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THE WINDFALL TAX AND PROCESSING TAX REFUND
PROVISIONS OF THE REVENUE ACT OF 1936

Keith P. Bondurant*

THE proposition that a seller who has collected from his vendees but has not paid to the government taxes imposed under an unconstitutional statute is unjustly enriched, and the correlative principle that a taxpayer has no right to recover invalid taxes paid by him if he has shifted the burden of such taxes to others, are embodied in title III and title VII, respectively, of the Revenue Act of 1936. Title VII prohibits refunds to processors and other vendors of amounts collected from them as tax under the Agricultural Adjustment Act unless the claimant can establish that he bore the burden of the amount and has not been reimbursed therefor nor shifted the burden to others. Title III imposes an eighty per cent tax on net income derived from

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4 “No refund shall be made or allowed ... of any amount paid by or collected ... as tax under the Agricultural Adjustment Act, unless the claimant establishes ... (a) That he bore the burden of such amount and has not been relieved thereof nor reimbursed therefor nor shifted such burden ... (1) through inclusion of such amount by the claimant ... in the price of any article with respect to which a tax was imposed under the provisions of such Act, or in the price of any such article processed from any commodity with respect to which a tax was imposed under such Act, or in any charge or fee for services or processing; (2) through reduction of the price paid for any such commodity; or (3) in any manner whatsoever ... or (b) That he has repaid unconditionally such amount to his vendee (1) who bore the burden thereof, (2) who has not been relieved thereof nor reimbursed therefor ... and (3) who is not entitled to receive any reimbursement therefor from any other source. ...” 49 Stat. L. 1747, § 902 (1936), 7 U. S. C. (Supp. 1937), § 644.

Title VII was upheld by the Supreme Court in Anniston Mfg. Co. v. Davis, 301 U. S. 337, 57 S. Ct. 816 (1937); petition for rehearing denied, 302 U. S. 772, 58 S. Ct. 3 (1937).
shifting the burden of federal excise taxes, where no tax has been paid or where the amount of the tax paid has been refunded. While this tax on unjust enrichment, popularly known as the "windfall tax," applies in terms to all federal excise taxes, it is primarily intended to prevent a windfall to processors who had added the amount of the processing tax to the prices charged buyers but who themselves either had not paid such taxes before the invalidation of the A.A.A. or had recovered such sums impounded in court after the Supreme Court's decision holding illegal the processing tax provisions of the act. Thus, the two titles are complementary and tend to equalize the positions of all processing taxpayers who "passed on" the tax to customers. Since title III provides that if the vendor reimburses his vendee, after having passed the tax on to him, the latter will be taxed on his reimbursements to the extent that he in turn shifted the burden to his vendees.

5 "The following taxes shall be levied . . . for each taxable year . . . upon the net income of every person which arises from the sources specified below: (1) A tax equal to 80 per centum of that portion of the net income from the sale of articles with respect to which a Federal excise tax was imposed on such person but not paid which is attributable to shifting to others to any extent the burden of such . . . tax and which does not exceed such person's net income for the entire taxable year from the sale of articles with respect to which such . . . tax was imposed. (2) A tax equal to 80 per centum of the net income received from reimbursement received by such person from his vendors of amounts representing Federal excise-tax burdens included in prices paid . . . to such vendors, to the extent that such net income does not exceed the amount of such Federal excise-tax burden which such person in turn shifted to his vendees. (3) A tax equal to 80 per centum of the net income from refunds or credits to such person from the United States of Federal excise taxes erroneously or illegally collected with respect to any articles, to the extent that such net income does not exceed the amount of the burden of such . . . taxes . . . which such person shifted to others." 49 Stat. 1734, § 501 (a) (1936), 26 U. S. C. (Supp. 1937), § 345 (a).

In a report of a subcommittee of the Committee on Ways and Means the tax rate of 90% was recommended. H. R. Rep. 2457, 74th Cong., 2d sess., p. 11 (1936). It had been intimated that a 100 per cent tax would be unconstitutional as confiscatory. See Hearings Before Committee on Finance on H. R. 12395, 74th Cong., 2d sess., p. 868 (1936). See also 50 Harv. L. Rev. 477, note 6 (1937).


J THE WINDFALL TAX

vendee, the avowed purpose of Congress to “tap the windfall in its every retreat” is clear.

JUDICIAL TREATMENT OF PROBLEM IN ABSENCE OF STATUTE

In the absence of a controlling statute, the federal courts have seldom concerned themselves with the question, “Who bears the burden of the tax?” Rather, their inquiry has been limited to asking, “Who is the taxpayer?”—the legal emphasis being upon impact, rather than incidence, of taxation. It has been generally held that the voluntary character of the payment of an invalid federal tax is no bar to a refund action, and only a statutory limitation can make the taxpayer’s enrichment significant in determining his right to recover the illegal tax. It is sufficient for the claimant to show that he was the person upon whom the tax was imposed.10

In contrast to the federal view in respect to recovery of unconstitutional taxes, state courts, in the absence of statute, have applied quasi-contractual principles of unjust enrichment in determining whether the taxpayer may receive reimbursement, and have denied refunds where the claimant, though he had paid the tax, had passed it on to others.11 The state courts have usually adopted the view that, absent statute, illegally collected taxes may not be recovered if they were paid “voluntarily” and not under protest.12 The theory has been advanced that the nominal taxpayer is merely a conduit for moneys paid to him to be repaid to the state, and that his position as collector and trustee of the funds estops him from attacking the validity of the tax.18 Where the ostensible taxpayer has agreed with his customers

