Tax Complexity, Reform, and the Illusions of Tax Simplification*, 2 GEO. MASON INDEP. L. REV. 319, 328–34 (1994).

51. A movement for tax simplification led by T.S. Adams, a Yale economist, criticized the tax bills for being too complex and suggested that in the future this complexity would be beyond patching. WITTE, *supra* note 30, at 91.

how the 1935 revenue act was enacted, Treasury official Randolph Paul commented: "It is doubtful whether more than a handful of those who remained on the floor understood the complicated 236 page measure."[52]

The role of the Treasury administration in shaping tax policy increased during this period. The administration's activities shifted from simply calculating the revenues and expenditures needed for war finance, to planning ways to accomplish budgetary goals. Treasury officials thus took on a major part in the politics of taxation.[53] They initiated revenue legislation and participated in formulating revenue acts in tax committees.[54]

In the late 1930s, the legislative process reflected constant compromise between the administration, which typically sought expansion of the government, and Congress, which was dominated by Republicans and Southern Democrats who generally opposed this objective.[55] The Great Depression was a decade of unemployment and stagnancy.[56] President Franklin D. Roosevelt's New Deal plan of relief and social development programs between 1933 and 1938 involved substantial expansion of the executive branch, and resulted in a need to raise more revenue.[57] As a result, the maximum individual tax rates were increased to 63% in 1933 and reached 79% in 1936.[58] The increased tax rates lead to increased friction between taxpayers and the government. This led to higher rates of tax evasion and multiplied the number of tax disputes between individuals and the government.[59] The growing number of tax disputes underscored the need for reform of administrative and judicial settlement procedures.[60]

Several incidents in the late 1930s involving senators and governmental officials exacerbated concerns about tax evasion.[61]

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52. *Id.* at 102.

53. The Roosevelt years began and ended with Congress taking the initiative, but the administration was again the major actor in the important tax bills of 1935 and 1936. WITTE, *supra* note 30, at 109; *see also* BROWNLEE, *supra* note 32, at 80.

54. BROWNLEE, *supra* note 32, at 57.

55. WITTE, *supra* note 30, at 104–05.

56. *See generally* ROBERT S. MCELVAINE, THE GREAT DEPRESSION: AMERICA, 1929–1941 (1993) (discussing the social and economic consequences of the Great Depression).

57. W. Elliot Brownlee, *The Public Sector*, 3 CAMBRIDGE ECONOMIC HISTORY OF THE UNITED STATES 1039–40 (2000).

58. TABLE 23, *supra* note 14.

59. Assaf Likhovski, *The Duke and the Lady:* Helvering v. Gregory *and the History of Tax Avoidance Adjudication*, 25 CARDOZO L. REV. 953, 1000 (2004).

60. Traynor & Surrey, *supra* note 15.

61. Some of those tax avaidance incidents included officials of the Gulf Oil Corporation and the Chairman of the Board of the National City Bank of New York, Charles E. Mitchell. Assaf Likhovski, *The Duke and the Lady:* Helvering v. Gregory *and the History of Tax Avoidance Adjudication*, 25 CARDOZO L. REV. 953, 1007–08 (2004). The most famous case concerned the Republican Treasury Secretary Andrew Mellon. This case symbolized the political struggle between the New Deal administration and Republicans. *See* Stark, *supra* note 24, at 189. Mellon was considered one of

Roosevelt responded by campaigning for taxation of accumulated wealth; Congress instead adopted a slow and conservative approach.[62] Revenue acts were enacted almost every year in an attempt to close new loopholes and halt the exploitation of tax laws by wealthy individuals and corporations.[63] Reports published in 1937 described rich individuals sheltering money in foreign holding corporations, and incorporating their private yachts to escape taxation.[64] In a bipartisan move, the government established a special Joint Committee on Tax Evasion and Avoidance. Within weeks, the Committee produced a report on common evasion techniques used by the sixty-seven wealthiest families in the United States.[65] The report generated intense public reaction, and Congress responded by unanimously passing an act applying strict limitations on personal holding companies.[66] It was clear at that time that compliance levels had declined, and the relationship between taxpayers and the government had deteriorated. As a result of those developments there was a shift in tax legislation: whereas previously officials had cited a need to raise revenue or a desire to make the tax system more progressive, the tax acts of the late 1930s marked the beginning of complex and frequent

America's richest men, and he was responsible for tax policy and tax administration by virtue of his duty as Secretary of Treasury. Senator James Couzens accused Mellon of corruption, illegal favorable treatment of tax relief, granting tax benefits to Mellon's companies, and of reducing his income tax return by creating artificial losses. *Id.* at 189–90; *see also* BROWNLEE, *supra* note 32, at 79–80; Assaf Likhovski, *The Story of Gregory: How Are Tax Avoidance Cases Decided?*, *in* BUSINESS TAX STORIES 89, 123 (Steven A. Bank & Kirk J. Stark eds., 2005).

62. BROWNLEE, *supra* note 32, at 82.

63. BROWNLEE, *supra* note 32, at 94–97; SUSAN B. HANSEN, THE POLITICS OF TAXATION: REVENUE WITHOUT REPRESENTATION 105 (1983) (discussing how tax revenues were misused to political advantage as "Christmas tree" bills to confer benefits on many social groups); WITTE, *supra* note 30, at 103. For a different approach to the New Deal tax policy, see MARK H. LEFF, THE LIMITS OF SYMBOLIC REFORM: THE NEW DEAL AND TAXATION, 1933–1939, at 5–6 (1984) (arguing that the government tax policy during those years was not meant to shift the tax burden, but rather was a rhetorical and symbolic instrument).

64. *Tax Evasion*, N.Y. TIMES, May 29, 1937, at 16. In his 1936 re-election speech, Roosevelt stormed against what he called "economic royalists," meaning rich tax evaders who used family trusts, pension plans, and family partnerships to avoid high surtaxes and estate taxes. *Text of Roosevelt's Tax Evasion Message*, L.A. TIMES, June 2, 1937, at 8. It so happened that Eleanor Roosevelt was also suspected of tax avoidance activity by transferring money received for her radio performances. Kirk J. Stark, *The Unfulfilled Tax Legacy of Justice Robert H. Jackson*, 54 TAX L. REV. 171, 259 n.87 (2001).

65. Report of the Joint Comm. on Tax Evasion and Avoidance of the Cong. of the United States, H.R. Doc. No. 75-337 (1937).

66. Revenue Act of 1937, Pub. L. No. 75-377, § 337, 50 Stat. 813 (1937). This act contained adjustments to the Revenue Act concerning personal holding companies and was the second act passed addressing personal holding corporations. The previous act, which was enacted three years earlier, defined personal holding companies as any corporation wherein 80% or more of the corporation's income was derived from certain passive-type income, and more than 50% of the stock was owned by five or fewer individuals. Revenue Act of 1934, ch. 277, § 351, 48 Stat. 680, 751 (1934). Nevertheless, tax attorneys abused the 1934 act and developed sophisticated legal methods to avoid entering into that definition and in 1937 the definition of "personal holding corporation" was altered.

tax revisions enacted in response to tax evasion.[67] As a result, taxpayers increasingly sought advice from tax lawyers, and the courts were faced with a high volume of tax disputes.[68]

In conclusion, the income tax underwent a major transformation from the period of its adoption in 1913 to the eve of World War II. Although it began as a "class tax" and a marginal source of revenue, it became a "mass tax" with a highly progressive rate structure.[69] From a top rate of 7% in 1913, income was taxed at a maximum rate of 81% in 1940.[70] Consequently, the income tax developed into a major source of revenue to fund government expansion and war expenses.[71] Tax compliance also changed dramatically throughout this period. Complex tax laws and the cost of complying with those laws posed a major concern of the government and the tax administration.[72] In this climate, Traynor acted to improve the interwar tax system. The next section will examine how incoherent fiscal practices as well as inefficient institutional structures overloaded the interwar tax system and created substantial delays in resolving disputes. Those delays weakened the efficiency of the tax system, created uncertainties and confusion, and threatened the Treasury's ability to raise the necessary revenue.

II. INCOHERENT FISCAL PRACTICES AND TOO MUCH LAW

A. BREAKDOWN OF JUDICIAL TAX REVIEW

In the midst of the 1920s, there was a general public discomfort with the Bureau of Internal Revenue, which experienced difficulties coping with administrative problems produced by the relatively new broad-based income and profits tax.[73] Congress recognized the need to reduce the caseload of tax disputes and in 1924 established the Board of Tax Appeals as an independent agency within the executive branch of the government.[74] Centralized in Washington, the Board was composed of

67. Assaf Likhovski, *The Duke and the Lady:* Helvering v. Gregory *and the History of Tax Avoidance Adjudication*, 25 CARDOZO L. REV. 953, 983 n.126 (2004) (quoting Learned Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947) (discussing tax complexity as a result of the anti-avoidance approach)).

68. On the judiciary response to increasing tax evasion cases at that time, see Likhovski, *supra* note 59, at 982.

69. *See also* EUGENE C. STEUERLE, THE TAX DECADE: HOW TAXES CAME TO DOMINATE THE PUBLIC AGENDA 13 (1992); WITTE, *supra* note 30, at 110. *See generally* Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 BUFF. L. REV. 685 (1989).

