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THE END OF DISCRIMINATION AGAINST SMALL BEGINNING BUSINESS IN THE TREATMENT OF RESEARCH AND DEVELOPMENT EXPENDITURES FOR FEDERAL INCOME TAX PURPOSES

By Burgess L. Doan* **

Section 174 of the Internal Revenue Code of 1954 was intended to remove the uncertainty which existed under prior law governing the deductibility of research and experimental expenditures. Prior Internal Revenue Codes, including the 1939 Code, contained no provision specifically dealing with research expenditures. There was continuing litigation in the courts with no definite rules coming out of the litigation to guide taxpayers in their planning of business expenditures. These expenses were commonly written off by large businesses with continuing research and development programs, while their smaller counterparts, such as the sole proprietor, the partnership, and joint venturer were, as a matter of routine, denied the deduction.1 The reason for enacting Section 174 was stated by Congressman Camp of Georgia as follows:

In order to clarify the existing confusion in respect to the tax treatment of such expenditures, and to prevent tax discrimination between large businesses having continuous programs of research and small or beginning enterprises ... 4326A Cong. Rec., July 12, 1951. (Emphasis supplied)

In 1954 Congressman Reid of New York, Chairman of the House Committee on Ways and Means, speaking on behalf of the proposed Section 174, stated:

Present law contains no statutory provision dealing with the deduction of these expenses. The result has been confusion and uncertainty. Very often under present law small businesses which are developing new products and do not have established research departments are not allowed to deduct these expenses despite the fact that their large and well-established competitors can obtain the deduction ... This provision will greatly stimulate the search for new products and new inventions upon which the future economic and military strength of our Nation depends. It will be particularly valuable to small and growing businesses. (Emphasis supplied)2

The Congressional intent in enacting Section 174 was, at least in part, to prevent tax discrimination against small and beginning businesses. The purpose of this paper is to examine the treatment of research and

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**Ed. note. Mr. Doan was counsel for the taxpayer in Snow v. Commissioner.

2. 100 Cong. Rec. 3424 (1954).
experimental expenses under Section 174 as it has been applied by the Internal Revenue Service and interpreted by the courts to determine whether Congressional intent has, in fact, been achieved.

**Pre-1954 Treatment of Research and Experimental Expenses**

Prior to the enactment of Section 174, the law was uncertain, unclear and confusing as applied at the administrative level and as interpreted by the courts.3

The courts early laid down the rule that research and experimental expenditures should be capitalized for both large and small businesses.4 Although there were decisions pointing in the other direction,5 certainly the weight of authority required the expenditures to be capitalized. The law continues to require capitalization6 wherever Section 174 does not apply. Taxpayers were not discouraged, though, and in general deducted costs of research and experimentation as ordinary and necessary business expenses, except where their situations were served better by capitalization7

The Internal Revenue Service usually adopted a more liberal approach than the courts and tended to allow deduction where the expenditures had been incurred under a continuing research program. However, a taxpayer could not depend upon this attitude in every case. Upon audit the position was sometimes taken that part or all of such expenditures should be capitalized, particularly where there were possibilities of obtaining patents. The position was less liberal with regard to small beginning businesses and those only sporadically engaged in research.8

The basis for this was that the taxpayer was not engaged in carrying on a trade or business.

The inconsistent positions of the courts, the Internal Revenue Service, and the taxpayers stemmed from the very nature of research expense — it represents an expenditure in the present in the hope of obtaining benefits in future years. Granted that premise, if there is to be a matching of expenses and receipts to clearly reflect income, capitalization

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5. Duesenberg, Inc. v. Commissioner, 84 F. 2d 921 (7th Cir. 1936); Universal Oil Products Co. v. Campbell, 49-1 U.S. Tax Cas. Section 9180 (N.D. Ill. 1948); Pittsburgh Screw & Bolt Corp. v. Commissioner, 2 CCH Tax Ct. Mem. 747 (1943).
7. Pittsburgh Screw & Bolt Corp., 2 CCH Tax Ct. Mem. 747 (1943). The tax treatment of research and experimental expenditures under the 1939 Code has been authoritatively stated to be as follows: "No specific treatment is authorized by present law for research and experimental expenditures. To the extent that they are new and necessary they are deductible; to the extent that they are capital in nature they are to be capitalized and amortized over useful life . . . ." S. Rep. No. 1622, 83rd Cong. 2d Sess. (1954).
should be mandatory with the expenses being recovered over the life of the invention. However, another characteristic of research is the unpredictability of benefits. The courts emphasized the first characteristic, while the taxpayers, and to a lesser extent the Service, stressed the second.

Accordingly, in response to insistent demands by taxpayers for legislative correction, and with Internal Revenue Service support, Congress, in 1954, enacted Section 174 to achieve equality of tax treatment between large businesses and small businesses. Section 174 took on the characteristics of a tax incentive, as pointed out by the Committee Reports, to encourage further research in the interest of creating new industries and strengthening national defense.9

Section 174, as finally enacted, provides in pertinent part as follows:

(a) Treatment As Expenses —

(1) In general. — A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

(2) When method may be adopted. —

(A) Without consent. — A taxpayer may, without the consent of the Secretary or his delegate, adopt the method provided in this subsection for his first taxable year —

(i) which begins after December 31, 1953, and ends after the date on which this title is enacted, and

(ii) for which expenditures described in paragraph (1) are paid or incurred.

(B) With consent. — A taxpayer may, with the consent of the Secretary or his delegate, adopt at any time the method provided in this subsection.

(2) Scope. — The method adopted under this subsection shall apply to all expenditures described in paragraph (1). The method adopted shall be adhered to in computing taxable income for the taxable year and for all subsequent taxable years unless, with the approval of the Secretary or his delegate, a change to a different method is authorized with respect to part or all of such expenditures.

What Are Research and Experimental Expenditures?

Section 174 contains no general definition of research and experimental expenditures and makes no attempt to distinguish between basic and applied research. Various expenditures are, however, specifically excepted from its application.

The Regulations limit the term research and "experimental expenditures" to expenditures which represent research and development costs in the experimental or laboratory sense. Thus the term includes generally all expenditures incident to the development or improvement "of an experimental or pilot model, a plant process, a product, a formula, an

invention, or similar property.” It does not include expenditures for research “in connection with literary, historical, or similar projects.” 10 Under this definition, research costs incurred in the library would not qualify if the end result sought were a book, treatise or paper. However, if related to a specific research project, library costs would be allowable. Moreover, costs incurred in developing a market for a new product rather than in developing the product itself do not constitute research or experimental expenditures under Section 174. 11

EXPERIMENTAL OR PILOT MODEL

Inclusion of an experimental or pilot model as research cost is perhaps the most favorable aspect of the statute for the established, on-going business. However, as the statute has been applied by the Internal Revenue Service and interpreted by the courts since its enactment, it has not changed the plight of the new and beginning business that has no established product line. In view of the recent Supreme Court decision in Snow v Commissioner, 12 the small beginning taxpayers should receive treatment equal to that of the established business with an existing product line. Among the many questions that may arise, the following is particularly significant: Will the right to current deductions be affected if the pilot model of a chemical process plant eventually may be used as a demonstrator for sales purposes? Apparently not, if the research is carried on in connection with an existing business. Yes, if it is not in connection with an existing business. And yet, if the primary motive for construction of the model is research in the experimental or laboratory sense, the cost should be considered as deductible although the pilot model eventually become a sales tool.

ITEMS EXCLUDED

Two types of expenditures are expressly excluded from the research and experimental category:

(1) those for the exploration of minerals, oils and gas which are now covered specifically under Sections 615 and 263(c);

(2) those for the acquisition or improvement of land or of property which is subject to the allowances for depreciation or depletion and is “to be used in connection with the research and experimentation.”

The restrictions relating to expenditures for the acquisition or improvement of land and property subject to depletion allowances normally will present no difficulty, but the exclusion of expenditures for depreciable property used in connection with research is likely to result in disputes. The purpose of the limitation is to prohibit charging the cost of a new research laboratory or equipment to expense. The wording of

the limitation, however, is vague as to whether the expenditures to be excluded are confined to costs of component materials, labor and other elements involved in construction and installation, or whether they also include amounts expended for preliminary research and experimentation. While no cases can be found involving this precise question, it is speculated by this author that preliminary research will be allowed if otherwise qualified.

Although expenditures for the acquisition of depreciable or depletable property to be used in research activities are excluded, allowances for depreciation and depletion constitute research expenditures under Section 174. This treatment appears to have tax accounting significance only to the extent that it applies or is apportioned to research projects deferred under Section 174(b). In this case, the depreciation would be accumulated as a deferred cost until the point at which benefits are derived. Taxpayers using the current expense method would be entitled to deduct depreciation or depletion under other Sections of the Internal Revenue Code.  

RESEARCH RESULTING IN DEPRECIABLE PROPERTY

Another occasion for capitalization relates to research which results in depreciable property as an end product which is or can be used in the taxpayer's business. In such circumstances, deductions are limited to the amounts spent for research or experimentation.

In the example given in the Regulations, the taxpayer expended $30,000 in the development of a new machine, of which $20,000 was deductible as research, and $10,000 represented labor, materials, and other costs of constructing the machine. The latter amount was to be capitalized as a depreciable asset. It is assumed that the new machine was to be placed on the production line and was not merely a pilot model. Difficulty undoubtedly may be encountered in establishing a cut-off point between the termination of research and the construction of the end product, particularly where production personnel work on the research phase of the project.

PERFECTING PATENT APPLICATION

The costs involved in making and perfecting a patent application were not deductible under the proposed Regulations. However, under the final Regulations they constitute research and experimental costs. This departure from prior thinking should help considerably in handling audit problems with the Internal Revenue Service. As long as the exception stood it was a serious stumbling block, not only because of the difficulty of isolating patents, but also because examiners were inclined to disallow a wide variety of costs as attributable to patents to be obtained only in

the future. To that extent Section 174 has resolved numerous cases that would otherwise be in dispute.

PAID OR INCURRED BY TAXPAYER

The opening sentence of Section 174 expressly limits the application of the section to expenditures paid or incurred by the taxpayer himself. This probably indicates an intent to exclude the costs of acquiring another’s patent, model or process. The Regulations categorically take the position that the purchase price of another’s “patent, model, production or process” does not constitute a research or experimental expenditure. This position has been litigated in the Tax Court and the Internal Revenue Service has prevailed.\(^1\)

EXPENDITURES FOR WORK DONE BY ANOTHER

In any event, Section 174 is not confined to expenditures for research and experimentation undertaken directly by the taxpayer. It also applies to expenditures for such work carried on for the taxpayer by another person or organization such as a research institute, foundation, or engineering company.

However, to the extent that the amounts paid by the taxpayer to his contractor represent expenditures for the acquisition or improvement of land or for the construction and installation of depreciable property of which the taxpayer will acquire ownership, they are not expenditures to which Section 174 relates. In connection with this limitation, the Regulations give an example indicating that for taxpayers who have elected to treat research and development expenditures under Section 174(a), it may be advantageous to purchase research rather than to undertake it directly. In the example provided, the taxpayer hires a research organization to conduct research and experimental work in order to create a new product. In the taxable year, the taxpayer pays the organization $150,000, of which $25,000 is expended for an addition to the organization’s laboratory and the balance for experimental work in connection with the project. It is agreed that the laboratory addition paid for by the taxpayer shall be retained by the research organization upon completion of the work. The Regulations state that the entire $150,000 represents research and experimental expenditures.\(^1\) Accordingly if the taxpayer had adopted the current expense method of accounting for research expenditures, he would be entitled to deduct that amount in his return for the year in which the expenditures were incurred. Because of the extended amortization period, this does not apply with equal force to those who have selected Section 174(b), the capitalization option of Section 174.

The case would be different if the taxpayer had undertaken the project

itself and had spent $25,000 either in constructing a new laboratory or in adding to existing facilities. In this situation, the taxpayer’s deduction would be limited to $125,000, and under Section 174 (c) the $25,000 paid for the new laboratory facilities would have to be capitalized and depreciated.

**DEPRECIABLE PROPERTY CONSTRUCTED BY ANOTHER**

Costs of research and experimentation incurred in connection with the construction or manufacture of depreciable property by another qualify as expenditures under Section 174 only if made upon “the taxpayer’s order and at his risk.”

It is not unusual for a taxpayer to order a specially-built machine from an engineering company under a guarantee by the latter that the machine will be capable of producing a given number of units per hour. Since the research expenses were not incurred at the buyer’s risk, the engineering company would be incurring the research and experimental expenses and not the buyer. On the other hand, the research expenses would be deductible by a taxpayer on the current expense method if the machine were purchased without the performance guarantee, since the outcome of the research would then be in doubt and, therefore, at the risk of the taxpayer.