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10 Builders’ Club of Chicago v. United States, 83 Ct. Cl. 556, 14 F. Supp. 1020 (1936) (the court pointing out that Congress specifically provided the requirement of absorption of the tax when it wished to make such a condition of taxpayer’s recovery); Alliance Country Club v. United States, 62 Ct. Cl. 579 (1926). The contrary result was reached in Shannopin Country Club v. Heiner, (D. C. Pa. 1924) 2 F. (2d) 393, on the theory that the club was merely a collection agency.
18 Richardson Lubricating Co. v. Kinney, 337 Ill. 122, 168 N. E. 886 (1929); Spencer v. Consumers Oil Co., 115 Conn. 554, 162 A. 23 (1932). Other cases, however, have rejected the “collector” theory. State v. Sunburst Refining Co., 76 Mont. 472, 248 P. 186 (1926), certiorari denied, 273 U. S. 722, 47 S. Ct. 112
to restore any sums recovered by him, refunds have been granted, on
the ground that there is no unjust enrichment in such a case.14 Where
the tax item has been absorbed in a total or composite price paid by a
vendee, there is no liability on the part of the vendor to repay any
part of a recovered tax to him, and the vendee is said not to have paid
the tax but rather a composite price for the goods which includes the
tax among many other items.15 But to conclude from this that the
vendor-taxpayer is not unjustly enriched, because he is under no
legal obligation to reimburse the vendees to whom the burden was
transferred, is to give a cramped and unrealistic meaning to the con­
cept of unjust enrichment antithetical to the equitable principles upon
which it has been formulated.16

POWER OF CONGRESS TO IMPOSE EQUITABLE LIMITATIONS
UPON RECOVERY OF ILLGALLY COLLECTED TAXES

There is no doubt but that Congress, even by retroactive statutes,
may condition the right to recovery of illegal taxes upon a showing
that the taxpayer is equitably entitled to reimbursement, or may tax
funds in his possession to which he has no equitable right and which,
if retained, will result in his being unjustly enriched. The first attempt
of Congress to apply such equitable principles to taxation was the War
Excess Profits Tax of 1918.17 That act levied a special income tax of

14 Benzoline Motor Fuel Co. v. Bollinger, 353 Ill. 600, 187 N. E. 657 (1933). In that case, refunds were allowed to a claimant who had kept records of his cus­
tomers' tax contributions and had promised to make refunds to them in case the
tax was held invalid. On the general problem, see Field, "The Recovery of Illegal

15 "The amount added because of the tax is paid to get the goods and for nothing
else. Therefore it is part of the price." Lash's Products Co. v. United States, 278
U. S. 175 at 176, 49 S. Ct. 100 (1929); Heckman Co. v. I. S. Dawes & Son Co.,
(App. D. C. 1926) 12 F. (2d) 154; Moore v. Des Arts, 1 N. Y. 359 (1848);
Texas Co. v. Harold, 228 Ala. 350, 153 So. 442 (1934).

16 In Van Antwerp v. State, 218 N. Y. 422, 113 N. E. 497 (1916), the court
proceeded on the theory that the taxpayer was the agent of his customers and liable
for his unauthorized acts in charging his principal's account for the amount of the
tax, and hence was not unjustly enriched in being allowed recovery, although it was not
shown that the claimant was under any contractual duty to repay his vendees. The
theory of the Van Antwerp case has generally been disapproved in jurisdictions other
than New York.

17 40 Stat. L. 1089.
from thirty to eighty per cent on excess profits from war contracts, and received the blessing of the Circuit Court of Appeals for the Second Circuit in *Hoe & Co. v. Commissioner.* Inasmuch as the purpose of the tax was to tap a windfall being reaped from the uncertainties and hysteria of war and thus to prevent an unjust enrichment to profiteers, this act was to some extent prophetic of the Windfall Tax of 1936. But the real ancestor of the refund limitations of title VII was section 424 of the Revenue Act of 1928. There, without the detailed elaboration of administrative provisions of titles III and VII of the 1936 act, Congress applied to claims for refunds of excise taxes on automobile accessories the principle that the claimant, in order to recover, must establish that he had borne the burden of the tax. The tax was retroactive in application. In *United States v. Jefferson Electric Manufacturing Co.*, the Court gave its unqualified approval to the unjust enrichment principle as a statutory limitation on tax refunds, declaring through Justice Van Devanter:

"it cannot be conceded that in imposing this restriction the section strikes down prior rights, or does more than to require that it be shown or made certain that the money when refunded will go to the one who has borne the burden of the illegal tax, and therefore is entitled in justice and good conscience to such relief. . . . If the taxpayer has borne the burden of the tax, he readily can show it; and certainly there is nothing arbitrary in requiring that he make such a showing. If he has shifted the burden to the purchasers, they and not he have been the actual sufferers and are the real parties in interest. . . ."

In the Revenue Act of 1932, Congress again embodied the qualification upon refunds that required the claimant to show that he had neither included the tax in the price of the article with respect to which it was imposed nor collected the amount of the tax from his vendee, or to show that he had repaid the amount of the tax to the ultimate purchaser.