70. TABLE 23, *supra* note 14.

71. WITTE, *supra* note 30, at 130.

72. Likhovski, *supra* note 59, at 967–68.

73. Theodore Tannenwald, Jr., The United States Tax Court: Yesterday, Today and Tomorrow, Erwin N. Griswold Lecture Before the Annual Meeting of the American College of Tax Counsel, San Antonio, Texas (Jan. 23, 1998), *in* 15 AM. J. TAX POL'Y 1, 2 (1998).

74. Revenue Act of 1924, Pub. L. No. 68-176, § 900, 43 Stat. 253.

seven members who were tax experts appointed by the president. It had parallel jurisdiction with the District Courts and the Court of Claims in suits for refund, and was subject to appellate review by the Circuit Courts of Appeal.[75] However, while the idea of establishing a special judicial-like body to rapidly resolve tax controversies made good sense, the Board had several weaknesses that defeated that purpose.

One of the Board's weaknesses was the fact that taxpayers could choose from three courts that possessed original jurisdiction over tax cases.[76] Many taxpayers opted for the Board of Tax Appeals because, as opposed to other jurisdictions, it did not require prepayment of tax liability.[77] Thus, the ease of filing a petition with the Board created a heavy load of cases.[78]

A second weakness of the Board was its limited jurisdiction. While the Board maintained original jurisdiction over tax matters that originated from a deficiency letter issued by the tax commissioner, it lacked authority over refund claims or any overpayment cases.[79] As a result, an issue decided by the Board could have received a different treatment in other federal courts, increasing the inconsistency of the tax system.[80]

Another weakness of the Board was related to its geographical location. Although the Board was based in Washington D.C., it had jurisdiction throughout the United States.[81] The Board traveled to all parts of the country, and appeared in each location once a year. Therefore, it had to accumulate enough petitions to justify visiting a certain location, which created huge delays and serious overload.[82] Because the Board was unable to hear most of the petitions filed with it, it was only a matter of time until the Board would fail to function under the sheer volume of the incoming petitions.

As a result of these weaknesses, and while "still very much in the

75. *Id.*

76. The taxpayer had the liberty to file a refund claim through the District Court or the Court of Claims, or a petition with the Board of Tax Appeals. *See* Traynor, *supra* note 20, at 1403.

77. *Id.* at 1396.

78. *Id.* at 1395, 1400.

79. This limited jurisdiction originated prior to the establishment of the Board, when the District Courts and the Court of Claims had the authority to adjudicate recovery of paid taxes and claims for refunds. *Id.* at 1402–03.

80. *Id.* at 1402–04.

81. A 1934 study showed that over 90% of Board cases were outside of Washington; seven states accounted for 59.5% of the cases, another seven states accounted for 16.9%, and the remaining 23% were spread over thirty-four other states, which emphasized the geographical spread of tax disputes before the Board. *Id.* at 1404–05.

82. "In fiscal year 1937–1938 the percentage of cases closed by Board decision after trial was only 19.1 percent—1,108 cases out of 5,799." *Id.* at 1396. "At the close of fiscal year 1938–1939 there were 7,864 cases involving $456,974,846 pending before the Board and the courts reviewing its decisions." Traynor & Surrey, *supra* note 15, at 337–38.

process of earning its reputation,"[83] the Board of Tax Appeals struggled to operate under an increasingly heavy load of petitions: 90.3% of cases closed in 1934 involved tax years prior to 1931, "66.3[%] involved tax years prior to 1930, and 37.3[%] involved tax years prior to 1929."[84] While waiting for a Board hearing, about 70% of petitions were closed by settlement with the Bureau of Internal Revenue.[85] However, nearly 5,000 new petitions were filed annually, leaving a large accumulation of cases for the year to come.[86] The great majority of the petitions involved only small dollar amounts or concerned factual questions, both of which could have been settled more efficiently and inexpensively between the taxpayer and the Bureau of Internal Revenue in purely administrative proceedings.[87] However, the tax system did not entail other mechanisms to solve the cases that did not require judicial-like review, and thus the system was inefficient.

B. Delays and Lack of Information

Taxpayers soon realized they could deliberately delay paying their tax obligation by filing a claim with the Board of Tax Appeals because the interwar tax system did not make a clear distinction between Board and administrative review of a case. Filing a petition with the Board should have marked the end of purely administrative review and the beginning of quasi-judicial consideration; but in fact, cases remained in administrative proceedings for at least two more years for further review by various Bureau officers.[88]

Although the majority of tax-dispute cases did not require judicial resolution and neither the taxpayer nor the government officials believed judicial review was necessary, delays in administrative settlement became a negotiation tool for the parties.[89] While Bureau officials had a common goal of settling the case administratively to rapidly recover unpaid tax liabilities, in reality, cases were pushed from one level to the next without being resolved. Initially, Bureau of Internal Revenue field office agents handled tax disputes.[90] If not resolved, the case was then transferred to the Conference Division, the Technical Staff and, if necessary, reviewed by the Office of Chief Counsel.[91] If not resolved by then, the Appeals

83. Stark, *supra* note 24, at 195.

84. Traynor, *supra* note 20, at 1394.

85. *Id.* at 1394 n.3.

86. Traynor & Surrey, *supra* note 15, at 338 & n.1a.

87. *See id.* at 339 ("By the close of the fiscal year 1938–1939 over 56% of the petitions filed with the Board involved amounts of less than $5,000 while over 38% involved amounts of less than $2,000.").

88. Traynor, *supra* note 20, at 1400.

89. *See id.* at 1399–1400.

90. *Id.* at 1399.

91. *Id.*

Division at the Bureau brought the case to the judicial level.[92] At each stage, Bureau officials had the authority to settle the tax dispute, whether in the administrative or judicial stage. Of the cases that ended with an agreement, about one-third were settled at the Technical Staff level and two thirds by the Appeals Division.[93]

While Bureau agents often offered to settle cases, many were reluctant to take responsibility for truly disposing of a case, knowing they could shift that responsibility to various other officers in the Bureau.[94] This gave taxpayers multiple settlement opportunities and encouraged them to litigate. Taxpayers could make one argument contesting their liability when they applied to the Board, then after multiple stages of review by field agents and other officials in the bureaucracy, they could assess which settlement offer was the best bargain.[95] By paying a ten dollar filing fee, a taxpayer who failed to pay his taxes or settle his case with the administration could defer his tax liability by entering the long Board line—even if he had not fully exhausted other settlement mechanisms.[96]

When the parties finally attended their long-awaited Board hearing, they were often surprised to learn about new issues not mentioned in the initial deficiency letter.[97] Taxpayers' inability to provide complete details in the petition to the Board, and the failure of the Bureau to demand full disclosure of the facts, created further delays for the Board, which now had to waste time compiling the necessary information. Had the administration known all the facts of the case beforehand, some cases would not have been disputed at all.[98] Since neither the taxpayer nor the commissioner could comprehend the correct legal treatment from the meager facts stated in the deficiencies, the government-taxpayer relationship was subjected to unnecessary strain and costs. At this point, the taxpayer had already sought professional advice, the Bureau had performed an investigation of the case, and the Board had to waste valuable time on a factual investigation instead of engaging in quasi-judicial review of important legal matters. This chain of events stemmed from the failure to obtain complete and accurate information from taxpayers before the Board hearing, and could have been avoided.

The constant delays in resolving tax disputes impaired tax collection, increased the likelihood of taxpayer default, and resulted in a substantial revenue loss for the government. Since years could pass between the

92. *Id.*
93. *Id.* at 1394.
94. *Id.* at 1399.
95. *Id.*
96. *Id.* at 1400.
97. *Id.* at 1401.
98. Traynor, *supra* note 20, at 1400–02.

filing date of a dispute and the final resolution, by the time of resolution the taxpayer might be in a different financial state, sometimes even insolvent.[99] Taxpayers were not required to provide any type of security when filing a petition with the Board. Consequently, in some cases, after long deliberation an issue could become merely a theoretical matter, due to the taxpayer's inability to pay the final judgment. In those days the government lost substantial amounts of revenue due to delays during which the taxpayer became unable to meet his full tax liability.[100]

C. Complexity and Uncertainty

The interwar tax system also produced high levels of confusion and uncertainty. Typically, six years passed between the date of the return and the decision of the Board of Tax Appeals. "As a rule, a case spent its first three years in the Bureau of Internal Revenue and its last three years in the Board of Tax Appeals."[101] However, the tax dispute was not over yet; many cases continued appellate litigation in the Circuit Courts for another two years, while others made it to the Supreme Court for another year. That meant it could take up to nine years for a tax dispute to be finally settled.[102] In the meantime, both the taxpayer and the government remained uncertain of the tax consequences.

Further complicating matters was the fact that the Board's decision-making lagged behind the legislative code. For example, when Congress solved problems from previous tax acts and enacted the Revenue Act of 1939, the Board was still interpreting the Revenue Acts of 1932 and 1934.[103] Before his appointment to United States Supreme Court and while serving as general counsel at the Bureau, Traynor's friend and supporter Robert H. Jackson criticized the interwar tax system, stating: "Some of the complexity, conflict and confusion in the tax law is due to the number of cooks who make the broth."[104] While testifying before the Joint Committee on Tax Evasion and Avoidance, Jackson claimed: "Many cases resulting in long periods of confusion and uncertainty in large litigation, and many unfair results could be cited in which the delay in learning what law the Court would apply has been responsible."[105] Appearing in front of Bureau tax lawyers, Jackson also noted: "You

99. *Id.* at 1396.