**RESEARCH EXPENDITURES VS. ORDINARY AND NECESSARY BUSINESS EXPENSES**

One of the difficulties confronting taxpayers in applying Section 174 is the distinction between research expenditures and ordinary and necessary business expenses. Section 174 is silent as to what specific items constitute research and experimental expenditures. However, the Regulations list the following as not being research and experimental expenditures:

1. those for the ordinary testing or inspection of materials or products for quality control; or
2. those for efficiency surveys;
3. management studies;
4. consumer surveys;
5. advertising or promotions.\(^\text{16}\)

The above items *may* be ordinary and necessary business expenses incurred in carrying on a trade or business and deductible currently.\(^\text{17}\) Otherwise, they are capital expenditures and not deductible currently. This list does not purport to be exhaustive. Accordingly, taxpayers normally will have to decide for themselves how to classify a given expenditure. Probably the decision is unimportant for those who adopt the current expense method of treating research expenditures, since their ex-

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expenses, whether for research or for ordinary business purposes, are deductible in the year in which incurred. However, it can become important if research and experimental expenditures are deductible in connection with a trade or business while in the preparatory stage. In contrast, ordinary and necessary business expenses are deductible only in carrying on a trade or business after it has matured beyond the preparatory stage.\textsuperscript{18}

Taxpayers electing to defer research expenditures under Section 174 (b) will also find the distinction important. As the statute operates, it may be a number of years before such a taxpayer can claim a deduction for his deferred expenditures. To the extent that these expenditures represent ordinary and necessary business expenses, they could be disallowed and consequently lost as deductions if the year in which they were incurred is barred by the statute of limitations at the time when the examiner makes the disallowance.

Research and Experimental Expenditures as Current Expenses

Section 174(a) (1) permits taxpayers to deduct research or experimental costs as a current expense of the year in which paid or incurred. By and large, this provision gives statutory recognition to the administrative practice of the Service and overrules the restrictive precedents established by the courts under the 1939 Code.

A taxpayer wishing to deduct his expenditures currently must "adopt" the method in his return for the first taxable year beginning after December 31, 1953 and ending after August 16, 1954 in which he has research or experimental expenditures. Adoption of the method requires merely that a deduction for the expenditures be claimed in the return in the first taxable year in which the expense is incurred.\textsuperscript{19}

A taxpayer who fails to adopt the current expense method in the first taxable year in which he could have done so may apply for the Commissioner's consent to adopt the current expense method in a subsequent year. The taxpayer's application must be filed not later than the last day of the first year for which the method is to be adopted, and if granted, is applicable to that year and subsequent years. Prior years remain unaffected.

The current expense method, once adopted, whether with or without consent, applies to all research and experimental expenditures for the taxable year and for all subsequent taxable years unless authorization is secured from the Commissioner to use a different method with respect to certain projects or to all of such expenditures. The opportunity to obtain permission to treat less than all of his expenditures as current expense allows a taxpayer to defer the cost of a special project without

\textsuperscript{18} Deputy v. Du Pont, 308 U.S. 488 (1940).
\textsuperscript{19} Treas. Reg. Section 1.174-3(a), (b).
losing the tax benefit to be derived from deducting currently the re-
mainder of his research costs.

In no event, however, will a taxpayer be permitted to deduct part of
the cost of a particular project and, in the same taxable year, to treat
the balance of the expenditures attributable to the project under a dif-
ferent method.

A taxpayer may, with the consent of the Commissioner, change from
the current expense method to the deferred method pursuant to the
procedure outlined in the Regulations at 1.174-3(b).

FACTORS GOVERNING CHOICE OF METHOD

It is probable that the great majority of taxpayers will choose to
deduct their research and experimental expenditures under Section
174(a). It will appeal to most taxpayers because the “bird in the hand”
approach is the dominant philosophy inherent in most tax planning.

The uncertainties inherent in the capitalization of research expendi-
tures under the 1939 Code likewise afflict the deferred expense
method, although to a slighter degree. The taxpayer cannot be sure
when he will get the deduction under the deferment method or how
much it will be.

If the taxpayer’s hopes and money are not translated into success to
the point of realizing some benefits, the Service will require a showing
that the research project and other projects related to it have been
permanently discarded from the business before the loss deduction will
be allowed. Moreover, under both the capitalization and deferred ex-
 pense methods, deductions may be lost through failure accurately to
segregate costs among research projects.

ADVANTAGES OF CURRENT EXPENSE METHOD

The current expense method obviates the elaborate cost accounting
systems required when expenditures are capitalized or deferred because
the expenditures are deductible currently without regard to the success
or failure of the projects to which they relate. It was in part the difficulty
of allocating the specific costs applicable to various projects and pro-
cesses that induced the Service, prior to the enactment of Section 174,
to permit the current deduction of research costs to large companies with
continuing research operations.

With the current deduction method now sanctioned by statute, there
would seem to be, in the usual case, no reason why a taxpayer should
expose himself to these vexations. Further, the current expense method
may be used effectively to offset other income of the owners of a new
undertaking which assumes the partnership form.

ADVANTAGES OF DEFERRED EXPENSE METHOD

Although deduction as a current expense normally is advantageous,
there may be special situations in which the deferred expense method
will be preferred. For example, a new corporation (or a partnership whose members have no other taxable income), engaged in research and anticipating losses in its early years, may feel that the five-year carryover of net operating losses is insufficiently long for it to obtain the maximum tax benefit for its research expenditures. Where an excess profits tax, tax surcharge, or a higher rate is anticipated, deferment eventually may produce substantial tax savings. Deferral may also be preferred where there is no other income and it is expected that the end product of the research will be sold at a large capital gain. It is conceivable that a personal holding company, which expects royalty income from current research work, will benefit from the deferment approach because the net operating loss deduction does not apply in arriving at undistributed income. These are all special cases, however, which will not often arise.

In general, taxpayers will be well advised to adopt the current expense method for the bulk of their research expenditures and to reserve use of the deferred expense method for a particular project or projects calling for such treatment. In no event should the deferred expense method be elected unless it can reasonably be anticipated that the project will be successful and unless the related costs can be ascertained accurately.

**CAPITAL GAINS OR LOSSES UNDER SECTION 174**

The values (usually tangible) stemming from expenditures under Sections 174(a) and (b) appear to constitute capital assets as defined in Section 1221 of the Code. Upon sale there would be capital gain under Section 1222, or capital loss under the same section as limited by Section 1211.

The point warranting elaboration is that where the unamortized cost of a Section 174(b) asset exceeds the selling price, depending on the circumstances, the loss may not bring about any tax benefit or may result in only a limited tax benefit. The reason is that a Section 174(b) asset is not "property used in the trade or business" within the meaning of Section 1231(b) because it is not subject to depreciation under Section 167.

Hence, when a taxpayer adopts Section 174(b), he should bear in mind that deferment of expenditures may lead to an unallowable capital loss. On the other hand, those who adopt Section 174(a) do not run this risk because of the current charge off of expenditures.

**EXPENDITURES IN CONNECTION WITH TAXPAYER'S TRADE OR BUSINESS**

The regulations state that the expenditures to which Section 174 applies may relate to a single project and do not have to stem from a general research program. Hence, it would seem that a company having no permanent research department, which undertakes a lone research
project, or a company or a joint venture set up solely to develop a new product would qualify.

Net operating loss carry-overs are small consolation to a corporation which must rely on the success of the research program in order to utilize them. Consequently, entrepreneurs with other sources of income to be offset will tend to favor the partnership form of organization in order to obtain immediate deductions for such losses. Similarly, two or more industrial concerns which are entering upon a combined research program should consider the advantages of the joint venture form.

However, a serious limitation on the operation of Section 174 is that the expenditures must be incurred in connection with the taxpayer’s trade or business. While this restriction has no effect on established business operations with continuing research programs, it has been used by the Government in recent cases to deny the benefits of Section 174 to small beginning businesses not yet engaged in “carrying on a trade or business” within the meaning of Section 162 of the Internal Revenue Code of 1954.20

“CARRYING ON” VS. “IN CONNECTION WITH” A TRADE OR BUSINESS

Section 174 requires that research and development expenses be incurred “in connection with his trade or business.” This requirement has been the “achilles heel” for numerous taxpayers seeking to deduct research and development expenses.

By far the greatest problem incurred by the small businessman just getting started is proving that the research and development expenses were incurred in connection with his trade or business. The term “trade or business” was a part of the Internal Revenue Code long before Section 174 was enacted. It has survived various revisions and is found in numerous sections. Yet, the term remains unclear and not well defined. The definitions with which we have to work are interpreted solely within case law with no examples found in the Code or in the Regulations, with the possible exception of Section 248 of the Treasury Regulations.21 The courts treat the question as one of fact.

The term “trade or business” as found in Section 162 of the Code is the most well known and most often used.

Section 162(a) of the Internal Revenue Code provides as follows:

(a) In General. — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including — . . . . (Emphasis supplied)

The language found in Section 162 has long been a part of the Internal


21. TREAS. REG. Section 1.248-1(a)(3).
Revenue Code and has been defined by the United States Supreme Court on various occasions.\(^{22}\)

Another Section using similar language is Section 512(a)(1) of the Internal Revenue Code which provides as follows:

(a) Definition.—For purposes of this title —

(1) General Rule — Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated \textit{trade or business (as defined in section 513)} regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b). (Emphasis supplied)

It is interesting to note that the Regulations under certain sections of the Internal Revenue Code state that the term "trade or business" has the same meaning as it has in Section 162. Thus, Section 162 has become an unofficial standard. The Regulations under Section 174, however, do not adopt the meaning of that term as used in Section 162. To appreciate the significance of the use of the term it must be remembered that Section 162 allows as a deduction expenses "incurred in carrying on a trade or business," while Section 174 allows a deduction for research or experimental expenditures "paid or incurred by him...in connection with his trade or business." The Internal Revenue Service and the courts, with the possible exception of the Fourth Circuit\(^{23}\) apparently attach no significance to the difference in language used in Sections 162 and 174, and have, therefore, limited the scope of Section 174 by contending the term trade or business has the same meaning in all sections of the Code.\(^{24}\)

The only question to which courts have directed their inquiry in Section 174 cases is what constitutes a trade or business. A myriad of cases have dealt directly with that question, including several cases reaching the Supreme Court of the United States. An examination of those cases reveals that the definition being applied to Section 174 cases since it was enacted with the 1954 Code stems from a construction of the term "carrying on a trade or business" as that term is used in Section 162.\(^{25}\) The taxpayer in \textit{Snow} argued the scope of judicial treatment should be extended to include a definition of "in connection with his trade or business" independent of Section 162 standards, since neither Section 174 nor the Regulations adopt Section 162 standards.

The classic statement used by the courts in determining whether the

\(^{22}\) Higgins v. Commissioner, 312 U.S. 212 (1941); Deputy v. Dupont, 308 U.S. 488 (1940).

\(^{23}\) Cleveland v. Commissioner, 297 F. 2d 169 (4th Cir. 1961).


\(^{25}\) \textit{Id.}
taxpayer qualifies as being engaged in a trade or business, mainly for
the purpose of deducting expenses, was stated by the United States Su-
preme Court in Higgins v. Commissioner as follows: “To determine
whether the activities of a taxpayer are ‘carrying on a business’ requires
an examination of the facts in each case.”26 Even though the 1954 In-
ternal Revenue Code, which was enacted more than a decade after the
Higgins decision, changed much of the previous law, courts continue to
adhere to the policy of deciding cases on the basis of the particular
factual situation. In so doing, a body of case law has developed which
tends to establish basic principles of law affecting numerous taxpayers
each year.