The 1936 act creates an administrative board of review within the Treasury Department, which board is given jurisdiction to review the allowance or disallowance by the commissioner of all claims for refund. The right to sue in any court for the refund of any amount

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paid or collected as processing tax is taken away, and the administrative procedure set up for presentation of claims for refunds is made exclusive.\textsuperscript{23} A right to judicial review of the board's decision in the United States Circuit Court of Appeals or the Court of Appeals for the District of Columbia is allowed both to the commissioner and the claimant, with final review by certiorari or certification by the Supreme Court.\textsuperscript{24} The liability of all collectors of internal revenue or customs, for any act done by them in assessing or collecting any amount as tax under the A.A.A., is expressly abolished.\textsuperscript{25} It has been strenuously asserted that these limitations upon means of invoking judicial aid in claims for tax reimbursements are unconstitutional in that they impair vested jurisdictional rights. The Supreme Court, however, in \textit{Anniston Manufacturing Co. v. Davis},\textsuperscript{26} upheld these procedural provisions as reasonable and adequate, impairing no vested rights of taxpayers and affecting only remedial forms of relief. While expressly dodging as unnecessary the question of the power of Congress to withdraw the right to suit entirely, both against the collector and against the government, the Court, through the Chief Justice, upheld the substitution of the exclusive remedy provided in the act as suitably protecting all legal rights, indicating, as to the scope of judicial review:

"We find nothing in the statute which limits the judicial review to questions of statutory construction or of mere regularity of procedure. The 'law' with which the decision of the Board may be in conflict, may be the fundamental law. Questions of validity as well as of statutory authority or regularity may be determined. These may relate to due process in the hearing or in the refusal of a refund. . . ."\textsuperscript{27}

It is obvious that the provisions of section 906 do take away causes of action which formerly existed. With reference to suits brought against the United States, there can be little doubt that, since the government may withdraw entirely its consent to be sued, it may prescribe any jurisdictional conditions it desires.\textsuperscript{28} But although the sovereign may withdraw its consent to be sued, it has recently been held by the Supreme Court that such withdrawal is remedial merely; no vested

\textsuperscript{23} Ibid., § 906(a).
\textsuperscript{24} Ibid., § 906(g).
\textsuperscript{25} Ibid., § 910.
\textsuperscript{26} Anniston Mfg. Co. v. Davis, 301 U. S. 337, 57 S. Ct. 816 (1937).
\textsuperscript{27} Ibid., 301 U. S. at 345.
\textsuperscript{28} Continental Mills, Inc. v. United States, (Ct. Cl. 1936) 17 F. Supp. 138, applies this principle in upholding an earlier section prescribing conditions upon which A.A.A. refunds could be had.
right is destroyed; the obligation "remains binding upon the conscience of the sovereign." 29

ACTION FOR REFUND AGAINST COLLECTOR PERSONALLY

The abolition of the liability to suit of the collector in his individual capacity raises more serious questions. The earlier federal cases held rather rigidly to the view that there was a vested right of action against a collector, and hence any attempt to deprive a taxpayer of a suit against the collector in his individual capacity was not merely a remedial change, but an impairment of substantive rights. 30 This theory was based upon the rationale that the action against the collector was founded upon the common-law right of action in assumpsit. Later cases, however, came to view the action, though in form an action of assumpsit, as one grounded on statutory authorization and hence subject to Congressional control. 31 Several decisions have held that the collector is a merely nominal party in an action against the government, and the Supreme Court has characterized the action against the collector as "an anomalous relic of bygone modes of thought." 32 These cases point to the almost automatic payment by the government of judgments secured against the collector as sustaining their theory that the "individual" suit is no more than a vestige of an ancient procedural device to bring the United States into court in the days when the government was not easily suable. 33 Certainly this appears to be a realistic position, especially in view of the statutory provision 34 entitling the collector to exoneration by the government upon the issuance of a certificate of probable cause by the trial court, which certificate operates as a perpetual stay of execution against the property of the collector and obligates the government, through the

30 Elliott v. Swartwout, 10 Pet. (35 U. S.) 137 (1836); Cary v. Curtis, 3 How. (44 U. S.) 236 (1845). This view was taken, in holding invalid the provisions of § 21 (d) of the amended A.A.A., in Priddy & Co., Inc. v. Early, (D. C. Va. 1936) 4 CCH FEDERAL TAX SERVICE, ¶ 9495 (1936). There the court indicated that the statute operated to extinguish a vested property right, the common-law cause of action against the collector, and thus contravened the Fifth Amendment.
31 Collector v. Hubbard, 12 Wall. (75 U. S.) 1 (1870); Arnson v. Murphy, 109 U. S. 238, 3 S. Ct. 184 (1883); Schoenfeld v. Hendricks, 152 U. S. 691, 14 S. Ct. 754 (1894).
33 As to the nature of such payments, see Dunnegan v. United States, 17 Ct. Cl. 247 (1881); Nixon v. United States, 18 Ct. Cl. 448 (1883).
commissioner of internal revenue, to pay the judgment. The Circuit Court of Appeals for the Fifth Circuit, in the Anniston case, 85 based its decision upholding the collector solely on jurisdictional grounds, without considering the adequacy of the remedy set up by section 906 of title VII. Holding stringently to the view that it had no jurisdiction to hear the case, the court pointed out that Congress had abolished the jurisdiction of federal district courts in suits against the government, and that there was no common-law liability of a collector who collected and paid over an illegal tax, in the course of his official duties, before the tax was declared unconstitutional. The court remarked:

"we are convinced that appellants have failed to establish . . . that the suits . . . are really personal suits against the defendant, at common law, to enforce vested rights against him as an individual, and not suits against the United States, consented to by it through the fiction of a suit against the collector. . . . the cause of action asserted is not a common-law action, for moneys had and received, based, as such actions must be, on wrongful seizures and detentions. . . . It is not claimed that the defendant had money in his hands which he had gotten from plaintiff, not in pursuance of his duties, but wrongfully, and is withholding from it under circumstances which make it inequitable for him to continue to do so. It is not even pleaded that the moneys . . . were paid under duress and protest. . . . This is an essential condition to a common-law action against the collector independent of statutes, for moneys had and received. . . ." 86

The Supreme Court, affirming the conclusion of the Circuit Court of Appeals, based its decision upon the adequacy of the remedy against the government provided by section 906, and failed either to affirm or to deny the lower court's theory of the suit against the collector.