100. In fiscal year 1936–1937, over 11% ($1,745,203) of the total amount assessed after hearing Board decisions proved uncollectible. In fiscal year 1937–1938, jeopardy assessments totaling $45,867,553 in taxes, interest, and penalties were made in respect to 2,327 income tax returns. *Id.* at 1397.

101. *Id.* at 1393.

102. *Id.*

103. *Id.* at 1398.

104. Robert H. Jackson, *Equity in the Administration of Federal Taxes*, 13 Tax Mag. 641, 642 (1935).

105. *Id.* at 644.

might be shocked to know that [Bureau representatives] sometimes ... take opposite sides of the same question, whichever will be to the advantage of the revenues. I was shocked at the apparent dishonesty of that policy."[106]

Another example of the confusion inherent in the system was the inverted pyramid of multiple appellate reviews that produced opposite opinions in similar federal tax matters.[107] Taxpayers filing a tax claim could choose among the Board of Tax Appeals, the District Courts, and the Court of Claims. While the Board was the most popular choice, the other tribunals had equal precedent power and were subject to an appellate review by eleven Circuit Courts that sometimes issued contradictory decisions, thereby causing vagueness until the Supreme Court settled the matter (if at all).[108] Taxpayers and their counsels used this lack of uniformity to their advantage in devising tax schemes. They reviewed the latest decisions in each tribunal, and chose to litigate in a specific tribunal if they thought it would rule in their favor.[109] The Bureau was not free from those considerations, and there were situations in which the main reason for its assertion of a deficiency was to foster a circuit split.[110]

In short, the historical evidence shows that the U.S. system for resolving tax disputes in the interwar period failed its purpose. Taxpayers could defer their tax liability by simply looking for a glitch or ambiguity they could use as a basis for filing a tax dispute. As a result, the Commissioner was forced either to litigate or to settle to prevent delays or an unfavorable precedent.[111] Duplicate appellate reviews of the Board's decisions created uncertainties, and an incentive for taxpayers to try their luck in litigating.[112] A dispute that went as far as the Supreme Court could take nearly a decade to be resolved, by which time Congress

106. Stark, *supra* note 24, at 185. When discussing Justice Jackson's insights on federal tax litigation from his position as a career government lawyer, Stark described the problems of the interwar tax adjudication:

> Jackson ... focused on the delay and uncertainty associated with lengthy appellate consideration of disputed tax issues. Disputed legal issues often festered unresolved for several years, perhaps even decades, before the Supreme Court offered its "final" resolution. And not uncommonly ... Congress promptly amended the statute to reverse the Court's decision. Such extended litigation, in combination with aggressively self-interested reporting positions and limitations concerning prior taxable years, produced unfairness and complexity in the administration of the law.

Id. at 206–07.

107. For similar criticism of the interwar tax system, see generally Theodore Tannenwald, Jr., The Tax Litigation Process: Where It Is and Where It Is Going, Herman Gold Memorial Lecture (Sept. 11, 1989), *in* 44 REC. ASS'N B. CITY N.Y. 825 (1989).

108. Traynor, *supra* note 20, at 1403–04.

109. *Id.* at 1403.

110. Stark, *supra* note 24, at 200.

111. Traynor & Surrey, *supra* note 15, at 349.

112. *Id.*

might have amended the statutes to provide for a different tax treatment. With those problems in mind, Traynor partnered with Surrey and prepared a comprehensive reform proposal.[113] Its principles are described in the next section. However, in order to understand Traynor's influence in the field of taxation, first we have to understand how he came to the study of tax law and to collaborate with Surrey. An outline of Traynor's life story and his acquaintance with Surrey will be presented, followed by a detailed discussion of their idea of preventive tax policy.

III. PREVENTIVE TAX POLICY

A. TRAYNOR'S TAX EDUCATION AND HIS ENCOUNTER WITH STANLEY SURREY

> There is no sounder currency in the courts across the country than a Traynor opinion.[114]

Roger J. Traynor was born on February 12, 1900,[115] the son of Irish immigrants[116] who settled in the small town of Park City, Utah.[117] He received both his Ph.D. in political science and J.D. in the spring of 1927.[118] While studying law, Traynor discovered his passion for tax law, and soon thereafter, he received an appointment as a tax law professor at U.C. Berkeley's Boalt Hall.[119] Traynor taught a course called "Principles of Income and Inheritance Taxation," using a unique method of combining dry law with complex tax policy and jurisprudence considerations, exposing students to both the practical and philosophical aspects of taxation.[120] His influence over his students encouraged many of them to pursue careers in the field of taxation.[121]

As a man of many interests, Traynor enjoyed putting his practical knowledge of tax law to use in the public service. In 1932, Traynor advised the California State Board of Equalization on devising methods

113. *Id.* at 336.

114. Walter V. Schaefer, *The Supreme Court of California, 1981–1982, In Memoriam—Roger John Traynor: A Judge's Judge*, 71 CAL. L. REV. 1050, 1051 (1983).

115. Elizabeth Roth, *The Two Voices of Roger Traynor*, 27 AM. J. LEGAL HIST. 269, 288 (1983).

116. James R. McCall, *Roger Traynor: Teacher, Jurist, and Friend*, 35 HASTINGS L.J. 741, 743 (1984).

117. BEN FIELD, ACTIVISM IN PURSUIT OF THE PUBLIC INTEREST: THE JURISPRUDENCE OF CHIEF JUSTICE ROGER J. TRAYNOR 2 (2003).

118. McCall, *supra* note 116. Inspired by Thomas Reed Powell, his constitutional law professor, Traynor decided to pursue a law degree while working on his dissertation and teaching in the political science department. *Id.* at 743.

119. EDWARD JOHNSON, HISTORY OF THE SUPREME COURT JUSTICES OF CALIFORNIA, 1900–1950, at 182–93 (1966).

120. Adrian A. Kragen, *In Memoriam: Roger J. Traynor: Chief Justice Traynor and the Law of Taxation*, 35 HASTINGS L.J. 801 (1984).

121. *Id.* at 802.

of local taxation to raise additional revenue.[122] He helped in drafting the retail sales tax,[123] the use tax,[124] the Bank and Corporation Franchise Tax Act[125] and the Personal Income Tax Act of 1935.[126] Those state taxes survived battles challenging their constitutionality, and served as models in many states and countries as central sources of local revenue.[127] In 1937, while Traynor was a tax counsel to California's Board of Equalization, he was appointed consulting expert in the Federal Office of the Secretary of the Treasury.[128] Throughout his federal service, Traynor collaborated with Surrey on ways to improve the federal tax administration system.

Traynor and Surrey worked together at the Treasury Department, and shared a passion for tax law. In 1937, Traynor became a consultant expert to the Treasury and chose Surrey, then a young assistant legislative counsel at the Treasury, as a reliable co-author and collaborator.[129] One of their mutual projects was to review the effort to prevent taxpayers' misuse of the statute of limitations on deficiencies and refunds.[130] Their recommendations were incorporated into section 820 of the 1938 Revenue Act.[131]

Traynor and Surrey continued to develop a critical analysis of contemporary tax problems. Their tax policy sought to balance the need to effectively collect revenue with the fundamental principal of taxation in accordance with the ability of taxpayers to pay.[132] Their goal was to

122. *See id.*

123. Retail Sales Tax Act of 1933, ch. 1020, 1933 Cal. Stat. 2599.

124. Use Tax Act of 1935, ch. 361, 1935 Cal. Stat. 1297.

125. Act of Mar. 1, 1929, ch. 13, 1929 Cal. Stat. 19.

126. Personal Income Tax Act, ch. 659, 1943 Cal. Stat. 2354.

127. Kragen, *supra* note 120, at 802.

128. *See id.* Since there were provisions of the Executive Order of 1873 prohibiting federal employees from holding office under any state, territorial or municipal government, President Roosevelt had to use his vested authority and sign a waiver to permit Roger Traynor to hold this position. *See* Exec. Order No. 7708, 2 Fed. Reg. 2167 (Sept. 16, 1937).

129. Although Traynor and Surrey wrote two articles together on their preventive tax policy project, the first article appeared only with Traynor as its author. Traynor acknowledged Surrey's contribution: "At his own request the name of Mr. Stanley S. Surrey does not appear as co-author, although this article could not have been written without his unselfish interest and cooperation." Traynor, *supra* note 20, at 1393, n.*.

130. Traynor collaborated with Professors John M. Maguire and Stanley S. Surrey and proposed a complete revision of the administrative provisions of the income tax system. The three professors wrote a series of articles explaining this reform and the remaining loopholes that need to be closed. *See, e.g.*, John M. Maguire, Stanley S. Surrey & Roger J. Traynor, *Section 820 of the Revenue Act of 1938*, 48 YALE L. J. 509 (1939).