In developing and applying these principles, the courts have used
certain axioms. Among the most important of these are: a taxpayer may
be engaged in more than one trade or business;27 it is not a prerequisite
that one devote himself completely to that one enterprise;28 and full time
employment elsewhere does not preclude another trade or business.29

The number of possible trades or businesses is practically limitless.
Courts have refined the phrase to include that which involves the time
and attention of men for the purposes of a livelihood or profit,30 but it
does not include every activity engaged in with the hope and expectation
of making a profit.31 It includes all those means of gaining a livelihood,
“Even those which would scarcely be so characterized in common
speech.” Among the less obvious ones listed by courts are: judges, actors,
research workers, professors, artists, athletes, wagerers and holders of
public office.32 More than half a century ago, the Supreme Court said
that for the Corporation Tax Law of 1909, “ ‘Business’ is a very com-
prehensive term and embraced everything about which a person can be
employed.”33 Thirty years later in Higgins, the Supreme Court held that
such a broad definition of the term business was inapplicable in deter-
mining the deductibility of expenses claimed to have been paid in
carrying on a trade or business.34

An often cited definition of “carrying on a trade or business” is taken
from Justice Frankfurter’s concurring opinion in Deputy v. Dupont,

27. Fahs v. Crawford, 161 F. 2d 315 (5th Cir. 1947).
28. E.g., Mercer v. Commissioner, 376 F. 2d 708 (9th Cir. 1967); Clement v. United
30. E.g., Doggett v. Burnet, 65 F. 2d 191 (D.C. Cir. 1933); Cushman v. United States,
31. E.g. Higgins v. Commissioner, 312 U.S. 212 (1941), where salaries and other
expenses incurred in taking care of an individual’s investments in stocks and bonds were
held not to be deductible as expenses incurred in carrying on a trade or business.
32. Trent v. Commissioner, 291 F. 2d 669, 671 (2d Cir. 1961).
wherein he stated: "Carrying on a trade or business involves holding oneself out to others as engaged in the selling of goods and services."\textsuperscript{35}

To qualify as a "trade or business" it is not necessary that the business be one of specific title. In \textit{Wiles v. United States},\textsuperscript{36} the taxpayers continually sought out, investigated and developed opportunities for the investment of their money. This was considered a business and the court allowed expenses incurred in carrying on that business to be deducted. Noting that the taxpayers were officers in four separate corporations, the court also determined that they were in the business of being corporate officers and employees.

Other cases have held that expenses incurred in investigating a new business for purposes of making the initial decision whether to establish the business or not are deductible under Section 162(a).

In \textit{Owen v. Commissioner},\textsuperscript{37} a government lawyer based in Washington was not allowed to deduct expenses incurred in maintaining his law office in his home town since he was not then "carrying on" the trade or business of practicing law.

The fact that an individual has professional status does not, in and of itself, establish that he is engaged in a trade or business. Thus, the fact that an individual is a "lawyer" by virtue of graduating from law school and passing the state bar examination, does not of itself put him in the trade or business of being a lawyer. Similarly, because an individual is a public official he is not guaranteed that expenses incurred in fulfilling the obligations of that office are deductible. An example of this situation is \textit{Green v. Bookwalter}.\textsuperscript{38} There, a "Commissioner of the Commission for International Relations and Trade of Kansas City," a position appointed by the mayor for a three-year term without pay, was denied deductions for travel expenses to Latin America, even though he did work at establishing better trade relations. The court ruled that the trip was primarily personal in nature and not deductible even though the taxpayer was officially representing the city.

"Corporate executives" can qualify under the definition. For example, in \textit{Hexter v. Commissioner},\textsuperscript{39} the court allowed a corporate executive to deduct rent and secretarial expenses even though he received no additional compensation, on the theory that his activities were far greater than what was necessary from an investor's point of view.

Another important category of trades and businesses is that of "employee." In deciding that "employees" qualify, the court in \textit{Trent v. Commissioner},\textsuperscript{40} based its conclusion in part on Section 62(1) of the 1954 Code which expressly excludes employees from trades or businesses.

\textsuperscript{35} Deputy v. Dupont, 308 U.S. 488, 499 (1940).
\textsuperscript{36} 312 F. 2d 574 (10th Cir. 1962).
\textsuperscript{37} 23 T.C. 377 (1954).
\textsuperscript{38} 207 F. Supp. 866 (W.D. Mo. 1962).
\textsuperscript{39} 47 B.T.A. 483 (1942).
\textsuperscript{40} 291 F. 2d 669 (2d Cir. 1961).
That court felt that by negative implication, "trade or business" must include employees unless expressly excluded. In application, this meant that in Trent a worthless debt was allowed to qualify as a business bad dept where the employee had loaned money to his employer in order to keep his job. The court reasoned that this was part of the business of being an employee under the circumstances of the case.

In deciding cases involving research and development expenses under Section 174, the courts have never established a workable definition of what constitutes "in connection with the taxpayer's trade or business," but instead continue to apply definitions from cases involving Section 162 cases. In Snow v. Commissioner both the Tax Court and the Sixth Circuit applied a Section 162 standard which was fashioned by Justice Frankfurter in his concurring opinion in Dupont. A review of the cases since the enactment of Section 174 will point out the need for a workable construction of Section 174 to provide the small businessman with the relief sought by Congress.

In Stanton v. Commissioner, an inventor was considered an employee of his own closed corporation. But the court denied him Section 174 deductions for expenses incurred in trying to invent a boat, because he pursued the endeavor during his off hours. And in Downs v Commissioner, although the taxpayer claimed that he was in the trade or business of inventing at his home in his spare time, the court refused him deductions under Section 174 on the grounds that he was a salaried employee and did his inventing from that position.

With employees and corporate executives, it is important to note whether the expenses are those of the taxpayer, or of the company for whom he works. As pointed out in Butler v. Commissioner, it is no less the trade or business of the employee because it is also one of the employer's. In that case, a practicing attorney became a member of a limited partnership to manufacture prefabricated houses and later advanced loans to the partnership. Under Section 23(k) of the 1939 Code (the forerunner of Section 162) the court ruled that by reason of being a partner in a business, the taxpayer was individually engaged in business, and the worthless debt to the partnership was a business bad debt. However, the expenses themselves must be those of the employee.

Deputy v. Dupont is the best example of the problem. The transaction there involved the borrowing of stock and the payment of interest, taxes and dividends in assistance to an employee stock purchasing plan. Even those justices who found the individual to be in a trade or business

42. 399 F. 2d 326 (5th Cir. 1968).
43. 49 T.C. 533 (1968), see pp. 539-541.
44. 36 T.C. 1097 (1961).
45. 308 U.S. 488 (1940).
refused to allow the deductions on the ground that the expenses were uniquely those of the company.

In addition, employees must show that the expenses were directly connected with the alleged business. Cases in which employees and corporate executives sought to deduct legal expenses directly or indirectly related to their positions illustrate this problem. In *Glimco v. Commissioner*, a union organizer sought to deduct legal expenses arising from an indictment for violation of the Hobbs Act. In order to protect its image, the union paid the taxpayer the cost of his legal expenses and was allowed to deduct that amount, but the taxpayer was forced to include those sums as wages and was denied his claim to deduct them. The court ruled that the taxpayer failed to show these expenses were part of his employment with the union or how they served the union's interests. Similarly, where the expenses of litigation arise primarily from non-business interests, they may be denied even though they are also connected with the trade or business. *Ditmars v. Commissioner* illustrates this point. There a stock broker was denied a deduction for litigation expenses for a suit based on the unreasonable brokerage fees he charged to a trust which he served. The court ruled that the litigation was not from his trade or business of being a stock broker, but were "personal" expenses specifically disallowed by Section 262 of the 1954 Code.

On the other hand, where the expenses from litigation were found to arise from the individual's position with a company, such expenses were deductable. Thus in *Mitchell v. U.S.*, expenses arose as a result of a fraud suit, settled out of court, dealing with the sale of corporate stock. The deductions were allowed as the court found that the misrepresentations were made in the taxpayer's capacity as president and director.

**Preparatory Expenses vs. Carrying on Expenses**

In requiring that a taxpayer be engaged in a trade or business, the courts have been consistent in their demand for an "existing" trade or business. This statement, however, must be qualified. In many situations, expenses may be deducted even though the activity ceased being a going concern. Certainly a doctor would be allowed to deduct expenses incurred in defending against a malpractice suit even if he had already retired when the suit was brought. Along the same line, a transformation in the business form should not deprive taxpayers of deductions to which they would otherwise be entitled. In *Flood v. U.S.*, each partner was allowed to deduct his pro rata obligation on a personal basis where the partnership paid each employee a bonus through a revocable trust set up by the

46. 397 F. 2d 537 (7th Cir. 1968).
47. 302 F. 2d 481 (2d Cir. 1962).
48. 408 F. 2d 435 (Ct. Cl. 1969).
49. 133 F. 2d 173 (1st Cir. 1943).
partners after the partnership itself had been sold. The district court had previously denied the deductions on the grounds that the partnership was no longer a going concern. Similarly, in *Estate of Walling v. Commissioner*, 50 a partnership which had incorporated was allowed to deduct the costs of repairs to barges made after the transfer of stock but before the transfer of the barges. The Tax Court had ruled that the partnership was no longer in business, but the Court of Appeals held that the amounts sought to be deducted need not necessarily be expended to carry on the business in the future. That court also ruled that it was of no consequence that the expenses were not necessary to continue the partnership business.

The demand for an "existing" trade or business has been expressed by the courts in cases in which the court found that the expenses were incurred in investigating a potential business or were merely preparatory to entering a new business. *Frank v. Commissioner* 51 is a leading case in which the expenses a taxpayer sought to deduct were incurred in investigating a potential business and were denied as deductions for that reason. In *Frank*, the taxpayers traveled around the country, trying to purchase a newspaper or radio station. They continued their search during the part of the year in which they also took employment with a newspaper in Arizona. Before the end of the year, they purchased a newspaper in Ohio and began publication. Their travel costs and other expenses incurred prior to the purchase of the paper were denied as being merely preparatory to entering the newspaper business. Similarly in *Westervelt v. Commissioner*, 52 a taxpayer lost his claim for travel expenses incurred while trying to buy a cattle herd and collecting information regarding the cattle business, although he already owned the land necessary for such a ranching operation. *Walet v. Commissioner* 53 was another case in which expenses were incurred in investigating a new business. There, a lawyer-corporate president devoted a small percentage of time seeking out, investigating and negotiating personal "deals" in oil and other natural resources. His business efforts were unsuccessful, as was his attempt to deduct travel and entertainment expenses connected with his efforts.

Not only is investigation considered outside the definition of trade or business, so are those expenses involved in preparing to enter a new business, although this often entails a finer line of distinction.

In *Polachek v. Commissioner*, 54 a taxpayer created an investment advisory service for small investors. When he was unable to obtain financial and advertising backing despite considerable effort, the project failed.

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50. 373 F. 2d 190 (3rd Cir. 1967).
51. 20 T.C. 511 (1953).
52. 8 T.C. 1248 (1947).
53. 31 T.C. 461 (1951).
54. 22 T.C. 858 (1954).
The court denied the deductions, claiming the project was still in the formative stages when it was abandoned. The corporate taxpayer in *Richmond Television Corp. v. United States*55 was denied deductions for pre-operation training of broadcast employees even though the corporation was completely formed. The court ruled that expenses were merely preparatory until the business began to function as a going concern and performed those activities for which it was organized. In this case, all expenses were preparatory until an F. C. C. license was obtained and the station started broadcasting. The Sixth Circuit Court of Appeals erroneously applied that case in *Snow v. Commissioner*.56 The taxpayer in *Worrell v. United States*,57 was found to have started to engage in a going concern. The taxpayer was beginning a quarter-horse training and showing operation and had entered horses into shows, although the winnings were minimal in relation to the losses. The court ruled that the entering of shows was performance of those activities for which it was organized and thus it had begun to function as a going concern.

In dealing with Section 174 deductions, courts have often denied such claims on the grounds that the expenses were incurred in preparing to enter a trade or business. The leading case in which an individual was denied a claimed Section 174 deduction on that basis was *Koons v. Commissioner*.58 The facts of this case were not typical insofar as they relate to individuals in their first attempt to invent or exploit an invention. *Koons* was an active advertiser who became interested in an invention which he purchased. He then paid the research laboratory, from which he had purchased the invention, to develop the product to the point of patentability and commerciability. The research was clearly the type of laboratory work covered by Section 174. The court ruled that the business was merely a prospective one, and denied the taxpayer's claim for a deduction. The correctness of that decision is questionable in view of the *Snow* decision.59 *Scull v. Commissioner*60 was a later case based on an interesting factual situation, in which the Tax Court again decided to deny Section 174 deductions on the grounds that the expenses were preliminary to the possible formation of a business. In that case, the taxpayer was on the board of directors of an instant coffee company which refused to enter into an agreement with a chemist who had developed a process of extracting aromatics from roasted coffee. The taxpayer advanced the necessary sums himself, and later that year established his own company to exploit the process. The court refused to allow the taxpayer to deduct the sums paid to the chemist on the grounds that,

55. 345 F. 2d 901 (4th Cir. 1965).
56. 482 F. 2d 1029 (6th Cir. 1973).
60. 23 CCH Tax Ct. Mem. 1353 (1964).
at most, they were preliminary to the possible formation of a new business.