The bulk of recent Supreme Court decisions, however, have held to the theory that the action against the collector is personal in nature. 87 The latest expression of opinion by the high court apparently adopts this view. 88 While these cases still hold to the proposition that the form of the action is properly against the collector as an individual, they do not deny the right of Congress, by specific enactment, to take

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86 Ibid., 87 F. (2d) at 778.
88 McEachern v. Rose, 302 U. S. 56, 58 S Ct. 84 (1937).
away such right to sue the collector. In other words, the reasoning is
that while, absent statute, a collector may be sued, this right is not
vested nor substantive in nature, and Congress may substitute another
exclusive remedy by suit against the government, provided the con­
ditions required to be met leave the taxpayer with an adequate remedy
by which his contentions may be tested. The consequences of holding
that an action against a collector is personal are indicated by decisions
that a suit against a particular collector survives his death and can
be revived against his executor or administrator, but it cannot be con­
tinued against his successor in office, who is viewed as a stranger to the
alleged unwarranted transaction which is the basis of the taxpayer's
suit. So, it has been held that a collector may be liable for interest.
While Justice Holmes, in Smietanka v. Indiana Steel Co., has stated,
as a reason for denying an action against a collector's successor in office,
that when the suit is begun it cannot be known with certainty that the
judgment will be paid out of the Treasury, this is not a convincing
argument for the proposition sought to be maintained; it is well­
known that, for both statutory and moral reasons, the government
will protect its collectors against personal liability and will direct
payment of an adverse judgment by the commissioner on behalf of the
government. The feeling of the courts seems to be that if Congress
desires to eliminate suits by taxpayers against collectors in particular
situations, it should explicitly provide, as does section 910 of title VII,
that the liability of any collector for illegal taxes assessed under the
act is abolished, substituting a provision for suit against the govern­
ment in lieu of the other remedy taken away. But if an act provides
merely that no suit shall lie against the government to enjoin col­
lection or recover payment of an invalid tax, such a provision should
not be construed as taking away the right to sue the collector by hold­
ing that such a suit is of itself one against the government, because
such reasoning would deprive the taxpayer of all remedies for testing
his claim of invalidity of the tax. It has been suggested that, absent
explicit statute, the collector no more partakes of the immunity of the
sovereign from suit than do state officers, who are held to be unpro­

39 Sheridan Flouring Mills v. Cassidy, (D. C. Wyo. 1937) 17 F. Supp. 598,
holds that federal district courts may be divested of jurisdiction to hear claims for
refunds of processing taxes against either the collector or the government, if another ade­
quate remedy has been provided.
41 Ibid. Today the government also is liable for interest. 42 Stat. 316 (1921),
42 257 U. S. 1, 42 S. Ct. 1 (1921).
43 See note 34, supra.
ected by the immunity granted to the state by the Eleventh Amendment.\(^4^4\)

Several decisions have indicated that neither the right of action against the collector nor the right to refund from the government itself are so far vested or absolute that, having once accrued, they are beyond the scope of governmental control. The decisions upholding statutes operating retroactively to validate the illegal collection of taxes, by ratifying the unauthorized acts of administrative agents, affirm such a principle.\(^4^5\)

It seems obvious that Congress cannot deprive a taxpayer of all his remedies for testing the validity of a federal tax assessed against him.\(^4^6\) However, *Lynch v. United States* \(^4^7\) contains disturbing dictum which seems to indicate that Congress could, conformably to due process, abolish all rights which existed against the collector without leaving any right of suit against the government. While the actual decision in the *Lynch* case held that an act repealing laws providing for governmental insurance was unconstitutional as impairing substantive and vested rights, yet the dictum is clear that Congress could constitutionally have achieved the desired result merely by forbidding all courts and administrative officers to hear any claims. By the Court's reasoning, the latter procedure would be remedial and hence permissible. The Court's approach to the problem is mechanical and stereotyped, and looks no farther than to a strict formula dividing "remedial" from "substantive" rights. Applying this type of reasoning to tax cases, the Court could divest the taxpayer of all right to challenge the constitutionality or validity of a tax, or to receive a refund of tax moneys paid under a statute later held invalid, by arguing as follows: The liability of the collector to suit may be extinguished by statute, such statute being "remedial" merely; the liability of the government to suit depends upon its consent as sovereign, and a statute taking such


\(^4^6\) Graham & Foster v. Goodcell, 282 U. S. 409 at 430, 51 S. Ct. 186 (1931), stating that while the United States may withdraw its right to be sued, it may not abolish all rights of recovery; Sage v. United States, 259 U. S. 33, 39 S. Ct. 415 (1919) (suit against the government could not be foreclosed where personal suit against the collector had been barred by his death). Compare Brinkerhoff-Faris Trust & Savings Co. v. Hill, 281 U. S. 673, 50 S. Ct. 451 (1930), where it was held that a state could not constitutionally so condition a taxpayer's remedies for tax recovery as to make them practically unavailable to him.

\(^4^7\) 292 U. S. 571, 54 S. Ct. 840 (1933).
right away, though it may leave an obligation "binding upon the conscience of the sovereign," is likewise "remedial"; therefore, the taxpayer may be left with all of his "substantive" and equitable rights to recovery, but with no remedy for enforcing them.