131. Revenue Act of 1938, Pub. L. No. 75-554, § 820, 52 Stat. 447, 581–83.

132. Traynor & Surrey, *supra* note 15, at 336 (1940). The principle of "ability to pay" denotes the theory of progressive taxation by which the government imposes gradually increasing tax rates as the income to which the rate is applied increases. *See* Slade M. Kendrick, *The Ability-to-Pay Theory of Taxation*, 29 AM. ECON. REV. 92 (Mar., 1939) (describing the justification for this policy).

create what they called a "preventive tax policy."[133] The goal of the policy was two-fold: to prevent tax disputes from arising, or reaching the judicial system, by improving the predictability, clarity and unity of the tax code (ex ante prevention), and to produce more effective administrative and judicial procedures for the swift resolution of those that did arise (ex post treatment).

B. *Ex Ante* Preventive Tax Policy

1. *Precluding Initiation of Disputes*

Traynor and Surrey thought it was essential for the tax system to attain equilibrium between equality and complexity.[134] Such a balance, they said, is like "an arrangement of cargo for the holds of a ship if they are to equilibrate the incidence of a variety of taxes."[135] Much of the complexity of the tax system is designed to protect taxpayers by creating progressive tax rates, various tax deductions, and credits. Those measures serve to regulate and redistribute society's resources. Nevertheless, they believed, the tax system must also retain a sufficient level of simplicity.[136]

As a first step toward avoiding tax disputes, Traynor and Surrey urged making the tax code clearer for two reasons. First, complex regulations without proper guidelines or clarification force taxpayers to "construe them at their peril."[137] Second, predictability of the law is essential for society, as taxpayers who are overwhelmed by the scope of the law are unable to fully comply with it.[138] As new circumstances arise over time, complicated tax rules make it difficult for taxpayers to know what the tax implications will be for a given transaction. Taxpayers seek confidence when planning their business and family affairs, and any vagueness can result in unnecessary tax litigation.[139]

2. *Advancing the Administrative Disposition of Tax Disputes*

The next step, Traynor and Surrey emphasized, is to improve the function of preliminary administrative negotiations between the taxpayer and the local revenue agent, because a great number of the deficiencies, particularly in small cases, could have been disposed of that way.[140] They

133. Traynor & Surrey, *supra* note 15, at 352.

134. *Id.* at 336. Justice Robert H. Jackson was one of the critics of the complexity of the interwar tax system. Stark, *supra* note 24, at 187. Further, he opposed the notion that complexity might serve other important purposes, such as fairness. *Id.* He criticized the "elaborate procedural apparatus as institutional overkill in the need of reform." *Id.*

135. Traynor & Surrey, *supra* note 15, at 336.

136. *Id.*

137. *Id.* at 353.

138. *Id.*

139. *Id.*

140. *Id.* at 338.

stressed the need for competent and fair handling of initial negotiations in order to provide the taxpayer with an informal, non-judicial, and inexpensive opportunity to settle the matter. If necessary, a case of particular importance could be further clarified by a conference of tax experts at the Bureau of Internal Revenue. The purpose of the conference would be to provide responsible examination of the issue and, at its conclusion, produce an official report.[141] At the end of this process, the taxpayer would be confident the case had been thoroughly considered, and both parties would be ready to defend their position in a judicial proceeding if necessary.[142]

If the matter was not settled in the conference, the commissioner would notify the taxpayer regarding the proposed deficiency, and the taxpayer could reply by filing a detailed protest to the commissioner.[143] The taxpayer would be required to give a full disclosure of the facts in the protest letter and provide a statement of all the transactions involved. Failure to file would result in a deficiency letter.[144] The proposed protest would be in writing, under oath, and contain all the information and documents relevant to the case. They emphasized that the statement would thus clear all factual issues and restrict any remaining controversy to legal questions. Furthermore, Traynor and Surrey suggested that the highest-ranking experts in the bureau should review this statement because they had the authority to correct the mistakes of their office and to prevent unnecessary litigation.[145]

The proposed protest procedure would shift the burden of proof to the taxpayer, making it the latter's responsibility to disclose information in his or her complete control.[146] It aimed to eliminate the ineffectiveness of the existing mechanism, which at that time provided poor and inadequate information.[147] The proposed disclosure requirement, which cost the taxpayer little because all the facts were in his or her possession, was crucial to the determination of the matter, and was in accordance with the self-assessment principle by which a return is filed. By the end of the protest procedure, the commissioner would issue a final deficiency notice, stating the specific finding, allowing the taxpayer to make a rational decision whether to pursue the matter with the Board of Tax Appeals.[148] Further structure would be imposed on this process as well.

141. *Id.* at 343.
142. *Id.* at 344.
143. *Id.* at 339.
144. *Id.*
145. *Id.* at 344.
146. *Id.*
147. On average, about 67.4% of the total amount of deficiencies, which the Commissioner was forced to abandon, reveal the difficulty of attempting to determine tax liabilities without full and accurate information. Traynor, *supra* note 20, at 1401.
148. Traynor & Surrey, *supra* note 15, at 340–41.

For example, during the hearing before the Board of Tax Appeals, the taxpayer would be confined to the grounds, documents and facts outlined in his protest. Likewise, the commissioner would be limited to the finding of facts in the deficiency notice.[149]

3. The Origins of the Closing Agreement and Private Letter Ruling

Further thinking on ways to improve the communication between the government and taxpayers led Traynor and Surrey to propose a two-step preventive tax policy, known today as the "private letter ruling" and "closing agreement." A "private letter ruling" is a written statement issued to a taxpayer by the IRS that interprets and applies the tax laws to the taxpayer's specific set of facts. Once issued, a letter ruling may be revoked or modified unless it is accompanied by a closing agreement.[150] A "closing agreement" is an agreement between the taxpayer and the government on the tax consequence of a specific set of facts. It is usually requested by the taxpayer who provides all facts and documentation and shows good reasons for requesting an agreement with the government. The agreement can address either the specific transaction or the total liability of the taxpayer.[151]

Traynor and Surrey proposed to establish a method of customized "declaratory administrative ruling" designed to determine the tax consequences of proposed transactions.[152] Furthermore, they suggested forming a binding "closing agreement" between the commissioner and the taxpayer, approved by the Secretary of the Treasury, which would end all disputes related to the facts at hand.[153]

Their proposal improved the existing closing agreements of that time by adding that agreements should relate to either a particular transaction's present or future tax consequences, whether it was an issue of fact or law.[154] The proposed procedures would thus enable taxpayers to ascertain the Bureau's stand on a given future transaction. Furthermore, their proposal would not only inform taxpayers of the Bureau's position on current tax issues (as issued in private letter rulings), but also would allow them to plan ahead as to whether to accept the administration's opinion and enter into an agreement with the Bureau (closing agreement), or proceed with litigating the matter in the courts.[155] For example, a taxpayer who wants to establish a trust in which he will retain some control of the flow of income to various beneficiaries can request the Bureau's ruling that the income is not taxable to him as a grantor,

149. *Id.* at 344.
150. Rev. Proc. 92-1, 1992-1 I.R.B. 519.
151. Rev. Proc. 68-16, 1968-1 I.R.B. 246.
152. Traynor & Surrey, *supra* note 15, at 353–56.
153. *Id.* at 354–56.
154. Traynor & Surrey, *supra* note 15, at 354–56.
155. *Id.*

and then enter into a binding agreement on those facts for the duration of the trust.

Traynor and Surrey claimed that applying binding agreements to current and future transactions, not just past transactions, would benefit both the taxpayer and the government.[156] The government would benefit because litigation overload would be reduced, as the agreement would prevent taxpayers from arguing later for a different tax result. Taxpayers would enjoy protection from future changes in administrative or judicial resolutions regarding the subject matter of the agreement.[157] If such changes occurred, the Bureau would have to apply the previous tax treatment stated in the binding agreement with the taxpayer.

C. *Ex Post* Tax Policy

After a tax matter had already reached the point of formal litigation, reducing the time required for a resolution was the primary concern for Traynor and Surrey.[158]

1. Reducing the Incentive to Litigate

One of the apparent problems in the late 1930s was the obvious incentive that taxpayers had to file a petition with the Board of Tax Appeals. Filing with the Board did not require prepayment of tax liability.[159] Thus, when given the choice between two identical procedures, taxpayers opted for the one that deferred their tax liability and did not involve initial payment.[160] Traynor and Surrey recommended extending the Board's jurisdiction to include not only refund cases (when the taxpayer files for recovery of paid taxes) but also deficiency procedures initiated by the Bureau when tax liability was alleged to be higher than what was reported by the taxpayer.[161] Thereafter they proposed that the taxpayer be required to post a bond prior to filing a petition with the Board in order to secure the collectibility of tax by the Bureau later on.[162] The proposed bond, they said, should not exceed the amount of deficiency in question excluding interest, and the taxpayer would be able to replace it at any time with other forms of security.[163] The Board would have the authority to waive this security requirement.[164]

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156. *Id.* at 355.

157. *Id.* At that time, Congress did not want to limit this legislative freedom, thus both the regulations and each particular closing agreement stated that the agreement was subject to future change in the statutory law. *Id.*

158. *Id.* at 345.

159. *See id.* at 338.

160. *Id.* at 347.

161. *Id.* at 347–48.