Other cases with similar fact patterns have been decided in favor of the taxpayer, with no apparent meaningful distinction other than the taxpayer's background in engineering and inventing. One such case was Bailey v. Commissioner. The taxpayer there was a wealthy, retired, graduate mechanical engineer, who, for over 50 years prior to retirement, was an inventor of some reputation with many honorary degrees and awards and numerous patents. During the four-year period in question, he actively worked on various inventions for which he received no income. He had received only one patent, and that one he assigned free to his old company. He also had five or six patents pending. In allowing the Section 174 deductions of more than $24,000 to this wealthy taxpayer, the court distinguished Koons on the ground that Bailey had been an engineer and inventor for a long time.

It seems as if this is an artificial distinction which works to frustrate the legislative intent of Section 174. However, it can be argued that when an inventor starts working on his project, he is engaging in the trade of inventing. On the other hand, when an individual without inventing experience starts a new business by buying an invention and hiring others to do the work, the business is organized to exploit rather than to invent. This argument was used by the court in Louw v. Commissioner, decided in December, 1971. The court ruled that the taxpayer, who had an engineering and inventing background, was not merely preparing to enter the trade or business, as his business was making inventions and selling them, rather than putting them to commercial use.

In Best Universal Lock Co. v. Commissioner, the taxpayer was allowed to deduct expenses for work on an isothermal air compressor even though he always had been engaged in the lock business with no exposure to the air compressor business. The government urged in that case that research and development expenses should be confined to the trade or business of making locks. Thus an inventing background, and not the taxpayer's experience in the particular field, is the crucial factor in determining the availability of the deduction.

Under this analysis, if a non-inventor started to invent with the goal of selling the invention, rather than exploiting it, he would not be preparing to enter that trade or business under the rationale in Louw v. Commissioner. On the other hand, if an inventor started to work on a product, he would avoid the "preparatory" problem by the mere fact of his past inventing activities, according to the rationale of the Best Universal Lock Co. decision. Further, the Treasury Regulations at 1.174-
2(a)(2) specifically provide that research and development can be carried on in the taxpayer's behalf by another person or organization.

**Profit Motive Must Be Primary Purpose**

The primary guideline used by courts in determining whether the taxpayer is engaged in a trade or business is whether or not the taxpayer's dominant intent is to make a profit. This does not mean that a loss by itself is controlling, but the financial results may be more important than other manifestations of intent. In applying this rule, the courts have decided that the taxpayer must have a bona fide expectation of profit from the venture. It has been considered immaterial that others might view that expectation as unreasonable. Thus it does not matter that the expectation was foolhardy or shrewd, impractical, idiosyncratic or how questionable of success it may have seemed to others. It was not for the court to second guess the taxpayer or criticize the management.

The Courts have also denied deductions claimed under Section 174 on the basis that making a profit was not the dominant motive. For the most part, a taxpayer's failure to file patent applications and make bona fide efforts to exploit inventions has been used as cogent evidence of a lack of profit motive. In such situations, courts have considered an expectation of profit as bordering on the brink of pure speculation. Further, minimal efforts at exploitation may not be enough to allow an individual to overcome this hurdle. Thus, in *Cherry v. Commissioner*, the court ruled that one patent search and two successful advertising attempts were not enough on one of the taxpayer's inventions to make his experimental activities at home a trade or business.

The profit motive must be the dominant purpose behind the activities. Success with a project may enhance an employee's position with his employer, but it does not support a claim that the employee himself was engaged in a trade or business with the intention of making a profit. Further, even though experimentation may be valuable to private industry, the federal government and society as a whole, deductions for research and development will be denied where the essential

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64. Godfrey v. Commissioner 335 F. 82 (6th Cir. 1964).
profit motive is lacking. Such was the case in *White v. Commissioner*,70 where a taxpayer, who had inherited a sizeable estate, operated a ballistics laboratory at a loss for a number of years.

A final example is *Mayrath v. Commissioner*.71 In that case, an inventor built an experimental house which he later occupied as his residence. He attempted to deduct the expenses, less the value of the land and non-experimental features of the house, under Section 174, even though he waited three years before trying to market some of the experimental features of the house and was unsuccessful. The court concluded that "... there is a point beyond which his propensity to experiment must be viewed as taking on the characteristics of a hobby."72

As with other areas, however, an individual taxpayer who happens to be an inventor may be successful in his effort to qualify as one engaged in a trade or business despite continual losses. Thus in *Bailey v. Commissioner*,73 the taxpayer’s total lack of income from his inventions during the period in question was overcome by proof of past inventive activities and the expenditure of substantial time and effort on the project. In *Brooks v. Commissioner*,74 an accomplished research scientist was allowed to deduct expenses incurred in traveling in connection with her research, even though she had not derived any income from that research. The court found that her past activities, coupled with her present position as a research assistant, upheld her contention that these activities were part of a projected profit-making scheme at the time in question. Finally, in *Best Universal Lock Co. v. Commissioner*,75 (a case better known for the proposition that an existing corporation can deduct Section 174 expenses for experimentation in a completely new product line) a mechanic was allowed to deduct his expenses incurred in working on an isothermal air compressor, although he failed to show an immediate profit. The court found that prior inventing activities, while not in the same field, plus substantial activity on the project in question, were enough to overcome lack of income.

Some courts have interpreted the profit motive requirement to mean that the taxpayer must establish that the activities were for the purpose of making a livelihood.76 The more realistic approach, given the general rule that an individual may be engaged in more than one trade or business, has been that the purpose must be to make a livelihood or profit.77

70. 227 F. 2d 779 (6th Cir. 1955).
71. 41 T.C. 582 (1964).
72. Id. at 591.
74. 274 F. 2d 96 (9th Cir. 1959).
75. 45 T.C. 1 (1963).
76. E.g., Austin v. Commissioner, 35 T.C. 221 (1960), aff’d 298 F. 2d 583 (2d Cir. 1962).
77. E.g., Trent v. Commissioner, 291 F. 2d 669 (2d Cir. 1961).
The desire of the courts to treat inventions as isolated transactions in order to place them outside the scope of "trade or business" is well illustrated in cases prior to the enactment of Section 1235. Frequently, taxpayers wanted capital gains treatment for the sale of their inventions and patents and, therefore, claimed the inventions were not held for sale in the regular course of their trade or business.

A chemical engineer in *Pike v. United States* succeeded in qualifying his invention for capital gain treatment by showing he only occasionally patented his inventions and all sales were unsolicited. The taxpayer in *Briggs v. Hofferbert* proved that he sold patents only to his own corporation for which he worked for a salary and royalties. The Court of Claims in *Kronner v. United States* found for a taxpayer who had obtained four patents but sold only one and who obtained most of his income from the royalties on that one invention. In *Evans v. Kavanagh*, even the fact that the individual was an engineer and inventor by trade and was always employed by corporations as an inventor was insufficient to find that the sale of an invention was made in the ordinary course of the taxpayer's trade or business. That court ruled that since he always worked under an agreement to assign all inventions to his employer, his activities over the years were not of such continuity or regularity as to imply the carrying on of a trade or business. It concluded that the sales of the patent and patent rights in this case were merely casual and non-recurring events. Similarly, in *Beach v. Shaughnessy*, the taxpayer was a life-long inventor, yet the court ruled the transaction was merely an irregular sale. It pointed out that:

"prior to the sale in question, the plaintiff was a manager of a family business, a salaried employee and a consulting engineer whose inventions were for the benefit of his then employer and were incidental to the service he was rendering."

Although in most cases the courts have found that employed inventors did not sell patents and inventions in the normal course of a trade or business, there are cases decided the other way. The facts of a leading case, *Avery v. Commissioner*, show that a substantial continuity is required. There the taxpayer was a civil engineer who, over a seventeen-year period, had obtained about twelve patents from inventions developed in his spare time. These inventions helped him find a job, but they were not part of any employment. The taxpayer spent between ten and thirty years.

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78. Int. Rev. Code of 1954, Section 1235. This section provides for long-term capital gains on the sale or exchange of patents, for individuals, under certain circumstances.
81. 110 F. Supp. 730 (Ct. Cl. 1953).
84. Id. at 775.
85. 47 B. T. A. 538 (1942).
hours per month pursuing his inventions. The court ruled that by selling five of his twelve patents for monetary reward, the hobby turned into a business. The court found it immaterial that no new patents were obtained during the year in which the patent in question was sold.

Whether Avery shows the existence of a "fuzzy" line of distinction, or simply the inconsistency in application of the basic rules, it remains clear that prior to the enactment of Section 1235, the courts saw inconsistent sales of patents and inventions as evidence that the inventors did not sell their inventions or patents in the regular course of a trade or business.

Taxpayers trying to deduct expenses under Section 174 are often faced with the lack of businesslike activities. The failure of the inventor to make a bona fide effort to exploit his inventions, his failure to hold himself out to the public as engaged in his claimed trade or business, and the lack of business records are accepted by the courts as strong evidence that no business existed. The court in Industrial Research Products, Inc. v. Commissioner, 86 denied Section 174 deductions based primarily on the taxpayer's failure to hold himself out to the public as selling his services or inventions and failure to make a good faith effort to exploit his invention. Similarly in Schafer v. Commissioner, 87 a salesman turned welder and inventor was denied Section 174 deductions incurred in the development of large, earth-moving equipment. The decision was based on the fact that he never applied for a patent or profitably exploited an invention, and he never held himself out to others as an inventor.

Courts have been less eager to allow deductions for partnerships than corporations, 88 which is not surprising in light of the fact that partnership losses are passed directly to the partners. As with individuals, partnerships must prove the requisite dominant profit motive, continuity of enterprise and businesslike activity. There is little in the way of structure that eases the burden such as occurs with corporations. The problem that expenses are merely preparatory is especially acute when partnerships attempt to deduct costs under Section 174. Not only must the taxpayers prove they are not merely preparing to enter a trade or business, but they are often faced with the task of proving it is really a partnership and not just a debtor/creditor relationship.

The agreement itself, or the lack of one, may determine whether a partnership was formed or the relationship was that of debtor and creditor. The leading case on this problem was Cleveland v. Commissioner. 89 In that case, Cleveland, a lawyer, became interested in an in-

86. 40 T.C. 578 (1963).
89. 297 F. 2d 169 (4th Cir. 1961).
vention being worked on by Kerla, a German immigrant with no business experience, when Kerla sought legal advice from him. Cleveland advanced money to Kerla to carry on his inventing and to care for his family, and, in 1945, they orally agreed to equal shares in an enterprise exploiting the invention. The next year, Cleveland bought a house in his own name, but allowed Kerla and his family to live there rent free. Prior to 1954, Kerla had patent applications filed for some aspects of his invention and anticipated others. Cleveland continued to handle the business aspects. In 1956, a trust agreement was entered into, retroactive to 1954, in which the two agreed to share equally in the profits, in return for past and future payments by Cleveland to Kerla. Cleveland claimed a deduction for those expenses for research and development expenditures under Section 174. The Tax Court denied all deductions, but the Court of Appeals reversed in part, allowing deductions for 1956 and 1957. It held that after the written agreement was executed, all future costs were allowed as deductions on the theory that the agreement created a joint venture. Although the terms "partnership" or "joint venture" were not used, the court felt that the effect of the agreement was to make them equal participants in a joint venture. Thus, from the time of the agreement, they were engaged in the trade or business of promoting the commercial development of the invention, in which Cleveland was the owner of a participating one-half interest.

Three years after Cleveland v. Commissioner, the Tax Court, in the case of Reiner v. Commissioner, allowed a partnership to deduct expenses incurred while in the preparatory stages of inventing new product lines in addition to those lines in which it was already established. The court seemed to treat the partners like it treated corporations. The partners in this case had a history of inventing, mainly in the areas of nuts and bolts and pin curls. They also entered a building contracting business in which they constructed their own business, trying novel building techniques. One of the partners bought land on which he planned to construct his residence, but it soon turned into a business venture of an experimental project. Instead of the $55,000 projected cost, they agreed to spend $400,000 and later $600,000. They hired a full-time marketing expert to evaluate the ideas being developed. From 1956-1963, the house was used strictly for research, and the originating partner was forced to purchase another residence. Detailed records were maintained throughout the construction process, and many patent applications were made with at least two being issued. The partnership deducted the costs, except for those costs attributable to depreciable items. The Tax Court allowed the deductions under Section 174 except those that merely went to "customizing" the house in accord with the one partner's personal tastes. The Court found especially important the taxpayers' engineering and inventing experience for a number of years prior to the taxable years.

in issue. The decision did not discuss the fact that such past experimentation had been in a completely different area. Also, the formation of a corporation to exploit the inventions, rather than a partnership exploiting them itself, did not affect the deductibility of the costs under Section 174. The court reasoned that if the taxpayers had paid outsiders to do the research and development, the costs still would have been deductible, as taxpayers should not be penalized for doing the research and development themselves.