That the courts will not blindly follow such narrow concepts to their logical conclusion seems apparent. It is well illustrated by the willingness of courts to grant injunctions against the collection of a federal tax where conditions of hardship or "exceptional and extraordinary circumstances" exist. Where a bill pending in Congress threatened to deprive processors of all remedies for recovery of processing taxes, even though the Agricultural Adjustment Act and its processing tax provisions were held unconstitutional, lower federal courts readily allowed processors the injunctive remedy against collection of the tax from them. 48

The better rule would seem to be that Congress may withdraw the remedy of suit against the collector for recovery of illegal taxes, provided a remedy against the government is substituted therefor; the particular remedy substituted may be administrative in nature and may be exclusive of all other remedies, provided only that it complies with due process and allows the taxpayer a reasonable means of presenting his claim and recovering the tax paid if he is equitably entitled thereto. The Supreme Court in the Anniston case found that the remedy provided by section 906 fulfilled these requirements, concluding: 49

"We conclude that the authorized procedure provides for a full and fair hearing and determination of all matters of fact and that, through judicial review, it provides for the protection of all the legal rights of the petitioner including any constitutional right which it may be entitled to invoke with respect to the refund which it seeks. The petitioner may thus obtain through this proceeding whatever judgment its case warrants, a judgment which the Government, by virtue of the requirement that the Commissioner shall make refund accordingly, binds itself to pay."

The fact that the provisions of titles III and VII operate retroactively is no bar to their validity. In the recent case of United States v. Hudson, 50 Justice Van Devanter stated the rule to be that:

"As respects income tax statutes it has long been the practice

50 299 U. S. 498 at 500, 57 S. Ct. 309 (1937).
of Congress to make them retroactive for relatively short periods so as to include profits from transactions consummated while the statute was in process of enactment, or within so much of the calendar year as preceded the enactment; and repeated declarations of this Court have recognized this practice and sustained it as consistent with the due process of law clause of the Constitution."

In *White Packing Co. v. Robertson*, one of the many grounds of attack made upon the windfall tax was its retroactive application. The Circuit Court of Appeals for the Fourth Circuit, in disposing of this objection, pointed out that the tax was imposed upon income which had recently been earned and which had either been paid to the government under an unconstitutional statute or paid into the registry of a court pending determination of its validity, and that for practical purposes it had thus come into the possession of the taxpayer during the year in which the tax was imposed. The maximum period of retroactivity under the statute is sixteen months, applying only with respect to taxable years ended during the calendar year 1935, and subsequent taxable years.\(^{52}\)

**Problems of Proof Regarding Incidence of Tax**

There can be little dissent from the unjust enrichment principle approved by the court in the *Jefferson* case.\(^{53}\) But in view of the numerous cases in the federal courts in 1935 and 1936 in which claimants have contended that it was impossible for them to prove whether and to what extent the burden of processing taxes were shifted to others, under the requirements for such showing set up in section 21 (d) of the amended A.A.A.,\(^{54}\) as well as those of titles III and VII of the 1936 Revenue Act, manifestly the Court was oversimplifying the situation when it stated that, "If the taxpayer has borne the burden of the tax, he readily can show it. . ." In the *Jefferson* case, the articles upon which the tax was levied were homogeneous in character and the problem of tax allocation was not acute. In the case of processing taxes, however, the undoubted difficulty confronting tax allocation is intensified by the fact that in many cases the processed commodity has gone into the manufacture of numerous products so that all costs, including the tax, were distributed over the sales prices of many articles which

\(^{51}\) (C. C. A. 4th, 1937) 89 F. (2d) 775.


were subjected to varying pressures as to prices because of varying economic and competitive conditions. Congress, realizing these difficulties, set up an elaborate system of presumptions and formulae in both titles III and VII; this system purports to furnish means for determining whether or not the tax was shifted. The standards and presumptions created by both titles, and their relation to actual tax incidence, are discussed in a later part of this article.

In marked contrast to the Court’s statement in the Jefferson case as to the ease of proving whether or not the burden of a tax has been shifted, Justice Stone, in his dissenting opinion in Indian Motorcycle Co. v. United States, expresses the cautious view that:

"whether the burden of any tax paid by the seller is actually passed on to the buyer depends upon considerations so variable and complex as to preclude the assumption a priori that any particular tax at any particular time is passed on."

Processors frequently have stressed the fact that processing taxes were levied on an operation or process by units which bore little relationship to the sales unit, whereas in the Jefferson case the tax was upon sales units, single manufactured items; they have contended that this difference so increases the improbability of accurate proof of non-shifting as to make the Jefferson case entirely distinguishable on its facts.

It probably would be generally agreed that a taxpayer has shifted the burden of a tax when he has passed it either forward in the form of higher prices to his customers or backward to the producer by compelling acceptance of lower prices from him. The Supreme Court, however, has adopted in the past some peculiarly stilted notions of the shifting of the tax burden, which only serve to cloud further the problem of deciding when a tax has been “passed on” so as unjustly to enrich the taxpayer if he recoups it. In the Jefferson case, the seller was not allowed to recover although he had reduced the price charged to his vendee by the full amount of the tax, the reason being that the tax was separately itemized in the customer's bill, and therefore the customer had the tax passed to him. The Court has apparently as-

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56 Compare the dissent of Cardozo, J. in Stewart Dry Goods Co. v. Lewis, 294 U. S. 550, 55 S. Ct. 525 (1935), to the effect that at times absorption of a sales tax may be accomplished by a reduction of price even when in form the amount of the tax has been added to the price charged the vendee.
57 Accord: American Chain Co. v. Hartford-Connecticut Trust Co., (C. C. A. 2d, 1936) 86 F. (2d) 105. In the first trial of this case [sub nom. American Chain Co. v. Eaton, (D. C. Conn. 1931) 58 F. (2d) 246], the trial court found that the claimant had first reduced the sales price to 20/21 of the original price, and then
assumed that a sales tax is always shifted,58 and that a tax on the manufacturing process cannot be passed on, since it is assessed upon an activity in which the buyer can have no part and becomes absorbed in the general price paid by him for the article.59 But if the tax on manufacturing is separately itemized in the buyer's charges, it has been held to have been shifted to him.60 It has been pointed out that if the Court had followed this legalistic reasoning in the Anniston case, title VII (as well as title III) would be absolutely impotent, since processing taxes are essentially taxes upon the manufacturing process.