162. Traynor, *supra* note 20, at 1433–35.

163. Traynor & Surrey, *supra* note 15, at 348.

164. *Id.*

An additional method of lowering the volume of tax litigation, suggested Traynor and Surrey, was imposing a requirement to use administrative procedures before filing a lawsuit.[165] They recommended adopting an exhaustion-of-remedies doctrine in tax matters, which would require that certain administrative procedures be initiated and followed before taxpayers could seek relief from the Board or the courts.[166]

2. The Establishment of a Single Court of Tax Appeals

Multiple appellate reviews of Board of Tax Appeals decisions created conflicting decisions and uncertainties in the interwar period. Due to differences of opinions among the circuit courts, a decision granted in one circuit court did not close the door to litigating the matter in another circuit court in hope of reaching a different outcome.[167] For example, in 1930 the Board of Tax Appeals denied a deduction made by a taxpayer for a loss on a sale of property to his wholly owned corporation.[168] That decision was reversed in a matter brought before the Court of Appeals for the District of Columbia in 1934,[169] and the Supreme Court denied certiorari.[170] The Second, Eighth and Ninth Circuit Courts of Appeals subsequently rendered similar decisions in such loss deduction cases brought before them.[171] However, in 1939, the Board's view was reconfirmed by a decision of the Seventh Circuit Court of Appeals.[172] Consequently, the Supreme Court granted certiorari and held that such losses were not deductible.[173]

In order to eliminate such uncertainties and to achieve uniformity in tax adjudication, Traynor and Surrey suggested passing the exclusive authority to decide cases of income, estate, and gift tax to the Board of Tax Appeals. This proposal aimed to transfer the review of tax disputes to professional tax experts who were better qualified than the average district court judge.[174] As for appellate review, they recommended establishing a single Court of Tax Appeals, which would have sole appellate jurisdiction over the Board's decisions.[175] The proposed court

165. Traynor, *supra* note 20, at 1411–18.

166. *Id.* at 1412, 1417.

167. Traynor & Surrey, *supra* note 15, at 349–52.

168. Jones v. Comm'r, 18 B.T.A. 1225, 1230 (1930).

169. Jones v. Helvering, 71 F.2d 214, 218 (D.C. Cir. 1934).

170. Helvering v. Jones, 293 U.S. 583 (1934).

171. Helvering v. Johnson, 104 F.2d 140, 144 (8th Cir. 1939); Smith v. Higgins, 102 F.2d 456, 458 (2d Cir. 1939); Foster v. Comm'r, 96 F.2d 130, 133 (2d Cir. 1938); Comm'r v. McCreery, 83 F.2d 817 (9th Cir. 1936); Comm'r v. Eldridge, 79 F.2d 629, 631 (9th Cir. 1935); *see also* Traynor & Surrey, *supra* note 15, at 350.

172. Comm'r v. Griffiths, 103 F.2d 110, 114 (7th Cir. 1939).

173. Comm'r v. Griffiths, 308 U.S. 355 (1939).

174. Traynor & Surrey, *supra* note 15, at 345–48.

175. *Id.* Traynor and Surrey provided other options to establishing a Court of Tax Appeals, such as expanding the jurisdiction of the Court of Tax Appeals for the District of Columbia, or the Courts of Claims. *Id.*

would supervise the divisions of the Board and promulgate the regulations governing their procedure. Appeals from the Court of Tax Appeals would require a grant of certiorari from the Supreme Court. If certiorari were denied, the Court of Tax Appeals decision would constitute a final, binding resolution on the parties, not an invitation to further litigate the matter, as was the practice at the time.[176]

IV. PREVENTIVE TAX POLICY: DEFEATED?

After this joint project, Traynor and Surrey parted ways. Surrey joined the law faculty at Berkeley and then Harvard and continued his public service, while Traynor was nominated to the Supreme Court of California. Their proposals to improve the interwar tax system were not fully accepted. While trying to put their innovative philosophy of preventive tax policy into practice, they encountered the limitations of reality and political constraints. Specifically, the operative part of their proposal aroused a storm of criticism.[177] Nevertheless, parts of their proposal were later adopted, contributing greatly to the development of the U.S. tax system. Furthermore, from his distinguished bench, Traynor promoted the philosophy of preventive tax policy when presented with state tax cases. This section presents the practice of preventive tax policy in Traynor's state tax decisions, along with historical review of the implementation of Traynor and Surrey's proposal in federal tax law, then and today.

A. THE TRAYNOR SYSTEM OF TAX ADJUDICATION

Traynor's nomination to the Supreme Court of California did not mark the end of his proposal for a preventive tax policy, but rather the beginning of its practice. In 1940, Traynor was appointed to the Supreme Court after a public debate over an earlier appointee.[178] Governor Culbert Olson had nominated Max Radin, Traynor's old Berkeley colleague, to the state Supreme Court, but the State Qualifications Committee rejected this appointment fearing Radin's radical tendencies.[179] Olson called Radin to ask his advice on a substitute nominee, and Radin recommended Traynor.[180] Appointed when he was

176. Traynor, *supra* note 20, at 1427–29.

177. *See, e.g.*, Montgomery B. Angell, *Procedural Reform in the Judicial Review of Controversies Under the Internal Revenue Statutes: An Answer to a Proposal*, 34 ILL. L. REV. 151 (1939); E. Barrett Prettyman, *A Comment on the Traynor Plan for Revision of Federal Tax Procedure*, 27 GEO. L.J. 1038 (1939); J.S. Seidman, *Proposed Procedural Changes in Federal Tax Practice*, 67 J. ACCOUNTANCY 221 (1939); William A. Sutherland, *New Roads to the Settlement of Tax Controversies: A Critical Comment*, 7 LAW & CONTEMP PROBS. 359 (1940); Aaron G. Youngquist, *Proposed Radical Changes in the Federal Tax Machinery*, 25 A.B.A. J. 291 (1939).

178. Schaefer, *supra* note 114, at 1050.

179. *Traynor Named to High Bench, Olson Raps Commission for Rejecting Max Radin, Another U.C. Educator*, L.A. TIMES, Aug. 1, 1940, at 1.

180. FIELD, *supra* note 3, at 5.

forty years old, Traynor was the youngest member of the California Supreme Court and the first academic lawyer appointed to the Court.[181] He served as Chief Justice from 1964 until his retirement in 1970.[182]

In the beginning of the 1930s, the jurisprudential ideas of Legal Realism emerged as a reaction to formalism, and later attracted many New Deal jurists.[183] To some, Roger Traynor might seem typical of many liberal New Dealers in his belief in administrative expertise and judicial passivity.[184] However, a closer look at his jurisprudence reveals a more complex outlook on law, reform, and the role of the judge as policymaker. Exposed to the ideas of Realism by his Berkeley professor, Thomas Reed Powell, Traynor believed judges should not direct their opinion by their desired outcome but should look beyond the mere facts of the case and consider social and environmental data.[185]

Consequently, in his judicial decisions, Traynor advocated his preventive tax policy by grounding the tax code in the real world. Although he resented the phrase "judicial activism,"[186] he felt it was important for judges to employ "judicial creativity"[187] to overrule old precedents and bridge gaps between tax law and the constantly changing everyday world. Only those innovations that connect the law with reality and social changes are desired legal changes, those that venture "new answers to old questions."[188] Accordingly, in *Sutter-Yuba Investment Co.*

181. James R. McCall, *A Basic Concern for Process: Commentary on Quo Vadis, Prospective Overruling*, 50 HASTINGS L.J. 805, 806 (1999).

182. Kragen, *supra* note 1.

183. Neil Duxbury contended that realist jurisprudence was never a "revolt against formalism" and the movement away from formalist legal thinking was very slow and hesitant. NEIL DUXBURY, PATTERNS OF AMERICAN JURISPRUDENCE 3 (1995). In his opinion there was no realist movement; it was nothing more than an "intellectual mood" and "a complex array of messages, some of which seemed rather feeble once placed in an institutional context." *Id.* at 4.

184. For a discussion of the effect of New Deal lawyers in the judiciary see Sanford N. Greenberg, *Ironies of Administrative Law*, 72 CHI.-KENT L. REV. 1349 (1997); Thomas W. Merrill, *Capture Theory and the Courts: 1967–1983*, 72 CHI.-KENT L. REV. 1039, 1055–59 (1997). For an intellectual history of the New Deal legal thinking, see generally PETER H. IRONS, THE NEW DEAL LAWYERS (1982); LAURA KALMAN, LEGAL REALISM AT YALE 1927–1960 (1986). For a comprehensive analysis of American legal realism, see generally LAWRENCE FRIEDMAN, AMERICAN LAW IN THE TWENTIETH CENTURY (2002); MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870–1960: THE CRISIS OF LEGAL ORTHODOXY (1992); WILLIAM NELSON, THE LEGALIST REFORMATION: LAW, POLITICS, AND IDEOLOGY IN NEW YORK 1920–1980 (2001).

185. Roger J. Traynor, *Better Days in Court for a New Day's Problem*, 17 VAND. L. REV. 109, 109 (1963).

186. A term used to describe the Supreme Court's use of its interpretation power to achieve social goals. Activist judges, Traynor thought, undermine the law by making too many changes that impair its stability. FIELD, *supra* note 3, at 121.

