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TAXATION - FEDERAL INCOME TAX - PAYMENT TO EMPLOYEES AS COMPENSATION OR GIFT

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TAXATION — FEDERAL INCOME TAX — PAYMENT TO EMPLOYEES AS COMPENSATION OR GIFT — The Universal Oil Products Company had been "extraordinarily successful," and its interests were very large and valuable. The stockholders transferred their stock to another corporation and the cash assets to the Unopco Corporation, an organization formed for the express purpose of managing this fund, whose stockholders were the same as of the former Universal Oil Products Company. At a stockholders' meeting, a resolution was adopted which in effect provided that a sum of money be allocated for payment to those employees who had loyally supported the former company. At the time this resolution was adopted the president of the new corporation declared: "It . . . would be a nice and generous thing for us to show our appreciation and to remember them in the form of a gift of honorarium." The beneficiaries thereof were attorneys, engineers, experts, etc. In the present action to determine whether the payments made pursuant to this resolution were taxable under the federal income tax as "compensation for personal services" [1] or exempt as "gifts," the Supreme Court, in reversing the circuit court and the decision of the Board of Tax Appeals, *held*, the payments were exempt from taxation, since they were made without legal or moral obligation and because no benefit in the future would accrue to the donor by reason thereof. Four justices dissented. *Bogardus v. Commissioner of Internal Revenue*, 302 U. S. 34, 58 S. Ct. 61 (1937).

The instant case is one of several actions [2] which have arisen out of the beneficence of the Unopco Company. The divergence of opinion [3] manifested in the circuit courts and the Supreme Court in these cases is not unexpected in the light of the fact that the Court is attempting not only to apply a rather tenuous standard but is trying to formulate the standard as well. The rule [4] is established that a payment to an employee or former employee may be considered as compensation within the meaning of the statutory provision here involved even though such payment is voluntary, without legal consideration. However, the

[1] Revenue Act of 1928, § 22 (a) [45 Stat. L. 791, 26 U. S. C. (1935), § 22]: "Gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . ." § 22 (b): "The following items shall not be included in gross income . . . (3) The value of property acquired by gift . . . ."

[2] Hall v. Commissioner of Internal Revenue, (C. C. A. 4th, 1937) 89 F. (2d) 441; Simpkinson v. Commissioner, (C. C. A. 5th, 1937) 89 F. (2d) 397; Walker v. Commissioner, (C. C. A. 1st, 1937) 88 F. (2d) 61.

[3] There were dissenting opinions in two of the lower court cases in addition to the difference of opinion in the present case.

[4] 110 A. L. R. 285 at 286 (1937).

two cases [5] most frequently cited in support of this proposition do not, under analysis, announce any such broad principle which the subsequent cases would apply. The following quotations, which are often cited, represent the usual curial pronouncement: "Whether a payment in a given case shall be deemed taxable compensation or a gift exempt from tax depends upon the intention of the parties, and particularly that of the employer, to be determined from the facts and circumstances surrounding the transaction"; [6] "That only is a gift which is purely such, not intended as a return of value or made because of any intent to repay another what is his due, but bestowed only because of personal affection or regard or pity, or from general motives of philanthropy or charity." [7] Certain elements have been seized upon by the courts as being indicative of an intent one way or another: that the stockholders themselves have voted the payment,[8] that the payment was a prospective one,[9] the particular words used,[10] the nature of the employer's bookkeeping entries as well as claims for federal

[5] Noel v. Parrott, (C. C. A. 4th, 1926) 15 F. (2d) 669, cert. den. 273 U. S. 754, 47 S. Ct. 457 (1927). The facts of this case show rather clearly that the payments were made in contemplation of special services to be rendered by certain officers of the corporation. And it further appeared that the payment was made after the deal had been carried through.

Old Colony Trust Co. v. Commissioner, 279 U. S. 716, 49 S. Ct. 499 (1929). This appears to be the only Supreme Court decision directly on this matter prior to the instant case. The court pointed out (279 U. S. at 729): "The certificate shows . . . that the employee entered upon his duties . . . under the express agreement that his income taxes would be paid by his employer."

[6] Fisher v. Commissioner, (C. C. A. 2d, 1932) 59 F. (2d) 192 at 193.

[7] Bass v. Hawley, (C. C. A. 5th, 1933) 62 F. (2d) 721 at 723.