Although the guidelines appeared to be well established, the Tax Court strictly construed Section 174 in the case of Snow v. Commissioner,91 and denied a deduction for partnership losses which resulted from Section 174 deductions, on the grounds that the partnership was merely preparing to enter a business. This result was reached by the Tax Court by applying a Section 162 standard, relying on the definition of "carrying on a trade or business" from Deputy v. Dupont. This view was apparently much more restrictive than Congress intended and, in effect, rendered Section 174 ineffective as a relief measure for small beginning businesses.

Snow, the limited partner who initiated the suit, had no engineering experience. Throughout the tax periods in question, he continued his full-time position as a corporate executive with a company he had worked for for thirty-three years. He had advanced from the advertising and marketing departments to the management level. Trott, the inventor, was a long-time business associate of Snow, and also a close personal friend. Until his retirement from the company in 1963, Trott had also worked in advertising, marketing and general management, but he lacked training or experience in engineering. (It is not understood why the Tax Court stressed a lack of experience or training in engineering). Upon retiring, Trott acquired a corporation that did shop work in machine and fabricating, and became interested in some aspects of that corporation's experimentation. Taking those ideas and those of his own, Trott formed three partnerships with different limited partners in order to develop those ideas. Agreements were signed and Certificates of Limited Partnership were filed under Ohio law, Snow becoming a limited partner in all three. Each partnership acquired interests in a separate "invention." Actual research and development were contracted out to Trott's corporation. The experimentation itself was clearly of a character covered by Section 174. Burns Investment Company was the limited partnership formed to develop a leaf burner. The other partnerships of which Snow was a member, Echo and Courier, were formed in earlier years, and by the year 1966 one of them had a patented product ready for licensing.

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and sale. The Commissioner did not disturb deductions of these two partnerships.

The partnership agreement provided that the general partner had the sole right of management and conduct of the business, while the losses were to be divided first by the limited partners up to the amount of their contribution. Patent applications were applied for in 1968 and granted in 1970. The partnership's 1966 return showed a net operating loss due to Section 174 deductions, but the Commissioner denied Snow his claimed deduction for his share of that loss.

The Tax Court held that deductions from the losses claimed by the Burns Investment Company were not allowable as that partnership was merely preparing to enter into a trade or business. Among the important factors relied on by the Tax Court were Trott's lack of previous inventive and engineering experience (yet Trott had spent his full time since 1963 inventing and exploiting inventions and doing research and experimentation work), failure to apply for patents until 1968 (yet Trott or his associates had applied for numerous patents prior to 1968), and the delay until several years after formation of the partnership for attempts to market or sell the device (yet Trott through the other partnerships had tried to sell other inventions during the year 1966). The court distinguished *Best Universal Lock Co. v. Commissioner* on the ground that the corporation in that case was already a going business. In concluding, the Tax Court pointed out that Burns Investment Company did not hold itself out to others as engaged in the sale of goods and services, and thus the research was not related to the development of new products or improvement of existing ones in connection with an existing trade or business. The court ignored the fact that the partnership filed its articles, filed tax returns, entered into contracts, etc., which certainly involved holding itself out as being an existing trade or business. In the *Snow* case, both Snow and Trott were engaged in two other partnerships which were engaged in the business of inventing, perfecting patents and the commercial exploitation of those patents. In addition, Trott, through another business entity, had patented devices then in production.

The Tax Court's decision in *Snow v. Commissioner*, was appealed to the Sixth Circuit Court of Appeals. In its decision the Sixth Circuit adopted the Tax Court's definition of trade or business, ignoring any distinction between the "carrying on" vs. the "in connection with" standard. The court described the transaction as follows:

Thus, as is so frequently true, two laudible public purposes are in direct conflict: (1) the Congressional purpose of stimulating research and development, including research and development on the part of

92. 45 T.C. 1 (1965).
inventors and small businessmen, and (2) the desirability of strict interpretation of tax laws so as to prevent unintended tax shelters.94

The court failed to recognize the distinction between tax shelters and tax incentives. Research and experimental expenditures fall into the category of a tax incentive, which is a provision, such as oil, gas and mineral depletion, etc., written into the tax law after careful consideration by Congress, to encourage research and experimental activity.

The court had two cases before it from the Fourth Circuit, Cleveland v. Commissioner,95 a Section 174 case, and Richmond Television Corp. v. United States.96

Cleveland held for the taxpayer and involved a case strikingly similar to the Snow case dealing with Section 174; while Richmond Television held for the government but involved Section 162. The court acknowledged the Cleveland case and the Richmond Television case and disposed of the two by saying: "... if, however, it be read as in conflict with our view in this case, we prefer the logic of the later Fourth Circuit holding in Richmond Television Corp. v. U.S., supra, to the Fourth Circuit's earlier holding in Cleveland."97 The problem with this analogy is that the logic of Richmond Television Corp., supra, a Section 162 case, is not applicable to a Section 174 case.

As a result of the Sixth Circuit decision, a petition for a Writ of Certiorari was filed with the Supreme Court of the United States requesting that the Court hear the case for the following reasons:

1. The decision below conflicted with the decisions of other Courts of Appeals as to the proper interpretation of 26 USC Section 174; and

2. The decision below raised significant and recurring problems concerning efforts of small and beginning businesses to invoke Section 174 of the Internal Revenue Code of 1954. In addition, the decision below was one of major importance in that it strongly tended toward fostering big business while inhibiting small, newly-organized competition.

The Writ was granted because of the apparent conflict between the Sixth Circuit and the Fourth Circuit.

Snow argued before the Supreme Court that the practical results of the Sixth Circuit's adoption of Justice Frankfurter's "trade or business" requirement in Deputy v. Dupont of "holding one's self out to others as engaged in the selling of goods or services" was contrary to the legislative intent behind Section 174. Under Justice Frankfurter's analysis, an established company with existing sales may refine and improve that product through research and development and be permitted to deduct the costs of such research. Further, an established company with existing sales of any given product may attempt to develop a completely new

94. Id. at 1031.
95. 297 F. 2d 169 (4th Cir. 1961).
96. 345 F. 2d 901 (4th Cir. 1965).
97. 482 F. 2d 1029, 1032 (1973).
product and will also be permitted to deduct the costs of such development, even though this new product is wholly unrelated to its current line of business. However, a new company with a new idea would not be entitled to deduct research and experimental expenses incurred in the development of its initial product. Snow asserted that allowing this discrimination between established and new businesses to continue would tend to foster and perpetuate monopoly by frustrating the development of inventions or improvements by newly organized competitors of businesses which were long established.

The Government argued that the term "trade or business" has a uniform meaning throughout the Code and that the phrase "in connection with his trade or business" of Section 174(a) is linked with the general "trade or business" expense deduction provision of Section 162(a), as explained by legislative history and decisions of the Supreme Court. Snow insisted that the "holding out" test used by the Sixth Circuit had absolutely no relevance to a case decided under Section 174.

As to the Sixth Circuit's observation that Snow was a high bracket taxpayer, Snow contended that his income in 1966 had absolutely no relation to whether Burns incurred its expenses "in connection with his trade or business" and that it was completely incorrect to refer to a Section 174 expenditure as an "unintended tax shelter." If Burns failed to realize a profit, the partners in Burns would sustain a genuine economic loss. Snow further contended that, in contrast to an unintended tax shelter, there was a statutory tax incentive in Section 174 to encourage research and development.

By a vote of 8 to 0, the Supreme Court reversed the Sixth Circuit's decision and held that Burns' expenses were "in connection with his trade or business" and therefore deductible pursuant to Section 174(a). The Supreme Court rejected the argument that the "trade or business" concept of Section 162(a) was applicable to Section 174(a) and found that the "holding one's self out" requirement set forth in the concurring opinion in Deputy v. Dupont was irrelevant to determinations made under Section 174. The Supreme Court decision in Snow was written by Justice Douglas, who also authored the Deputy v. Dupont majority opinion in 1940. The Sixth Circuit's adoption of the Deputy v. Dupont case was based upon the concurring opinion of Justice Frankfurter rather than the opinion of the Supreme Court written by Justice Douglas, which opinion did not establish a "trade or business" definition.

In the Snow opinion, the Supreme Court stated: "The words 'trade or business' appear, however, in about 60 different sections of the 1954 Act. Those other sections are not helpful here because Congress wrote into Section 174 'in connection with' and Section 162 is more narrowly written than is Section 174 allowing 'a deduction' of 'ordinary and neces-
sary expenses paid or incurred... in carrying on any trade or business.' That and other sections are not helpful here...”

The Supreme Court concluded that the Sixth Circuit decision was contrary to the broad legislative objective of the Congress when it enacted Section 174 to provide an economic incentive, especially for small and growing businesses, to engage in the search for new products and new inventions.

Justice Douglas' opinion in Snow observed that: "Congress may at times in its wisdom discriminate taxwise between various kinds of business, between old and oncoming business and the like. But we would defeat the congressional purpose somewhat to equalize the tax benefits of the ongoing companies and those that are upcoming and about to reach the market by perpetuating the discrimination created below and urged upon us here.

'We read Section 174... 'to encourage expenditure for research and experimentation'... that incentive is embedded in Section 174 because of "in connection with," making irrelevant whether petitioners were rich or poor.” This comment was in response to the Sixth Circuit's comments on Snow's earnings and his being a "high-bracket taxpayer.”

The "holding one's self out" requirement was first articulated by Justice Frankfurter concurring in the case of Deputy v. Dupont. However, that case concerned the disallowance of “ordinary and necessary” business expenses which had been claimed under Section 23(a) of the 1928 Code (now Section 162). Deputy v. Dupont was decided in 1940, prior to the enactment of Section 174 in 1954. The Service, prior to 1954, generally permitted taxpayers to deduct expenditures paid in connection with regular and continued research activities. However, occasionally the Service challenged such deductions and invariably the courts approved the disallowance. In explaining the bill which eventually became Section 174, Representative Camp stated that the Section should be enacted “in order to clarify the existing confusion in respect to the tax treatment of such expenditures...”

In Snow, the Supreme Court interpreted the function of Section 174 to "encourage expenditure for research and experimentation" and thereby once and for all eliminated the confusion with respect to the role of Section 162 in cases to be decided under Section 174. The Supreme Court found that Congress in drafting Section 174 did in fact purposely abandon the "carrying on" concept of Section 162 for the broader concept of "in connection with."

CONCLUSION

The Snow decision will make a substantial contribution to the growth and development of small businesses in this country. Now individuals

98. 94 S. Ct. 1876, 1878 (1974).
99. Id. at 1878-9.
with new ideas will be able to develop such ideas with the added incentive that they will be allowed deductions for expenditures made for research and development even though they may be developing their initial product and are not yet in a position to offer such product for sale. Snow also makes it clear that there is no uniform interpretation of the phrase “trade or business” in the Code.\(^{100}\)

In addition, Snow thwarted the attack on the tax shelter aspect of Section 174, evidenced by the Sixth Circuit’s opinion, by finding that it was irrelevant whether the taxpayer was rich or poor. The implications for tax shelter investments may be important despite the limited construction of the decision under Section 174 only. The Court clearly will not sustain challenges to the allowance of deductions solely on the basis that they are of benefit to a taxpayer in the form of offsets against other sources of income if the deductions are within the scope of the Congressionally-approved categories of deduction or otherwise are supported by law. The Court believes that Congress may choose to legislate areas of incentive and that these incentives may be exploited (even in fashions not conceived of by Congress) in a manner requiring recognition. Within the framework of this philosophy, Congress may also legislate other restrictions if it wishes to do so to impose restraints on allowance of deductions to offset other sources of income of the taxpayer. Section 183 is an example of this type of Congressionally-imposed restriction.

Another important implication is the recognition that inherent in many business ventures is the necessity to first incur losses by way of expenditures before income can be generated. The area of research and development expenditures may be somewhat unique in that the ultimate product to be developed for sale will almost always be nonexistent at the time of the allowed expenditures. In fact, it is for that reason that Congress determined to allow the expenditures specifically to encourage new product development. There are, however, many other areas of activity where the product for sale at the outset of a business must necessarily result from early expenditures which are deductible. This is true of cattle feeding, film making, construction of a building, hotel opening activities, to name a few. All of these areas involve presently allowable deductions for expenditures in beginning the enterprise before the product is income-generating. These “start-up” costs have traditionally been deductible, and the Supreme Court decision in Snow lends judicial support for a continuation of this approach unless Congress specifically legislates in the area, as has been suggested with respect to so-called “artificial accounting losses.”