187. An analytical and creative judge "bears no relation to that ill-defined character, the so-called judicial activist." Roger J. Traynor, *The Limits of Judicial Creativity*, 63 IOWA L. REV. 1, 2 (1977). Judicial creativity, he theorized, occurs when the judge succeeds in persuading the involved parties and the legal community of the necessity of modifying existing law. *Id.*

188. Robert B. McKay, *Constitutional Law: Idea in the Public Forum*, 53 CAL. L. REV. 67, 67

v. Waste,[189] Traynor bridged the gap between the "dry law" and the new reality he faced in this case.[190] He decided that although state law allowed taxpayers the right of redemption until disposal of their property, it does not allow them to escape paying their taxes while local authorities held on to their delinquent property.[191]

In further attempt to promote his preventive tax policy Traynor engaged in clear and consistent interpretation of the law that would give guidance to taxpayers and allow them to predict the tax implications of future transactions. In his opinion, the role of the judge was significant in preserving the consistency, predictability, and unity of the law. Inconsistent decisions puzzled both taxpayers and the administration, and created incentives to litigate in order to achieve different results. One way of promoting this consistency was by looking to the legislative intent behind the tax law. By tethering the letter of the law to the purposes behind it, as expressed in the legislative history, Traynor could help ensure that the law would be interpreted consistently over time, and not be subject to the vagaries of different and conflicting judicial understanding. Thus, in the case of *Roehm v. Orange County*, Traynor exhibited this interpretative style by examining the legislative history of article XIII, section 14 of the California Constitution and concluding that liquor licenses were not historically intended to be subject to *ad valorem* taxation.[192]

(1965).

189. Sutter-Yuba Inv. Co. v. Waste, 136 P.2d 11, 12 (Cal. 1943). Although this seemed to be a straightforward redemption of property case, it had significant consequences for the overall process of calculating the tax liability on delinquent property. In this case, the taxpayer contended he should not have to pay taxes imposed on delinquent property for the years it was held by the local government. *Id.* at 12.

190. *Id.* at 14. A tax policy issue was at stake that could seriously affect the redemption process of tax delinquent property. Traynor decided to reject the taxpayer's contention, and stated that taxes for that period must be included in calculating the redemption cost. He considered the inevitable repercussions of a decision to accept the taxpayer's interpretation of the law. "If [the county] did not require that redemption prices take into account taxes imposed had the property not been deeded to the state, owners would find it advantageous to allow their property to be deeded to the state with the intention of delaying redemption as long as possible to escape taxes that attended ownership." *Id.*

191. *Id.* Twenty years later, another tax redemption case came to Traynor's desk. People v. Lucas, 360 P.2d 321 (Cal. 1961). This time Traynor believed that a wrong judgment might give taxpayers an incentive to loot their tax-deeded property before its seizure by the government. *Id.* at 324. The defendants in this case sold timber cut from tax-deeded land. When they were required to pay their taxes, they claimed the amount they paid to redeem the property included taxes on the value added to the land by the timber before it was removed. They asserted that by paying a redemption price based on the value of the land including the timber, they have in effect paid the state for the timber. *Id.* at 322. In rejecting their contention, Traynor was concerned that owners of tax-deeded property would extract its natural resources and then argue that the harvest is excluded from the tax deed on the property. *Id.* at 324.

192. 196 P.2d 550, 556–57 (Cal. 1948). Traynor demonstrated how the framers of the amendments of Article XIII and generations of Supreme Court decisions sustained the view that only intangibles listed in the Constitution were taxable property. *Id.* at 563. Foreseeing the administrative problems of

Another goal of Traynor's preventive tax policy was to give clarity to the law by using lots of details and examples in his tax opinions, perhaps drawing his experiences as a teacher and scholar on the bench. Hence, his opinions employed a sort of scientific, pedagogical air to them by portraying his decisions as an objective analysis of the facts and inevitable result of the public interest.[193] His thoughtful opinions provided extensive details and examples, in the hope that these careful expositions would guide taxpayers, Bureau agents and fellow judges in future cases, thus preventing further litigation. For example, in *Estate of Law v. Kirkwood*, Traynor provided details and examples of how to compute marital deductions in the estate tax.[194] Similar to a textbook solution, Traynor constructed a table comparing the controller's computation to the executor's computation, followed by a detailed explanation of their differences, and supported by relevant sections of the Revenue Code. Thus, this decision appeared to be more a "class exercise" than a traditional judicial opinion and involved a deep understanding of accounting. It was important to Traynor to explain and demonstrate his calculations so it would be clear for future estate executors how to apply the convoluted law.[195]

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future taxation of intangible property, Traynor noted that among the absurdities of such taxation would be taxing life insurance policies, which would result in increasing tax avoidance by exchanging taxable intangible assets for tax-free intangible assets. *Id.* at 556. To be cautious, Traynor added that in case the Legislature was not satisfied with his ruling in this matter, it has the vested power to change the terms of the license. *Id.* at 557. Familiar with the bureaucracy and the legislation process, Traynor warned that such a change should be accomplished by a proper constitutional ratification process and not by an administrative procedure. *Id.*

193. This process of inquiry is similar to the Pragmatists' concept of scientific method. *See* FIELD, *supra* note 3, at 9–14. Legal pragmatism is a nineteenth century philosophic school that emphasized the importance of context and the eclectic nature of the law. *See generally* RICHARD A. POSNER, LAW, PRAGMATISM, AND DEMOCRACY (2003) (discussing principles of legal pragmatism).

194. Estate of Law v. Kirkwood, 325 P.2d 449, 449, 451 (Cal. 1958). In this case, the deceased's will provided that his estate taxes should be paid out of the residuary estate. The controller subtracted all the allowable deductions including federal estate tax from the fair market value of the estate. Then the controller declared half of the remainder of the estate as a marital deduction. *Id.* at 449. The executor of the will objected to this calculation arguing that the marital deduction should have been subtracted from the fair market value of the estate *prior* to the deduction of the federal estate tax. *Id.* at 451. Traynor affirmed the controller's computation, holding the marital deduction was properly determined. He detailed the way to compute the estate tax by first subtracting federal estate taxes to ascertain the clear market value of the estate. Traynor stated the marital deduction should be determined only then, and from that clear market value. *Id.* at 451.

195. Another example of Traynor's academic opinions came a few years later, in the dissenting opinion of *Rosemary Properties v. McColgan*, 177 P.2d 757, 766 (Cal. 1947). At issue was the matter of the deductibility of dividends received by a corporation under section 8(h) of the Bank and Corporation Franchise Tax Act. *Id.* at 758. The majority opinion in this case agreed with the plaintiff, holding that any dividend paid from earnings and profits would be a dividend paid out of income included in the measure of the tax and, as such, the recipient corporation was exempt from franchise tax on that dividend. *Id.* at 762. In a long and detailed dissenting opinion, Traynor incorporated an illustration of the differences between "income" and "earning and profits"; the latter included a deduction of federal taxes. *Id.* at 767. Next, Traynor provided a mathematical example to demonstrate

Finally, in an effort to prevent unnecessary tax litigation by encouraging administrative settlement of tax controversies (ex post preventive tax policy), Traynor established a judicial rule by which taxpayers must provide full information and properly communicate with the administrative agencies in order to be eligible to seek judicial relief. Accordingly, in *West Publishing Co. v. McColgan*, he established a requirement that taxpayers provide the Bureau with the necessary information prior to filing a lawsuit with the court.[196] The taxpayer, Traynor held, cannot call upon the court's help to determine whether agencies acted properly when it refuses to submit issues of fact to such agencies.[197] In *Star-Kist Foods v. Quinn*,[198] Traynor continued to implement this idea by establishing a rule that taxpayers could not receive remedies from the court unless they had exhausted their remedies with the tax administration.[199]

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the differences between "net income" and "earning and profits." *Id.* at 768. His opinion detailed the majority's mistake of allowing the plaintiff to declare dividends out of "earning and profits" in excess of the "net income" even though no tax was paid on this excess. *Id.*

196. West Pub. Co. v. McColgan, 166 P.2d 861, 865 (Cal. 1946). In this case, the taxpayer was a Minnesota corporation engaged in the business of selling law books and other publications. The corporation shipped its books to California from orders taken in California by its employees. *Id.* at 862. However, it refused to file returns under the California Income Tax Act or to furnish any information requested by the commissioner, claiming that the tax levied under the Bank and Corporation Income Tax Act was an unconstitutional California tax on a foreign corporation engaged in interstate commerce. *Id.* at 862–63. Without the information he requested, the commissioner had no choice but to acquire data from the State Board of Equalization and to estimate the company's income. *Id.* at 865.

197. *Id.* Traynor concluded that taxpayers cannot complain of errors in the computation of their tax liability when they refuse to avail themselves of administrative remedies to prevent or correct such errors. *Id.*

198. Star-Kist Foods v. Quinn, 54 Cal. 2d 507 (Cal. 1960). The issue in this case was erroneous assessments. Although the taxpayer had the option to apply to the Board of Equalization for the correction of his return, he instead filed a claim in court seeking a writ of mandate against the tax assessor to cancel the assessments. *Id.* at 509. Traynor was familiar with this issue, as he had written extensively on the problem of the taxpayer's choice according to the affordability of the dispute resolution mechanism. He claimed that taxpayers often chose the less-expensive option of filing a court claim before exhausting other appellate mechanisms, which overloaded the court system with unnecessary litigation. *Id.* at 511. Reversing the trial court judgment, Traynor held that since the only issue was the constitutionality of California's Tax Code, the taxpayer was not required to file with the Board of Equalization before it sought a judicial determination. However, since the taxpayer had a plain, speedy, and adequate remedy in the ordinary course of law by paying the tax under protest and then seeking to recover it, the court held that the writ of mandate was not available to the taxpayer. *Id.* at 510.