[8] 110 A. L. R. 285 at 288 (1937), which states: "Since the officers and directors of a corporation are usually unauthorized to make a gift of corporate funds, there is a strong presumption that a payment by them to one performing services for the corporation is authorized and is compensation subject to income tax rather than tax exempt therefrom." See also Rogers v. Hill, 289 U. S. 582, 53 S. Ct. 731; 88 A. L. R. 744 at 751 (1933); Jones v. Commissioner, (C. C. A. 3d, 1929) 31 F. (2d) 755. See 40 A. L. R. 1423 (1926) on the general problem of the power of a corporation to grant a bonus to its officers and employees. But see Botchford v. Commissioner, (C. C. A. 9th, 1936) 81 F. (2d) 914, 110 A. L. R. 281 at 285 (1937), where the court pointed out that the fact that the resolution is submitted to the stockholders is not determinative, because even where it has been so submitted the payment has been considered as compensation rather than a gift.

[9] See note 5, supra; Levey v. Helvering, 62 App. D. C. 354, 68 F. (2d) 401 (1933), where the company had a fixed policy of passing resolutions to pay its officers the amount of the federal tax.

[10] 110 A. L. R. 285 at 299 (1937); Simpkinson v. Commissioner, (C. C. A. 5th, 1937) 89 F. (2d) 397, where the court considered it of significance that "bonus" was used in the resolution; Levey v. Helvering, (App. D. C. 1933) 68 F. (2d) 401; Botchford v. Commissioner, (C. C. A. 9th, 1936) 81 F. (2d) 914, where "remuneration" was used. With respect to the use of the word "honorarium," see Bogardus v. Helvering, (C. C. A. 2d, 1937) 88 F. (2d) 646, the principal case. But cf. Cunningham v. Commissioner, (C. C. A. 3d, 1933) 67 F. (2d) 205; Daly's Appeal, 3 B. T. A. 1042 (1926).

tax deductions,[11] whether the payment is made to a stranger.[12] Some cases[13] have established applicable presumptions as well. The word "gift," [14] though not a wholly unitary concept, has come to have a more or less definite meaning to the profession. And though the term "consideration" leaves room for wider significance it too partakes of well recognized characteristics. The difficulty, therefore, would appear to be a conceptual one, for the situation under discussion manifests some of the characteristics of both, at least in some cases. No matter what degree of specificity one may attach to these terms, to hold that "in recognition of the long and faithful services of the officers, etc . . ." (for which due compensation has already been made) is *consideration*[15] would put an inordinate strain on the accepted connotation of that word, and would destroy, proportionately, the usefulness of the symbol in legal thought. The circuit court, and apparently the dissenting justices in the instant case, cut the Gordian knot, not by making a dichotomous division as did the majority of the Supreme Court, but by declaring that "gifts" and "compensation for personal services" were not mutually exclusive within the meaning of the statute—a construction which the majority held to be "inadmissible and confusing." It is submitted that the analysis of the circuit court is the preferable one and that the test should be a determination, to paraphrase Judge Hand's statement, whether or not the gift finds its roots in the services rendered to the employer.[16] It might be pointed out that this discussion is not concerned with the question of administrative law involved in the present case, i.e., the effect to be given to a finding by the Board of Tax Appeals on the matter of intent.[17]

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[11] 110 A. L. R. 285 at 301 (1937); Lucas v. Ox Fibre Brush Co., 281 U. S. 115, 50 S. Ct. 273 (1930). But see Brauer v. Commissioner, 6 B. T. A. 579 (1927); Simpkinson v. Commissioner, (C. C. A. 5th, 1937) 89 F. (2d) 397; Levey v. Helvering, (App. D. C. 1933) 68 F. (2d) 401.

[12] But where the donor is economically identified with the former employer it is held to be compensation, other elements present. See the dissenting opinion in Walker v. Commissioner, (C. C. A. 1st, 1937) 88 F. (2d) 61, and the opinion of the court in Bogardus v. Helvering, (C. C. A. 2d, 1937) 88 F. (2d) 646.

[13] See the instant decision as well as the dissenting opinion in Bogardus v. Helvering, (C. C. A. 2d, 1937) 88 F. (2d) 646.

[14] 73 A. L. R. 1536 at 1539 (1931).

[15] Schumacher v. United States, (Ct. Cl. 1932) 55 F. (2d) 1007 at 1011. See also Acme Land & Fur Co. v. Commissioner, (C. C. A. 5th, 1936) 84 F. (2d) 441, where moral sanctions removed the situation from the gift category; Levey v. Helvering, (App. D. C. 1933) 68 F. (2d) 401. And see the discussion in the instant case.

[16] Bogardus v. Helvering, (C. C. A. 2d, 1937) 88 F. (2d) 646. See also Bickford v. Commissioner, 34 B. T. A. 461 at 465 (1936): "There is no doubt . . . that the payments would not have been made . . . except for their prior service."

[17] The dissent in the instant case as well as the decisions in the circuit court in the present case and in the cases cited in note 2, supra, rest on the fact that the courts felt that the decision of the Board, since it involved a question of fact, should stand unless it could be considered an unreasonable interference. The majority of the Court, on the other hand, considered the matter as a mixed question of law and fact.