The difficulty in discovering who has borne the burden of processing taxes is further complicated by the fact that titles III and VII do not deal with the "ultimate effects" of taxation. Thus, the processor may actually have suffered a loss because of diminishing volume of sales at higher prices, and yet may have shifted the tax itself. In such a case, total profits to him are decreased although the amount of the tax itself has been shifted forward. The possibility of such a differential between the extent to which the tax itself was shifted and the actual enrichment of the taxpayer was emphasized by the appellant in the Anniston case; but the argument was disregarded as immaterial in the Circuit Court of Appeals and evidently was entirely ignored in the Supreme Court in view of the apparent intention of Congress in framing title VII and the inherent impossibility of providing for such a differential in the statute.

It is not the purpose of this article to analyze the complicated and intricate economic considerations and formulae which determine the actual extent of tax shifting and the characteristics of tax incidence.61

invoked 1/21 as tax, from which the court concluded that the tax had been "returned" to the vendees. The Supreme Court, 291 U. S. 386 at 409, 54 S. Ct. 443 (1933), characterized this as unsatisfactory reasoning and remanded the case for a new trial. In this trial, the court held that the tax had never been collected from the buyers. 11 F. Supp. 770 (1935). This decision was then reversed because the invoicing was a representation that the purchaser was paying 1/21 of the amount of the price as tax.


60 Wayne County Produce Co. v. Duffy-Mott Co., 244 N. Y. 351, 155 N. E. 669 (1927). In that case the tax was paid upon the manufacturer's price, not upon the sales price, and was subsequently added to the sales price.

It must be apparent, however, even to the most casual student of economics, that it is seldom true that the tax burden has been shifted to the purchaser to the extent that the price charged for the article has increased following the imposition of the tax. Thus, suppose that a given article normally sells for one dollar per unit. A tax of ten cents per unit is imposed upon the producer. The fact that buyers pay one dollar and ten cents for the article after the tax has been assessed does not necessarily, nor probably, mean that the buyer has borne the full burden of the tax. It would mean this only if the costs of manufacturing had remained constant as to each unit, and if the consumer-demand market had not decreased. But a number of economic forces combined with an uncertain number of unpredictable variable factors normally so operate as to make this result highly improbable. Thus, where the price of an article is increased by a tax, there is usually a drop in consumption of the article. This decreased demand will ordinarily precede any opportunity of the producer to counteract its effect by cutting down his production rate or his supply on hand, and the consequent surplus in his hands means an increase in his costs of production and a consequent lessening of profits. The diminishing consumer market will eventually result in the producer’s hedging by buying fewer raw materials, and the producer’s inability to buy in such large quantities as formerly may result in a higher charge to him for each unit of the raw material purchased.

In addition, profit rates are affected by a large number of apparently unrelated and wholly unassessable factors. The demand market may be affected by such artificial buying stimulants and depressants as the passage of a soldiers’ bonus bill, a war scare, a governmental building program, monetary inflation, long-time and seasonal trends, low or high credit terms, or customer displeasure resulting from a lag in reduction of prices after the invalidation of the tax. It is virtually impossible to determine how much a particular price increase may be attributable to such factors, or to assign a numerical value to any one of them as an influence in price change.

There is always a period of adjustment following the imposition of a tax, during which there will be attempts to limit and regulate production processes to the lowered pace required by a depressed buying market. The weaker marginal producers or processors are operating at a bare subsistence profit before the imposition of a manufacturing or processing tax. Upon the imposition of the tax, there will

not be an instantaneous or immediate raise in the price charged. Adjust­ment to curtailed production and higher prices must necessarily be a gradual process, lagging behind the tax assessment itself. During this adjustment period, such marginal producers, operating at a loss, will be eliminated. Consequent on their elimination, other adjustments must take place among the producers remaining. The marginal producers who survive this process have become more efficient, and ordi­narily do not have to raise their prices by the amount of the tax and will tend to be forced by competition not to raise them that much. As this efficiency of remaining marginal producers increases, the necessary price change is lessened. Where a producer, because of efficiency in operating and retrenchment forced upon him because of the tax, has decreased his costs of production, he may have shifted the entire burden of the tax to consumers although the prices charged them have not been increased by the amount of the tax. In fact, if operating efficiency has been great, the producer may be able to shift the entire tax burden to consumers without changing the prices from what they were before the tax was assessed against him.

**Statutory Presumptions Affecting the Problem of Proof**

Realizing the economic considerations involved in tax shifting, and aware that section 21 (d) contained no standards to aid in deter­mining tax incidence, Congress provided an elaborate set of presumptions in sections 501 and 907 of titles III and VII, respectively. All the presumptions are made rebuttable, and section 907 (e) provides that either the claimant or the commissioner may offer proof of the actual extent to which the claimant shifted to others the burden of the tax. While subsections 907 (e) (1) and (2) suggest what proof may be included, they do not limit proof on the issue of shifting to those suggestions. Thus, any claimant, if he is able to do so, may introduce complicated economic principles to show non-shifting, although, as Mr. Mark H. Johnson has suggested, there still remains the problem of getting the board and the courts to understand such economic theory.68

In order fully to appreciate the significance of the presumptions and tests which have been set up in titles III and VII to aid in deter­mining whether the burden of processing taxes has been shifted, it must be understood that Congress assumed that, in the normal case,

processors would and did add the amount of the tax to commodities sold to buyers. Senator Murphy, in the Congressional debates on these provisions, stated the general feeling that "when Congress was considering the subject of processing taxes, it was very well understood that such taxes would be passed on to the consumer. ... I assert that the processor who did not pass on the tax in the goods he sold is an incompetent business man. ..." That this assumption had much factual foundation has been indicated by surveys made for the government to indicate the incidence of the tax. Messrs. Ezekiel and Bean, supporting the administration, estimated in 1933 that over seventy-five per cent of the tax on cotton could and likely would be shifted. In this view of the matter, it is not surprising to find the "evidence and presumptions" section of title VII providing in section 907 (a) that:

"Where the refund claimed is for an amount paid or collected as processing tax ... it shall be prima-facie evidence that the burden of such amount was borne by the claimant to the extent (not to exceed the amount of the tax) that the average margin per unit of the commodity processed was lower during the tax period than the average margin was during the period before and after the tax."