199. *Star-Kist Foods*, 354 P.2d at 3.

> Star-Kist, however, could have obtained relief by paying its taxes under protest and suing for recovery thereof . . . . Mandate is ordinarily denied when the petitioner has a plain, speedy, and adequate remedy in the ordinary course of law. . . . In more recent cases, however, the adequacy of such remedies has been considered and mandate has been denied. . . . The fact that Star-Kist filed its petition for mandate before the assessment was complete, however, does not affect the adequacy of its remedy by payment of taxes under protest and suit for recovery thereof.

Id. (citations omitted).

B. TODAY'S IMPLEMENTATION OF PREVENTIVE TAX MEASURES

By the late 1930s, the idea of a tax appellate tribunal had gained momentum primarily due to Traynor and Surrey's proposal.[200] However, eventually Congress rejected the proposal to establish a single Court of Tax Appeals because some of its members refused to grant life tenure and judicial power to the Board members. Many articles have been written on the need for final judicial authority in tax matters,[201] but the idea has continuously been rejected by the legislative branch.[202]

A few years later, the Revenue Act of 1942 changed the name of the Board to the Tax Court of the United States, elevating the status of the Board to a judicial body and its members to judges. Over two decades later, the Tax Reform Act of 1969 changed the court's characterization: it would no longer be considered an agency within the executive branch but rather a court under Article I of the Constitution (and thus enjoy a higher status), a change which had been suggested by Traynor and Surrey.[203] This Act also created a category of small tax cases which were to be decided by special tax trial judges, thus removing the burden of small tax matters from the rest of the Tax Court docket.

Nevertheless, one of the most significant changes the Tax Court has experienced in the last decade is in its role as a fact finder, a problem which Traynor and Surrey had raised in their reform plan. Today's Tax Court judges are involved in pre-trial activities, and when necessary, conduct inquiries to inform themselves about the facts of the case.[204] While judges in the past were limited to the information in the petition or the deficiency letter, Tax Court judges today have become involved in obtaining the necessary information themselves through modern means of communication such as telephones, facsimiles, emails, video conferences, and other electronic methods.[205] Moreover, in recent times, the Tax Court has established a preventive practice with the California

200. Justice Robert H. Jackson also recommended the establishment of a centralized tax tribunal as a final appellate tax review, stressing its retrospective character as interpreting tax cases in light of the tax changes over the years. He suggested that the members of the congressional committee will sit in this court, with a notion of harmonious interpretation of the tax court. Stark, *supra* note 24, at 188.

201. *See, e.g.*, Mortimer M. Caplin & Stuart L. Brown, *A New U.S. Court of Tax Appeals: S. 678*, 57 TAXES 360, 363 (1979); Martin D. Ginsberg, *Making Tax Law Through Judicial Process*, 70 A.B.A. J. 74, 75 (1984); Erwin N. Griswold, *The Need for a Court of Tax Appeals*, 57 HARV. L. REV. 1153, 1153 (1944); Stanley S. Surrey, *Some Suggested Topics in the Field of Tax Administration*, 25 WASH. U. L.Q. 399, 419–20 (1940). For historical overview on this idea, see Todd H. Miller, *A Court of Tax Appeals Revisited*, 85 YALE L.J. 228, 228 (1975).

202. The proposal for federal judicial reform in 1997 rejected the idea of a separate court of tax appeals and suggested it be centralized in the federal circuit system. Act of Nov. 26, 1997, Pub. L. No. 105-119, 111 Stat. 2440; COMMISSION ON STRUCTURAL ALTERNATIVES FOR THE FEDERAL COURTS OF APPEALS, 105TH CONG., FINAL REPORT 73 (1998).

203. Traynor & Surrey, *supra* note 15, at 351.

204. Tannenwald, *supra* note 73, at 6.

205. *Id.*

Bar by which special tax trial judges act as mediators in an effort to settle cases prior to regular sessions.[206] These developments have reduced delays in the Tax Court's docket and enabled the parties to save expensive judicial time.

Throughout the years, appeals from the Tax Court were confined to "clearly erroneous cases," thus limiting appellate review to unusual matters.[207] Nonetheless, today's Tax Court appellate review is still in the hands of the various Circuit Courts. Moreover, there is still no requirement for prepayment of tax liability or of any bond in order to file with the Tax Court. For these reasons and more, Traynor and Surrey's proposals still have merit today. Their suggestions for lowering the incentive to litigate tax matters, standardizing tax decisions and minimizing the current tax uncertainties have not been fully achieved.

Yet, Traynor and Surrey's biggest success was enacting a provision for binding taxpayer-government agreements. For years, the Bureau of Internal Revenue refused to apply the idea of a "closing agreement" to future transactions. Its caution originated in the notion that the determination of a commissioner in one case cannot bind his successor or other taxpayers outside the agreement.[208] Traynor and Surrey used their influence in the Treasury to incorporate this mechanism of binding taxpayer-government agreements in the Revenue Act of 1938.[209] They also added a requirement that taxpayers show a bona fide motive in seeking the ruling. This measure was necessary to prevent the Bureau from becoming a huge information authority abused by tax avoiders.[210] Moreover, the idea of a private letter ruling as we know it today originated in Traynor and Surrey's concept of preventive tax policy and improving taxpayer-government negotiations. Its extensive contemporary use as a preventive mechanism for tax disputes is no doubt a product of Traynor and Surrey's project.

Today's most challenging problem is in the area of international taxation. Specifically, the government has been grappling with how to address the implications of Cross-Border Tax Arbitrage, which take advantage of inconsistencies between different countries' tax rules such as transfer pricing transactions.[211] The use of these types of transactions

206. *Id.* at 7.

207. *Id.* at 4.

208. Traynor & Surrey, *supra* note 15, at 353.

209. Revenue Act of 1938, Pub. L. No. 75-544, § 801, 52 Stat. 447, 573 (1938) (amending Revenue Act of 1928, Pub. L. No. 70-562, § 606, 45 Stat. 791, 874 (1928)). By striking the words "ending prior to the date of the agreement" the Act established that a closing agreement may be related not only to a past tax year already closed, but also to a present tax year not yet terminated, or to a future tax year not yet commenced. *Id.* at 573.

210. Traynor & Surrey, *supra* note 15, at 355.

211. *See generally* Insop Pak, *International Finance and State Sovereignty: Global Governance in the International Tax Regime*, 10 ANN. SURV. INT'L & COMP. L. 165, 165 (2004); Philip R. West, *Foreign*

as a form of tax avoidance and income allocation among different taxing jurisdictions became widespread with the development of multinational organizations.[212] The phrase "transfer pricing transactions" refers to the pricing of goods and services between a parent company and its foreign subsidiary, or between various divisions of a multinational corporation. Given that the parties in this transaction are clearly related, this mechanism is used to affect the profits of different divisions in the company, along with the company's overall tax liability, and its tax position in various jurisdictions.

In conjunction with traditional mechanisms for confronting this phenomenon, such as enacting laws and regulations, the U.S. government, followed by other governments around the world, developed Advance Pricing Agreements (APAs) to prevent future tax litigation over international transactions.[213] An APA is an agreement between the taxpayer and the government relating to a future transaction whereby the parties agree upon the price and time period of a specific transaction.[214] This mechanism prevents future litigation and guarantees that the taxpayer is acting in good faith. Today there are bilateral and multilateral APAs that involve taxing authorities in each of the countries relevant to the transaction. These agreements protect the taxpayer from double taxation and assessments procedures[215] while reducing the risk of artificial transactions designed solely to yield tax advantages.

Today's Advance Pricing Agreements constitute preventive tax policy *per se*, which originated in the 1940s with Traynor and Surrey's concept of using a closing agreement for future transactions. They demonstrate that preventive tax policy can serve as a model for reducing litigation and preventing controversies in other areas of the law and, most especially, how 1940s public policy continues to shed light on current developments in the legal system.

Traynor and Surrey's idea of preventive tax policy is especially timely as the government struggles to improve the effectiveness, integrity and fairness of our tax laws. Various proposals have been drafted suggesting the transformation of our income-based tax system to one based on a consumption tax. Some of those proposals have suggested enacting a value-added tax, a national sales tax, or a broad individual and

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Law in U.S. International Taxation: The Search for Standards, 3 FLA. TAX REV. 147, 171 (1996).

212. Reuven Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1576 (2000).

213. For more on the emergence of APAs, *see* Diane M. Ring, *On the Frontier of Procedural Innovation: Advanced Pricing Agreements and the Struggle to Allocate Income for Cross Border Taxation*, 21 MICH. J. INT'L L. 143, 160 (2000).