In Snow, the Supreme Court appears to have determined the character of the deduction at the partnership level and then permitted a

\(^{100}\) Horwood and Hindin, *Supreme Court Adopts Liberal Definition of Research and Development*, *The Journal of Taxation* (July 1974).
transmission of such deduction to the partners under Section 702(b). Under this "entity" approach, the "trade or business" activity at the partnership level is determinative and it is not necessary to separately consider the activities of the partners. Thus, the Supreme Court did not create a distinction between partners by viewing the activities at the partners level but rather determined the character of the deduction solely at the partnership level.

The effect of the Snow decision is thus likely to be broader than reflected by the Section 174 question alone. It will be interesting to note its effect on Internal Revenue Service audit and litigation policies.
JUSTICE OVERDUE: TIME TO REEVALUATE THE CONSTITUTIONALITY OF CORPORAL PUNISHMENT IN SCHOOLS

By Marc I. Steinberg*

INTRODUCTION

Corporal punishment has been inflicted upon school children for several centuries. In this country, it is well recognized that "corporal punishment of pupils by teachers was practiced in the schools long prior to the adoption of the Fourteenth Amendment." A direct result of this practice is the enactment of statutes in several states authorizing the use of such punishment.

The constitutionality of such corporal punishment statutes has been attacked recently in the federal and state courts. In all of these cases, the respective courts have upheld the constitutionality of the statutes. These decisions support the general rule that teachers have discretionary power to inflict reasonable corporal punishment upon students for violating rules and regulations.

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1. N. Cutts & N. Moseley, PRACTICAL SCHOOL DISCIPLINE AND MENTAL HYGIENE 75-76 (1941); E. Phillips, D. Wiener, N. Haring, DISCIPLINE, ACHIEVEMENT AND MENTAL HEALTH 13 (1960); E. Williamson & J. Foley, COUNSELING AND DISCIPLINE 15-17 (1949); Baechle, Corporal Punishment in Schools: An Infringement on Constitutional Freedoms, 20 CLEV. ST. L. REV. 560, 566 (1971). Cutts and Moseley note that two thousand years ago, the Roman poet, Horace, described his former schoolmaster as plagosus Orbilius, "whiploving Orbilius."


3. E.g., OHIO REV. CODE § 3319.41 (1970) states in relevant part: A person employed or engaged as a teacher, principal, or administrator in a school, whether public or private, may inflict or cause to be inflicted, reasonable corporal punishment upon a pupil attending such school whenever such punishment is reasonably necessary in order to preserve discipline while such pupil is subject to school authority.

   See also ARIZ. REV. STAT. § 13-246 (1939); MINN. STAT. ANN. § 609.06 (1963); TEX. PEN. CODE ANN. § 9.62 (1973).

4. E.g., Gonyaw v. Gray, 361 F. Supp. 366 (D.C. Vermont 1973); Glaser v. Marieta, 351 F. Supp. 555 (W.D. Pa. 1972); Sims v. Board of Education, 329 F. Supp. 678 (D.N.M. 1971); Ware v. Estes, 328 F. Supp. 657 (N.D. Texas 1971), aff'd. per curiam 458 F. 2d 1360 (5th Cir. 1972), cert. denied 409 U.S. 1027 (1972). In Glaser at 557-58, the district judge framed the question in the following terms: "The question is whether this method of disciplining children is per se unconstitutional and, hence, subject to attack by the person most directly affected, the child on the receiving end of the paddle."

Although the case law clearly supports the constitutionality of such statutes, there are persuasive arguments which suggest that the infliction of corporal punishment on pupils should be ruled unconstitutional. Since the standards of a civilized society hopefully become more enlightened through the progression of time, these arguments merit serious consideration.

Generally, the purpose of this article is to analyze the constitutionality of statutes permitting the infliction of corporal punishment on pupils. First, this article shall discuss the reasoning of prior decisions which have considered the constitutionality of these statutes. After discussing these holdings, this article will then consider the various arguments advanced for the position that corporal punishment on pupil statutes should be ruled unconstitutional.

I. TRADITIONAL LAW REGARDING THE CONSTITUTIONALITY OF CORPORAL PUNISHMENT ON PUPIL STATUTES

In determining whether the infliction of corporal punishment on students is constitutional, an Illinois state court held: "We have no doubt of the right of a teacher to inflict corporal punishment in the process of enforcing discipline." The Illinois decision thus supports the general rule that the infliction of reasonable corporal punishment is not prohibited by the Federal Constitution. In formulating this concept, the federal and state courts have considered various arguments which have been raised by parties attacking this method of punishment. The manner in which the courts have traditionally confronted these arguments is the basis for the following discussion.

One of the arguments which has been advanced is that corporal punishment on pupil statutes are unconstitutional since they are violative of procedural due process. The proponents of this argument contend that pupils have the right to formal notice, hearing and representation before school authorities can inflict corporal punishment upon them. This contention has been uniformly rejected by the courts. In Sims v. Board of Education, the district court, relying especially on Hannah v.

Larche,\textsuperscript{11} stated that procedural due process within the realm of the fourteenth amendment cannot be defined precisely but "must be determined in the light of that which is just and reasonable, considering all factors."\textsuperscript{12} Utilizing the above test, the courts have held that corporal punishment on pupils "is a sanction which simply is not serious enough to require the prerequisite of a formal hearing."\textsuperscript{13} In fact, one court has taken "judicial notice" that the purposes to be advanced by corporal punishment would be stymied if formal notice, hearing, and representation were required.\textsuperscript{14}

Another argument which has been raised is that corporal punishment on pupil statutes deprive the affected students of substantive due process. In discussing this issue, the courts have continually emphasized that it is not within their competence, nor their proper function, to judge the value of corporal punishment as an educational policy or as a method of discipline.\textsuperscript{15} Rather, the only relevant question is whether the evidence has shown corporal punishment on pupils to be arbitrary, capricious, unreasonable, or wholly unrelated to any legitimate educational purpose.\textsuperscript{16} Applying the above principles, all courts which have ruled upon this issue have held that "liberty," as provided for by the fourteenth amendment, does not protect a student from the reasonable imposition of corporal punishment.\textsuperscript{17} These holdings therefore stand for the proposition that "the authorization of corporal punishment . . . is reasonably related to the legitimate purpose of school discipline."\textsuperscript{18}

An equal protection argument has also been proposed by those who have challenged the constitutionality of corporal punishment on pupil statutes. The equal protection clause ensures the equal application of the laws. Although a law may be fair and equal on its face, if it "affords different treatment to persons similarly situated,"\textsuperscript{19} there is then a

\textsuperscript{11} 363 U.S. 420, 442 (1960). In \textit{Hannah v. Larche}, then Chief Justice Warren defined procedural due process in the following terms:

"Due process" is an elusive concept. Its exact boundaries are undefinable, and its content varies according to specific factual contexts. . . . Therefore, as a generalization, it can be said that due process embodies the differing rules of fair play, which through the years, have become associated with differing types of proceedings. Whether the Constitution requires that a particular right obtain in a specific proceeding depends upon a complexity of factors. The nature of the alleged right involved, the nature of the proceeding, and the possible burden on that proceeding, are all considerations which must be taken into account.

\textsuperscript{12} 329 F. Supp. at 683.

\textsuperscript{13} 361 F. Supp. at 371.

\textsuperscript{14} 329 F. Supp. at 683.

\textsuperscript{15} 361 F. Supp. at 370; 329 F. Supp. at 684, 690; 328 F. Supp. at 659. In \textit{Sims} at 684, the district judge stated this prevailing view: "The courts are not concerned with the expediency, necessity, wisdom, utility and propriety of legislative enactments so long as constitutional principles are not violated."


\textsuperscript{17} \textit{See} 361 F. Supp. at 369-70; 329 F. Supp. at 684-83; 328 F. Supp. at 660.

\textsuperscript{18} 361 F. Supp. at 369.

deprivation of equal protection in the administration of the law.\textsuperscript{20} Applying these concepts, in none of the respective cases was it shown that the particular corporal punishment regulation being challenged afforded “different treatment to persons similarly situated.”\textsuperscript{21} In \textit{Sims v. Board of Education}, the court stated:

The record is absolutely devoid of any proof that the regulation’s application in this case was the result of selective enforcement of the regulation against these students, so as to sustain the allegation that they have been denied the equal protection of the laws.\textsuperscript{22}

Another argument which has been raised on numerous occasions is that corporal punishment on pupil statutes are violative of the eighth amendment. The eighth amendment proscribes the imposition of “cruel and unusual punishments.” This proscription applies to the states by virtue of the due process clause of the fourteenth amendment.\textsuperscript{23}

Some courts have held that corporal punishment on pupil statutes do not violate the cruel and unusual punishment clause since the proscription protects only against those penalties inflicted for criminal behavior.\textsuperscript{24} The majority of courts, however, have held that the cruel and unusual punishment clause applies also to civil penalties.\textsuperscript{25} Even if the eighth amendment is applicable to such corporal punishment statutes, the courts have thus far held that “corporal punishment of school children is not a \textit{per se} cruel and unusual punishment in the constitutional sense.”\textsuperscript{26}

The most troublesome issue which the courts have confronted is whether corporal punishment on pupil statutes are unconstitutional since they unreasonably interfere with the right of parents to direct the raising of their children. Although no court has yet held that corporal punishment is unconstitutional upon this basis, there are recent decisions which indicate that such a ruling may be forthcoming in the near future.\textsuperscript{27} These decisions shall be discussed in the next section.

Other courts which have dealt with this question have recognized that the state cannot arbitrarily interfere with the freedom of parents to direct the raising of their children.\textsuperscript{28} This right, however, is not without

\begin{itemize}
  \item \textsuperscript{21} \textsuperscript{2} See 361 F. Supp. at 368-69; 329 F. Supp. at 685.
  \item \textsuperscript{22} 329 F. Supp. at 685; \textsuperscript{2} see also Jackson v. Dorrier, 424 F. 2d 213, 218 (6th Cir. 1970).
  \item \textsuperscript{23} Robinson v. California, 370 U.S. 660, 666 (1962); 329 F. Supp. at 689; \textsuperscript{2} see also Cooper v. Aaron, 358 U.S. 1, 16 (1958) where the Supreme Court stated that, “the members of the School Board \ldots are local officials; from the point of view of the Fourteenth Amendment, they stand in this litigation as the agents of the State.”
  \item \textsuperscript{24} 361 F. Supp. at 368.
  \item \textsuperscript{25} See 351 F. Supp. at 558; 329 F. Supp. at 689-90; 328 F. Supp. at 660.
  \item \textsuperscript{26} 351 F. Supp. at 558; 329 F. Supp. at 690; 328 F. Supp. at 660.
  \item \textsuperscript{28} 361 F. Supp. at 369; 328 F. Supp. at 659.
\end{itemize}
limitation. As stated by the Vermont Supreme Court, "[t]he State has a legitimate interest in protecting its educational system from disorderly disruption during classes scheduled for the instruction of students." Due to this legitimate interest, parents must delegate some of their disciplinary authority over their children to the teachers and administrators who must maintain order within the schools. This delegation includes the exercise of reasonable corporal punishment under appropriate circumstances.

The preceding discussion clearly indicates that the federal and state courts have considered and have rejected the various arguments which have been raised by parties who have attacked the constitutionality of corporal punishment on pupil statutes. It may therefore be concluded that the courts have traditionally regarded the infliction of reasonable corporal punishment on students as "the common sense resolution of the day to day problems of school discipline, without violating the constitutional rights of parents or pupils."

II. NEW APPROACHES REGARDING THE CONSTITUTIONALITY OF CORPoreal PUNISHMENT ON PUPIL STATUTES

This section shall discuss the more persuasive arguments which support the proposition that corporal punishment on pupil statutes should be ruled unconstitutional.

A. Public Policy Considerations

Before considering the merits of the constitutional issues involved, it might be helpful to evaluate the imposition of corporal punishment on students from a public policy viewpoint. One disadvantage of corporal punishment is that it has the tendency to be inflicted without adequate supervision. In most instances, records are not required to be kept.