While section 907 (a) provides that if the processor's average margin of profit was higher per processed unit during the tax period than before and after there is a presumption that the burden of such amount was shifted, there is also a contrary presumption if the average margin during the tax period was lower. Thus, presumptions as to the extent of the shift may operate either for or against the litigant. Either of these presumptions is rebuttable by proof of such facts as a change in production rate or customary seasonal fluctuations. The presumptions are obviously based upon the fundamental principle that, had no processing tax been imposed, the margin of profit would have been the same during the tax period as during the comparative base period. It has been suggested that if these presumptions are held to have the effect of substantive evidence, they are objectionable, inasmuch as no consideration is given to changes in variable factors involving costs of production other than the cost of raw materials. If the operation of

64 79 Cong. Rec. 11458 (1935).
66 50 Harv. L. Rev. 477 (1937).
the presumptions is merely to shift the burden of coming forward with
the evidence, however, they cannot be adjudged arbitrary or without
some foundation.

Section 907 (b) defines the average margin of profit for the tax
period as the average of the margins for all months within the period,
and section 907 (c) declares that the "period before and after the
tax" (the margin of profit during such a period is used as a basis of
comparison with the margin of profit during the tax period itself)
shall mean twenty-four months immediately prior to the effective
date of the processing tax, and the six months from February to July,
1936, inclusive. Curiously enough, this comparative base period of
two and one-half years differs from a six-year base period provided
for the windfall tax by section 501 (f) (1). It is difficult to under­
stand the intention of Congress in providing two different base periods
as part of the machinery contrived to furnish a basis for determining
an answer to the same question—whether the tax was shifted. The
only other discrepancy between the two titles is the difference in defi­
nition of selling price, title III employing actual selling price and
title VII using a theoretical selling price based upon the claimant's
sales prices current at the time of processing for articles of similar
quality. Section 501 (j) (3) provides that the processor shall not be
taxed upon any refund secured to him under title VII, thus preclud­
ing any attempt to tax the processor on amounts of tax which he did
not shift to others. All other provisions and presumptions are sub­
stantially alike in the two titles.

While sections 907 (e) and 501 (i) both provide that a difference
in profit during the tax period may be shown to be due to changes in
costs of production or in the quality of the commodity, the effect of
such evidence to establish that these and similar factors accounted for
the increased margin of profit rather than a shift in the burden of the
tax is left within the discretion of the commissioner.

If the taxpayer's business records are inadequate to show the
amount of his profits during the tax period or the applicable period
before or after tax, the commissioner is authorized to compute such
margin from the average margins for that period of representative
concerns engaged in a similar business under similar circumstances.
But the Treasury Department has held that the taxpayer may report as

(f) (3).
68 49 Stat. L. 1747, § 907 (b) (6).
69 49 Stat. L. 1734, § 501 (f) (1); 49 Stat. L. 1747, § 907 (c).
his average profit in such a case that of concerns believed by him to be representative, or his own average profit for the period when his records were adequate.\textsuperscript{70} The spread or difference between such profits per unit is presumably (subject to rebuttal by proof of other causes) the amount of the tax shift.

While these presumptions and conditions are imperfect in many respects, they do bear some relation, at least, to the actual determination of tax shifting, and cannot be considered wholly irrelevant or arbitrary. The chief contention of processors objecting to the imposition of the windfall tax against them is that it is impossible for them to show the facts necessary to invoke the statutory presumptions, or any other facts tending to prove non-shifting. In such a case, since the burden of proof is upon the processor, his tax liability is left to the whim of the commissioner.\textsuperscript{71} Where the factual situation makes the criteria provided by the statute inapplicable, the question of the shifting of the tax burden is left to mere conjecture, as illustrated by the following hypothetical case:

"There has been an increase in the margin of six cents per unit item. The processing tax amounted to six cents per unit. Labor costs rose six cents per unit at the same time that the tax was imposed. No other material factors can be shown. The commissioner must determine whether the six-cent increase in the margin was due to the inclusion of the tax or labor cost. Lacking the assistance of any standards, he will probably split the difference. That is a type of rough justice which is not very appealing."\textsuperscript{72}

Where the extreme difficulty of proving any facts tending to show the non-shifting of the tax burden has been alleged, the courts have been firm in holding that mere expense of searching the records, accounting difficulties, and allocation problems are not sufficient to excuse the petitioner from liability for the windfall tax.\textsuperscript{73} While it frequently has been stated that the petitioner would not be liable for the windfall tax if it was actually impossible for him to prove that he had borne any part of the burden, where the government could not prove that he had shifted any part of the burden, yet situations of practical impossibility apparently are ignored by the courts and the petitioner held liable if he cannot prove actual non-shifting.