214. Rev. Proc. 91-22, 1991-1 C.B. 526 (defining APAs).

215. Ring, *supra* note 213, at 170.

business postpaid consumption tax.[216] Those proposals may revive the need to reconsider the creation of a National Court of Tax Appeals, simplifying the tax code and unifying deficiency and refund litigation under a single tax court, as Traynor and Surrey proposed nearly seventy years ago.[217]

CONCLUSION

As Traynor and Surrey so aptly put it, "[t]here is something basically wrong in a procedure which enables so many cases to travel the long, expensive and futile route up to the threshold of a judicial settlement only to retrace their steps at that point to an administrative settlement or to be abandoned altogether by the taxpayer or the government."[218]

Between World War I and World War II, the United States tax system underwent a dramatic change with the evolution of the individual income tax. In about twenty years, the income tax went from a novel measure that generated very little revenue to a major source of income for the federal government.[219] One of the consequences of that development was that the tax code became very complex. Public discontent with the system grew and tax litigation increased, along with tax evasion.[220]

During the 1930s, the interwar system of tax disputes involved "too much law," and served as an open invitation for litigation.[221] Multiple appellate reviews of the Board of Tax Appeals decisions by the various Circuit Courts enhanced tax uncertainties. Moreover, the lack of a proper limit or precondition for a petition to the Board of Tax Appeals clogged the system, creating huge delays and uncertainties. This situation created negative externalities and unnecessary costs to both the government and the taxpayer.[222]

Some can predict the consequences of changes in present legal treatment based on past experience. However, there are very few who can foresee entirely new problems and predict the effect that alternative

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216. For consumption tax proposals *see* The Armey-Shelby Flat Tax, H.R. 2060 & S. 1050, 104th Cong. (1st Sess. 1995); The Nunn-Domenici USA Tax, S. 722, 104th Cong. (1st Sess. 1995); DAVID BRADFORD, UNTANGLING THE INCOME TAX (1986); ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX (1995); LAURENCE S. SEIDMAN, USA TAX, A PROGRESSIVE CONSUMPTION TAX (1997); PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR & PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 21–22 (2005).

217. *See* Traynor & Surrey, *supra* note 15, at 349.

218. *Id.* at 339.

219. *See* STEUERLE, *supra* note 69, at 13; WITTE, *supra* note 30, at 110; Jones, *supra* note 69, at 685–86.

220. Likhovski, *supra* note 59.

221. *See* Traynor, *supra* note 20, at 1411.

222. *Id.* at 1394.

reform proposals will have on different sets of circumstances.[223] In 1938 and 1939, two relatively unknown tax administrators came together to admonish that a major overhaul of the tax system is needed. One was Roger Traynor, who would go on to be recognized as one of the most accomplished and brilliant state judges in U.S. history.[224] The other was Stanley Surrey, who later would be called the greatest tax scholar of his generation.[225]

Traynor and Surrey were among those who early on recognized the growing public dislike of the convoluted tax system and formulated solutions for improving it. They advocated a decentralized, simpler, and more accessible system, in which the taxpayer, with the help of his attorney and his books could solve the matter with a Bureau of Internal Revenue technical staff member in a field office close to his residence.[226] They aimed to create a unified division staff powerful enough to settle tax disputes and to expedite their resolution.[227] They regarded as a success any case that was settled by the administration and avoided judicial or judicial-like proceedings. There was a need in the interwar period to draw a clear conceptual line between administrative and judicial review, crossing it only in exceptionally complicated matters.[228]

In addition to improving administrative settlement procedures, Traynor and Surrey sought to prevent disputes from arising in the first place by decreasing the friction between taxpayers and the government.[229] They contended that it is necessary for the legislative, executive, and judicial branches to implement the concept of a preventive tax policy in two basic ways. First, they recommended creating a coherent and simple tax code that would enable taxpayers to comprehend the correct tax treatment of a given transaction.[230] Second, they argued for requiring that the taxpayer disclose complete and accurate information in a protest letter so that the executive branch could quickly dispose of cases that otherwise would block the system. This disclosure of all the facts would free the judiciary to focus on legal rather than factual questions, thus ensuring taxpayers fair and fast application of the law to their cases.[231]

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223. On the ability to predict legal changes, see Robert Charles Clark, *The Morphogenesis of Subchapter C: An Essay in Statutory Evolution and Reform*, 87 YALE L. J. 90, 92 (1978).

224. American legal historian Harry N. Scheiber wrote, "In any list of the most admired and influential state judges in the nation's history, Traynor stands at the very top level." FIELD, *supra* note 3, at ix–xi.

225. Griswold, *In Memoriam: Stanley S. Surrey*, *supra* note 7, at 331.

226. Traynor & Surrey, *supra* note 15, at 341.

227. *Id.*

228. *Id.* at 343.

229. Griswold, *In Memoriam: Stanley S. Surrey*, *supra* note 7, at 344.

230. Traynor, *supra* note 20, at 1400.

231. *Id.* at 1401.

Many of the problems that plagued the interwar tax system remain today. Tax acts have become more and more complex in their attempt to close loopholes exploited by shrewd tax attorneys. Changes of time and circumstances or legal treatment create uncertainties, which if not settled immediately, develop into tax disputes. This process results in increased tax litigation, which in turn creates contradictory and inconsistent legal doctrines. The incentive to litigate tax matters in the court has not lessened throughout the years. Therefore, today, these dilemmas continue to occupy practitioners and scholars who are striving to improve the current tax system. Traynor and Surrey called for administrative guidance on a regular basis to prevent taxpayers from resorting to litigation to achieve such guidance from the judiciary. By implementing their proposals, one might hope to "return to innocence" and reduce the uncertainties that surround tax matters, while improving the relationship between taxpayers and the government.

Throughout their careers, Traynor and Surrey continued to promote their philosophy of preventive tax policy. As professors, consultants, and, in the case of Traynor, a state Supreme Court judge, they no doubt influenced the federal and state tax systems.[232] After joining the law faculty at Harvard, Surrey advanced preventive tax policy through his lectures. In 1961 Surrey became assistant secretary of the Treasury for tax policy.[233] While speaking in classrooms, professional conferences or testifying before federal committees, he continued to emphasize the need for simplifying the code as a preventive measure.[234]

Traynor's administrative experience established his reputation as a tax expert and an architect of California's tax system. In an attempt to provide as much guidance as possible to prevent the same issues from being relitigated, Traynor's opinions resembled mathematical proofs, containing examples, explanations, and references. He used textual interpretation, legislative history, and frequent citations of the language of the law to demonstrate his faithfulness to it as well as maintain the

232. On September 9, 1952, while continuing to suggest improvement of tax administration, Surrey published a paper supporting the separation of the Bureau of Internal Revenue from the Treasury, making it an independent agency of the executive branch. The paper was delivered in the 1952 meeting of the National Tax Association, in Toronto, Canada. Stanley S. Surrey, *A Comment on the Proposal to Separate the Bureau of Internal Revenue from the Treasury Department*, 8 TAX L. REV. 155, 155 (1953).

233. Griswold, *In Memoriam: Stanley S. Surrey*, *supra* note 7, at 330.

234. In one of his lectures at the University of New York at Buffalo, Surrey commented:

> The achievement of tax simplification requires a high measure of sheer ingenuity mixed with an intelligent weighing of what is valuable complexity proper to achieve needed fairness and what is expendable refinement and detail. . . .Where simplification is possible without pain to the taxpayers involved, and without serious loss of revenue, it will obviously be adopted as soon as the solution is perceived.

Honorable Stanley S. Surrey, Assistant Sec'y of the Treasury, The James McCormick Mitchell Lecture at the School of Law State University of New York(April 21, 1966).

legislative intent behind it. Traynor's opinions interpreted the text in a straightforward way, explaining the relationship between words so readers could accept that he was not adding new meaning but rather applying "simple rules of grammar" and clear meaning of the text as both reason and justice dictated.[235]

His insights on tax policy and his experience in both academic and government roles echoed throughout his State tax opinions.[236] His reputation allowed him to continue and advance his philosophy of preventive tax policy through his prestigious position as California Supreme Court justice.[237] In 1970, Traynor retired from the Supreme Court and returned to Berkeley, where he taught and wrote dozens of articles until his death in 1983. Although he is mostly known for his non-tax adjudication, his legacy of preventive tax policy continues to contribute to today's tax debate.

235. Estate of Law v. Kirkwood, 325 P.2d 449, 454 (Cal. 1958). Another example of Traynor's use of legislative history to track legislative intent was in the case of *W.F. Bray v. Jones*, where Traynor examined the legislative history of the Political Code and the idea behind its amendments. 129 P.2d 357, 359 (Cal. 1942). Thus, he noted that in 1895 the Legislature adopted an amendment replacing the word "percentage" with the word "penalty." *Id.* Traynor clarified that the choice of words was not incidental and its purpose was "not to inaugurate a new concept but to lend greater precision to the old." *Id.*

236. Don Barrett, Traynor's clerk and friend, called the period from 1945 to 1956 the "Long Court" for its long and unchanged composition. Donald P. Barrett, *The Supreme Court of California, 1981–1982, In Memoriam—Roger John Traynor: Master of Judicial Wisdom*, 71 CAL. L. REV. 1060 (1983). During this period Traynor became a "leading state court judge in the nation" who set a high literary standard for judicial writing. *Id.*

237. Traynor wrote 892 opinions and seventy-five law review articles. FIELD, *supra* note 3, at 121. In the field of taxation, Traynor wrote about twenty-five majority opinions and over twenty dissenting opinions. For a list of Traynor's tax decisions, see Kragen, *supra* note 1, at 813. On the judicial philosophy of Traynor, see John W. Poulos, *The Judicial Philosophy of Roger Traynor*, 46 Hastings L.J. 1643, 1646 (1995).