School discipline, like parental discipline, is an integral and important part of training our children to be good citizens—to be better citizens. . . . [S]chool officials should be accorded the widest authority in maintaining discipline and good order in their institutions.
32. 361 F. Supp. at 369; see 329 F. Supp. at 687-88; 328 F. Supp. at 659-60. Under the general rule, this delegation of parental authority takes place even when the parents request that corporal punishment should not be inflicted upon their children. RESTATEMENT (SECOND) OF TORTS § 153(2) states:
One who is in charge of the education or training of a child as a public officer is privileged to inflict such reasonable punishments as are necessary for the child's proper education or training, notwithstanding the parent's prohibitions or wishes.
33. 361 F. Supp. at 371; see also Farrell v. Joel, 437 F. 2d 160, 163 (2nd Cir. 1971), where the court observed that "in cases of minor discipline, particularly, parent, student, and administrator should remember that substitution of common sense for zealous adherence to legal positions is not absolutely prohibited."
34. N. CUTTS & N. MOSELEY, PRACTICAL SCHOOL DISCIPLINE AND MENTAL HYGIENE 78 (1941); G. SCOTT, THE HISTORY OF CORPORAL PUNISHMENT 192 (1959); W. SMITH, CONSTRUCTIVE SCHOOL DISCIPLINE 191 (1936).
CORPORAL PUNISHMENT IN SCHOOLS

Even where they are maintained, the actual extent of the practice is unknown. Under these circumstances, the frequency and severity of corporal punishment are difficult to accurately determine. "The secrecy associated with the use of physical punishment may itself be a strong indication that its value as an effective method of discipline should be questioned."35

The use of corporal punishment also suggests that the teacher-pupil relationship suffers as a result of this practice. This conclusion has been reached by a large number of experts who have dealt with this problem.36 These experts recognize that the experiences which occur in the classroom have a great impact in the development of the child. In such a situation, the teacher "is shaping the attitude of young minds toward the society in which they live."37 In regard to this teacher-pupil relationship, the United States Supreme Court has stated:

No one should underestimate the vital role in a democracy that is played by those who guide and train our youth . . . Scholarship cannot flourish in an atmosphere of suspicion and distrust. Teachers and students must always remain free to inquire, to study and to evaluate, to gain new maturity and understanding; otherwise our civilization will stagnate and die.38

The practice of corporal punishment in schools impairs the quality of the educational process by creating feelings of humiliation and resentment on the part of the child.39 Because of the important role which the


37. Baechle at 567; see E. WILLIAMSON & J. FOLEY, COUNSELING AND DISCIPLINE 16 (1949).

38. Sweezy v. New Hampshire, 354 U.S. 234, 250 (1957); see Boilan v. Board of Education, 357 U.S. 399, 407 (1958), where the Court reaffirmed the principles stated in Sweezy:

(1) it has always been the recognized duty of the teacher to conduct himself in such a way as to command the respect and good will of the community . . . Educators have always regarded the example set by the teacher as of great importance.

39. R. AMSTERDAM, CONSTRUCTIVE CLASSROOM DISCIPLINE AND PRACTICE 83 (1957); E. PHILLIPS, D. WIENER, N. HARING, DISCIPLINE, ACHIEVEMENT AND MENTAL HEALTH 13 (1960); G. SCOTT, THE HISTORY OF CORPORAL PUNISHMENT 190 (1959); Baechle at 567, 570. Scott, for example, contends that the practice of corporal punishment "will create sullenness, hypocrisy, and cunning where they did not previously exist, or that it will develop or extend these undesirable characteristics in all instances where they were already in existence."
teacher plays in the child's education and development, the propriety of this punishment must be scrutinized very carefully.

In inflicting corporal punishment upon a child, there is a substantial possibility that the child may suffer injuries. Although serious harm may be inflicted unintentionally, accidents do occur and are not infrequent. In situations where teachers are given considerable power to use this practice, the possibility of injury to the child is that much greater. These factors in themselves are persuasive reasons for not inflicting corporal punishment.

Corporal punishment has been largely justified because of its continued use throughout the years. To rely upon this rationale is an inadequate justification for upholding the constitutionality of this punishment. As stated by Justice Holmes:

It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past.

Corporal punishment is frequently used today because other methods of discipline are more difficult to implement. To permit teachers to inflict this punishment largely because it has been allowed in the past, is tantamount to giving teachers a free hand to use this practice as a "crutch." Such a practice is clearly not desirable for the educational process.

Three basic conclusions may be reached from the foregoing discussion. First, corporal punishment has the tendency to be inflicted without adequate supervision. Second, the use of this punishment hinders the effectiveness of the teacher-pupil relationship. Third, there is a substantial possibility that the child may incur accidental injuries. It is submitted that these conclusions are alone sufficient justification for abolishing the practice of corporal punishment in schools.

B. The Right of Parental Discipline

Even assuming that the practice of corporal punishment on school children may have some public policy attributes, the practice still cannot be constitutionally upheld. Specifically, corporal punishment on pupil statutes unconstitutionally interfere with the right of parents to direct the upbringing of their children.

The United States Supreme Court has frequently held that parents

41. See D. Brown, Changing Student Behavior: A New Approach To Discipline 44 (1971); K. Larson, School Discipline In An Age Of Rebellion 98 (1972); W. Smith, Constructive School Discipline 191 (1936); Baechle at 566.
42. O. Holmes, Collected Legal Papers 187 (1921).
have the right to raise and to educate their offspring according to their own beliefs and convictions. In *Meyer v. Nebraska*, the Court held that liberty, as protected by the fourteenth amendment, "denotes not merely freedom from bodily restraint but also the right of the individual to... marry, establish a home and bring up children..." In *Pierce v. Society of Sisters*, the Court again recognized that "[t]he child is not the mere creature of the state; those who nurture him and direct his destiny have the right, coupled with the high duty, to recognize and prepare him for additional obligations." Referring to its decisions in *Meyer* and *Pierce*, the Court in *Prince v. Massachusetts* directed the following language to the liberty of parents to raise their children:

It is cardinal with us that the custody, care and nurture of the child resides first in the parents, whose primary function and freedom include preparation for obligations the state can neither supply nor hinder... [a]nd it is in recognition of this that these decisions have respected the private realm of family life which the state can not enter.

Relying upon the Court's most recent decisions, it is submitted that the infliction of corporal punishment on school children violates the right of privacy in the parent-child relationship. In *Griswold v. Connecticut*, the Court recognized that the marital relationship is within the zone of privacy which is constitutionally protected as a fundamental right. Justice Douglas, writing for the Court, characterized the right of marital privacy as "within the zone of privacy created by several fundamental constitutional guarantees." Justice Goldberg, concurring in *Griswold*, stated that the fourteenth amendment guarantees not only those rights mentioned in the Bill of Rights but also other rights deemed as fundamental, though not specifically mentioned. Support for this contention is derived from the ninth amendment which states that other rights, though not specifically mentioned, are retained by the people. One of these retained rights is the right of marital privacy.

Relying upon the Court's reasoning in *Griswold*, the right of parental discipline must also be included within the zone of privacy which is constitutionally protected as a fundamental right. Indeed, recent holdings

44. 262 U.S. 390 (1923).
45. Id. at 399 (emphasis added).
46. 268 U.S. 510 (1925).
47. Id. at 535.
49. Id. at 166.
50. 381 U.S. 479 (1965).
51. Id. at 485; see also Poe v. Ullman, 367 U.S. 497, 551-52 (1961). Speaking of family life, Justice Harlan, dissenting in *Poe*, stated that "the integrity of that life is something so fundamental that it has been found to draw to its protection the principles of more than one explicitly granted Constitutional right."
52. 381 U.S. at 493 (Goldberg, J., concurring).
53. Id. at 491; see Baechle at 563-64.
seem to suggest this result. In *Stanley v. Illinois*, the court stated that "the rights to conceive and raise one's children have been deemed 'essential' . . . 'basic civil rights of man.'" In *Roe v. Wade*, the Court discussed the constitutional right of privacy and whether this right extended to the parental-child relationship:

(T)he Court has recognized that a right of personal privacy, or a guarantee of certain areas or zones of privacy, does exist under the Constitution. In varying contexts, the Court or individual Justices have, indeed, found at least the roots of that right in the First Amendment . . . in the Fourth and Fifth Amendments . . . in the penumbras of the Bill of Rights . . . in the Ninth Amendment . . . or in the concept of liberty guaranteed by the first section of the Fourteenth Amendment . . . These decisions make it clear that only personal rights that can be deemed "fundamental" or "implicit in the concept of ordered liberty" . . . are included in this guarantee of personal privacy. They also make it clear that the right has some extension to activities relating to marriage . . . procreation . . . contraception . . . family relationships . . . and child rearing and education . . .

Surely, the terms signifying "family relationships" and "child rearing and education" must also include the task of parental discipline. The task of disciplining a child plays an integral part in his upbringing. To deprive parents of this obligation would be in practical effect to deny them the right to raise their children as they see fit. As a result, the right of parental discipline must be viewed as a fundamental right. One court has already so held. In *Glaser v. Marieta*, a United States District Court held that a parent's desire to discipline her child according to her own precepts and convictions was among "her fundamental rights to raise her child in the manner in which she chooses . . ." In characterizing the right of parental discipline as a "fundamental" right, the court relied heavily upon the Supreme Court's holding in *Stanley v. Illinois*. Specifically, the district court quoted the following language from *Stanley*:

"The private interest here, that of a man in the children he has sired and raised, undeniably warrants deference and, absent a powerful countervailing interest, protection." From this reasoning, the court held that corporal punishment could not be constitutionally inflicted upon a

54. 405 U.S. 645 (1972).
55. Id. at 651. In *Stanley*, the Court recognized that it "has frequently emphasized the importance of the family."
57. Id. at 152 (emphasis added). In determining whether these principles applied to the abortion decision, the Court stated at 153 that in its view the right of privacy is "founded in the Fourteenth Amendment's concept of personal liberty and restrictions upon state action . . ." rather than "in the Ninth Amendment's reservation of rights to the people . . ."
59. Id. at 560.
60. 405 U.S. 645 (1972).
61. Id. at 651.
school child if the parents of that child notified the school that they did not desire such punishment imposed.\(^{62}\)

A Louisiana state court has recently held that the infliction of corporal punishment on school children constitutes an unwarranted and unintended delegation of parental authority to the schools.\(^{63}\) The court stated:

It might have been said, in days when schooling was a voluntary matter, that there was an implied delegation of such authority from the parent to the school and teacher selected by the parent. Such a voluntary educational system . . . has long since disappeared. Parents no longer have the power to chose either the public school or the teacher in the public school. Without such power to choose, it can hardly be said that parents intend to delegate the authority to administer corporal punishment by the mere act of sending their child to school.\(^{64}\)

Although the court did not expressly hold that corporal punishment in schools is unconstitutional, it is certainly implicit in the court's reasoning that the imposition of such punishment is an unreasonable interference with the freedom of parents to direct the upbringing of their children.

Viewing the right of parental discipline as a fundamental right, it is established law that regulation limiting such a fundamental right may be justified only if the state interest is "compelling"\(^{65}\) and that "legislative enactments must be narrowly drawn to express only the legitimate state interests at stake."\(^{66}\) Under the above tests, it is not sufficient that the state merely has a rational basis to support the legislation.\(^{67}\) Rather, if there are reasonable and sufficient alternatives available, the regulation cannot be upheld.\(^{68}\)

Applying the above principles, it may be assumed that the state's interest in providing for corporal punishment in schools is to regulate discipline and to maintain order within the state's schools. Such an interest is clearly a legitimate one. But where a fundamental constitutional right is limited, here the right of parental discipline, then the question must be asked whether there are "reasonable and adequate" alternatives available.\(^{69}\) In confronting this question, it must be emphasized that

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\(^{62}\) 351 F. Supp. at 561.


\(^{64}\) Id. at 591.


\(^{67}\) McLaughlin v. Florida, 379 U.S. 184, 196 (1964). In Griswold, 381 U.S. at 497, Justice Goldberg stated that "where fundamental personal liberties are involved, they may not be abridged by the States simply on a showing that a regulatory statute has some rational relationship to the effectuation of a proper state purpose."

\(^{68}\) Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951); see Baechle at 568-69.

\(^{69}\) Id.
this situation is not one where the courts operate as a "super-legisla-
ture(s) to determine the wisdom, need, and propriety of laws that touch
economic problems, business affairs, or social conditions."70 Rather,
corporal punishment in schools denies parents the fundamental right of
disciplining their children and for this reason the practice must be
carefully scrutinized.71

In searching for "reasonable and adequate" alternatives, the question
may be asked whether the infliction of corporal punishment on pupils
is a universal practice in this country and in the world or whether schools
have been able to operate efficiently without the imposition of this
punishment. The evidence on this subject strongly supports the con-
clusion that alternatives do exist. The New Jersey schools, for example,
have outlawed the practice of corporal punishment since 1867.72 Several
individual school boards also prohibit this practice.73 In addition, a num-
ber of foreign countries have abolished this method of punishment.74
All of these school systems operate under the prohibition of corporal
punishment and yet have no apparent ill effects. Such a result indicates
that corporal punishment is not necessary for the maintenance of school
discipline. Rather, it is a convenient method of punishment which is
practiced only because more recent and innovative methods are more
difficult to implement.75 When a fundamental constitutional right is
limited, such a justification is without merit. Since corporal punishment
inflicted upon school children does limit the fundamental right of parents
to discipline their children and since "reasonable and adequate" alterna-
tives are available, the conclusion must be reached that this practice
violates the Federal Constitution. As a result, this primitive and outdated
punishment must be abolished.