\textsuperscript{70} U. S. Treas. Reg. 95, Art. 1, 2 CCH Federal Tax Service, \$ 2026 (j) (2) (1937).
\textsuperscript{71} See 50 Harv. L. Rev. 477 at 487 (1937).
\textsuperscript{72} 50 Harv. L. Rev. 477 at 483, note 39 (1937).
\textsuperscript{73} See cases cited in note 5, supra.
EFFECT OF RESTITUTION TO CUSTOMER IN SETTLEMENT OF CONTRACT

Section 501 (f) (3) (A) provides a credit for tax moneys repaid to or credited to purchasers in bona fide settlement of a written agreement entered into on or before March 3, 1936, as reimbursement for amounts paid as taxes. Section 501 (b) (2) makes the tax inapplicable in all events if the taxpayer has made a tax adjustment with his vendee by repaying or crediting to him the amount of the tax collected, but such repayment or credit must be of the entire amount of the tax and must have been made on or before June 1, 1936, or thereafter in the settlement of a written agreement entered into on or before March 3, 1936. There is no provision in either title III or title VII for a recovery or a windfall tax exemption conditioned upon a bond or promise to repay vendees after the refund applied for has been given or after the windfall tax has been imposed. Both titles require a prepayment to the buyer. A written agreement has been defined by the Treasury as a promise in writing, though not necessarily legally enforceable. An administrative interpretation of the Internal Revenue Bureau decided that:

"payments or credits made [by a processor] to vendees in settlement of agreements will not be considered as made within the limitations prescribed by section 501 ... unless such agreements ... are signed by either the vendor or vendee, or, if not signed by either party, it can be shown by correspondence or other writings signed by either party, or both, on or before March 3, 1936, that the parties intended to be bound by the terms of such agreements. ..."74

EFFECT OF STATUTORY PROVISIONS UPON CUSTOMER'S EQUITIES

The Jefferson case referred to the buyer who had paid the amount of the tax as the "real party in interest."75 That the reference is anomalous, however, is witnessed by the fact that neither section 424 of the Revenue Act of 1928,76 under which the Jefferson case was decided, nor any later refund provision allowed a buyer who had paid an illegal tax imposed upon his seller any right of recovery. It is true

76 45 Stat. L. 866 (automobile accessories tax refund).
that section 424 contained a stipulation allowing the vendor a refund upon his giving a bond conditioned upon his repaying the recovered tax moneys to his vendees who had borne the burden thereof. But there was no procedure by which the paying buyer could require the vendor to sue for recovery in the buyer's name, nor could the buyer to whom the tax had been shifted sue the government directly on any "real party in interest" or subrogation basis.

Titles III and VII of the 1936 Revenue Act are stripped of any pretense of protecting the purchaser, with their requirement of prepayment to him before the time that the acts were passed. A processor cannot secure a refund under title VII, nor escape the windfall tax under title III, by entering into an agreement with his vendees to reimburse them to the extent that they bore the burden of the tax, and there is no provision by which the processor can give a bond conditioned on payment of recovered sums or untaxed surpluses to the real taxpayers, his vendees. 77

The general rule, as before stated, is that the buyer who has paid the tax as part of a composite price cannot recover its amount from his vendor even though the tax has been declared illegal and the vendor has recouped the amount from the government. The reasoning is that the buyer did not pay the tax, but only a total price in which the amount of the tax was absorbed. 78 Where there has been a clear agreement between vendor and vendee that the amount of the tax paid by the latter shall be refunded to him in case it is recovered by the vendor, vendees have been allowed recovery upon contractual or quasi-contractual principles. 79 But such agreements in reference to processing taxes have been strictly construed against the buyer. 80

The lower federal courts consistently denied the rights of buyers to intervene in suits by processors attacking the tax, on the ground that the processor, not the buyer, paid the tax, and the buyer had no equitable interest in the litigation. 81 In the recent case of Johnson v. Igleheart Bros., 82 the court denied any right of recovery by the buyer

78 See cases cited in note 15, supra.
82 (C. C. A. 7th, 1938) 95 F. (2d) 4.
from his seller of that part of the processing tax assumed by him and not paid to the government by the seller. A like result was established where the processor had already paid the windfall tax on processing tax funds secured from buyers but not paid to the government. 83

United States v. Moor 84 is an outright holding that a buyer who had paid illegal taxes imposed upon his vendor cannot recover such payments by a suit against the government. 85 The reasoning of these cases is contrary to the theory of unjust enrichment which is the basis of titles III and VII, but it has been indicated that the apparent reluctance of courts to allow recovery of processing taxes by purchasers who assumed them may be justified on practical grounds. Thus,

“If a wholesale buyer may recover, there seems to be no logical reason why the retail buyer from him, and finally the individual consumer, should not recoup their share of such refunded taxes. It is submitted that this raises administrative problems of allocation so intricate that the courts are justified in denying a right of recovery to vendees of taxpayers, though such vendees have borne the tax, in the absence of specific contract provisions stipulating therefor.” 86

Titles III and VII of the Revenue Act of 1936 mark a noteworthy advance in the application by Congress of equitable principles to taxation cases. Certainly it is true that, in considering tax incidence, rather than mere tax impact, the national legislature has looked beyond the narrow common-law concept that the one against whom the tax was imposed had invariably paid the tax and was entitled to reimbursement as a matter of course if the tax was illegally imposed. Behind the economic justification for applying principles of unjust enrichment to tax recovery, there is of course a practical financial policy. Congress has found a fruitful field in which it may garner more taxes for the federal treasury, a field in which it may tax with impunity and good grace, approved by economic theory and sanctioned by equitable considerations of fairness and justice.

84 (C. C. A. 5th, 1937) 93 F. (2d) 422, cert. denied 303 U. S. 663, 58 S. Ct. 830 (1938).
85 Cf. the very recent decision in Stahmann v. Vidal, (U. S. 1938) 59 S. Ct. 41, holding that the producer of cotton had standing to maintain an action for refund of taxes assessed against the ginner under the Bankhead Cotton Act. The Court pointed out that this act was unique in that it evidenced an intention to have the tax fall on the producer and simply made the ginner and collector part of the machinery for compelling payment.