70. Griswold v. Connecticut, 381 U.S. 479, 482 (1965); Sims v. Board of Education,
71. Baechle at 569.
72. N. J. STAT. ANN. 18A:6-1 (1964); K. JAMES, CORPORAL PUNISHMENT IN THE
PUBLIC SCHOOLS 38 (1963); Baechle at 570. The New Jersey statute states:
Corporal punishment of pupils. No person employed or engaged in a school or edu-
cational institution, whether public or private, shall inflict or cause to be inflicted,
corporal punishment upon a pupil attending such a school or institution. . . . Every
resolution, bylaw, ordinance, or other act of authority permitting or authorizing
corporal punishment to be inflicted upon a pupil attending a school or educational
institution shall be void.
73. Baechle at 570. Philadelphia, Chicago, Pittsburgh and Baltimore are among the
school boards which prohibit corporal punishment.
74. Id. All of the Scandinavian countries have abolished corporal punishment in their
schools.
75. R. AMSTERDAM, CONSTRUCTIVE CLASSROOM DISCIPLINE AND PRACTICE 82 (1957);
N. CUTTS & N. MOSELEY, TEACHING THE DISORDERLY PUPIL 34 (1957); H. DOUGLAS,
MODERN ADMINISTRATION OF SECONDARY SCHOOLS 332 (1963); M. KARLIN & R. BERGER,
DISCIPLINE AND THE DISRUPTIVE CHILD: A PRACTICAL GUIDE FOR ELEMENTARY
TEACHERS 41 (1972); Baechle at 566, 570. J. HYMES, BEHAVIOR AND MISBEHAVIOR 60
(1960), lists some of the alternatives to corporal punishment, such as, requiring pupils
to stay after school, isolating them in the hall, depriving them of certain recreational
activities (e.g., gym, shop, or art periods), sending them to the principal's office, or
suspending them.
C. The Proscription Against Cruel and Unusual Punishments

Another reason why corporal punishment on pupil statutes should be ruled unconstitutional is because they violate the proscription against cruel and unusual punishments found in the eighth amendment and applied to the states by virtue of the due process clause of the fourteenth amendment. Although corporal punishment has been inflicted upon students for centuries, it must be remembered that the proscription against cruel and unusual punishments "is not fastened to the obsolete but may acquire meaning as public opinion becomes enlightened by a humane justice." In *Trop v. Dulles*, the Supreme Court stated that the eighth amendment "must draw its meaning from the evolving standards of decency that mark the progress of a maturing society." Recently, in *Furman v. Georgia*, Justice Brennan interpreted the clause in the following manner:

(T)he Cruel and Unusual Punishments Clause prohibits the infliction of uncivilized and inhuman punishments. The State, even as it punishes, must treat its members with respect for their intrinsic worth as human beings. A punishment is "cruel and unusual," therefore, if it does not comport with human dignity.

The above definitions indicate that the clause is not static but must be flexibly applied in order to meet the changing and hopefully, more civilized, values of American society. Thus, as stated by Justice Marshall in *Furman*, "a penalty that was permissible at one time in our Nation's history is not necessarily permissible today."

Justice Brennan, concurring in *Furman*, established a four-step test in order to determine whether a challenged punishment violates the eighth amendment. Utilizing this test, it is submitted that the infliction of corporal punishment upon school children constitutes a cruel and unusual punishment. The first principle is that "a punishment must not be so severe as to be degrading to the dignity of human beings." By being subjected to corporal punishment, school children develop feelings of humiliation and resentment. If the punishment is inflicted in front of one's peers, this situation only adds to the embarrassment and insecurity felt by the child. Today, when the most advanced teaching methods are being advocated, such a punishment is certainly degrading to the dignity of school children.

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79. Id. at 101.
80. 408 U.S. 238 (1972).
81. Id. at 270 (Brennan, J., concurring).
82. Id. at 329 (Marshall, J., concurring).
83. Id. at 271 (Brennan, J., concurring).
The second principle is that "the State must not arbitrarily inflict a severe punishment."85 Although corporal punishment on pupil statutes are enacted in several states, the fact of the matter is that many schools and teachers do not utilize this disciplinary measure.86 These schools and teachers which do not inflict corporal punishment certainly have students who are just as troublesome as those which do. As a result, whether a student who needs corrective disciplinary measures is subjected to corporal punishment depends upon where he attends school and to which teacher he is assigned. The infliction of corporal punishment upon such a basis is certainly arbitrary.

The third step of the test is that contemporary society must find the punishment unacceptable.87 Even though corporal punishment on pupil statutes are still in effect, most schools and teachers abstain from inflicting this punishment.88 Such evidence indicates that this practice is unacceptable to the American people.

The fourth principle is that "a severe punishment must not be excessive."89 A punishment is excessive "if there is a significantly less severe punishment adequate to achieve the purposes for which the punishment is inflicted . . . ."90 There are several alternatives to corporal punishment that are arguably just as effective. As evidence for this contention, there are several individual school boards which do not permit the infliction of corporal punishment upon school children and yet have efficiently operated schools.91 Under such circumstances, the imposition of corporal punishment in the schools clearly constitutes an "excessive" punishment.

Upon applying the above mentioned four-step test to the practice of corporal punishment on school children, it appears that the imposition of this punishment is violative of the proscriptions against cruel and unusual punishments. In addition, the tests established by Justices Stewart and White in Furman also seem to apply to corporal punishment in the schools. In his concurring opinion, Justice Stewart concluded that the death penalty as it was applied at that time constituted a cruel and unusual punishment because it was "so wantonly and so freakishly imposed."92 In another concurring opinion, Justice White stated that the death penalty as it was then administered abridged the prohibition against cruel and unusual punishments because "the penalty is so infrequently imposed that the threat of execution is too attenuated to be of substantial service to criminal justice."93

85. 408 U.S. at 274 (Brennan, J., concurring).
86. K. JAMES, CORPORAL PUNISHMENT IN THE PUBLIC SCHOOLS 26-28, 63, 84 (1963).
87. 408 U.S. at 277.
89. 408 U.S. at 279 (Brennan, J., concurring).
90. Id.
91. Baechle at 570-71.
92. 408 U.S. at 310 (Stewart, J., concurring).
93. Id. at 313 (White, J., concurring).
Applying the above principles, it is submitted that the infliction of corporal punishment upon school children constitutes a cruel and unusual punishment. First, corporal punishment in the schools is "wantonly" and "freakishly imposed." Among all of the school children who have committed "reprehensible" acts, those who are subjected to corporal punishment are "a capriciously selected random handful . . . ."94 The many variables involved in whether a pupil suffers this penalty include (1) whether the school he attends has abolished this practice, (2) whether the teacher to which he is assigned uses corporal punishment, (3) his teacher's personal feelings of affection or dislike toward him, and (4) his teacher's moods or whims on that particular day. Clearly, the practice of inflicting corporal punishment in such a "wanton" or "freakish" manner cannot withstand constitutional scrutiny. Second, the penalty is so infrequently imposed in the schools today that the threat of corporal punishment is too attenuated to be of substantial service to maintaining discipline within the schools. Corporal punishment "is exacted with great infrequency" even for the most atrocious misconduct and "there is no meaningful basis for distinguishing the few cases in which it is imposed from the many cases in which it is not."95 As a result, the infliction of corporal punishment upon school children violates the proscription against cruel and unusual punishments.

CONCLUSION

The traditional rule stating that teachers have discretionary power to inflict reasonable corporal punishment upon students for violating rules and regulations must be reevaluated in light of public policy and constitutional considerations. Standing alone, there exist persuasive policy reasons for not imposing corporal punishment. In addition, corporal punishment inflicted upon school children limits the fundamental right of parental discipline and also constitutes a cruel and unusual punishment. Under such conditions, the practice clearly cannot withstand constitutional scrutiny. Therefore, the practice of corporal punishment in the schools must be abolished.

94. Id. at 309-10 (Stewart, J., concurring); see K. JAMES, CORPORAL PUNISHMENT IN THE PUBLIC SCHOOLS 26-28, 63, 84 (1963).
95. 408 U.S. at 313 (White, J., concurring); see K. JAMES, CORPORAL PUNISHMENT IN THE PUBLIC SCHOOLS 9-10 (1963).
LIFE INSURANCE AND THE DECEDED'S GROSS ESTATE UNDER SECTIONS 2042 AND 2035

By James J. McGraw*

INTRODUCTION

As our economy becomes more financially demanding, insurance is becoming more and more a necessity. Indeed, it is important to protect our health from the moment of birth\(^1\) to the time we die, and even beyond in providing financial security for our families and business associates.

Specifically, as the usefulness of life insurance continues to expand and encompass a greater part of our investment dollar, the tax consequences on the maximum realization of our life insurance investments increases. Perhaps the major advantage of life insurance—in some cases the only reason it is utilized at all—is its effect on the size of the decedent's gross estate.

This paper concerns itself principally with the determination of when a policy on the life of the decedent will be included in his gross estate for federal estate tax purposes. Following a brief general history of the development of this issue, we will examine the present position of the IRS and the courts, vis-a-vis a case analysis which will demonstrate their current inconsistencies on this matter. These inconsistencies have led some commentators to opine that the "incidents of ownership" test may be giving way to the old "payment of premiums" test.

In any event, the tax liability for life insurance is anything but simplistic as it fits into the general estate taxing scheme of the United States Treasury. Basically, liability is based upon "incidents of ownership" under Sec. 2402 of the 1954 Code. However, this little phrase has resulted in nightmares for many an unsuspecting taxpayer and estate planner. Likewise, the fact that these incidents may be exercisable "in conjunction with another person" has created problems demanding equal caution. Determination of estate tax liability in community property states has produced continuing controversy. Moreover, group term life insurance policies have been a special source of complexity, leaving the estate planner varying rules with which he must cope. The situation with respect to corporate owned beneficiaries has improved to the relief of the taxpayer, at least for the time being.

Finally, the potential scope of tax liability for life insurance proceeds

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1. See H.B. 1217 & S.B. 330 Ohio 110th General Assembly, proposals to enact sections 1739.18 & 3923.26 of the Ohio Revised Code to require family health insurance policies contracts to provide coverage to newly born children from birth.
is surprisingly broad under Sec. 2035, taxing transfers in contemplation of death. Equally controversial is the tax liability for premium payments under this section. Fortunately, there has been no argument for includability of policy proceeds and policy premiums paid by the decedent within the last years before death. It appears that the zest for taxing by the Service combined with the desire for clarity by the courts has left the once simple language of Secs. 2042 and 2035 in a state where the best advice to the estate planner is to be cognizant of all the situations laid out herein and to avoid them.

History

Legislation prior to 1918 made no provision for including proceeds of a life insurance policy in a decedent's gross estate. 2 The federal estate taxation of life insurance proceeds was given birth by the Revenue Act of 1918. 3 This explicit legislation was promulgated as a response to the fear that the original 1916 Act might not be broad enough to encompass taxation of policies payable to beneficiaries other than the decedent's executor. The 1918 Act called for inclusion of life insurance proceeds in the gross estate when (1) the proceeds were received by the decedent's estate, (2) proceeds in excess of $40,000 were receivable by other beneficiaries or (3) the policies were taken out by the decedent upon his own life. Unlike the latter two classifications, the first category regarding payment to the decedent's estate remains unchanged under current law.

In response to the third category demanding proceed inclusion in the gross estate, a 1919 Regulation introduced the "payment of premiums" test by stating that the insured's taking out a policy on his own life meant that he (the insured) had paid the premiums on that policy. 4 Thereby, it was not necessary that the insured be the same individual who actually applied for the policy.

The next development came in 1929 when section 402 of the Act was constitutionally challenged in Chase National Bank v. United States. 5 In upholding the law, the Court found that the significant factor was that the decedent retained legal incidents of ownership and its termination at his death "would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death." 6 In that same year the courts took a consistent stand with regard to includability of proceeds received under an accident policy in the gross estate. 7 Still in that year the Treasury issued a regulation based on Chase stating that in addition to paying the premiums on the policy, the insured must

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5. 278 U.S. 327 (1929).
6. Id. at 335.
have possessed certain "incidents of ownership" in the policy as a prerequisite to proceed inclusion in the decedent’s gross estate.8

The Treasury’s requirement of these factors conjunctively was modified in 1934 when a Regulation was issued making “payment of premiums” and “incidents of ownership” alternative tests in determining the taxability of insurance proceeds when payable to beneficiaries other than the decedent’s estate.9 These alternative tests were utilized until 1941 when the Treasury adopted the payment of premiums as the exclusive test.10

The next major revision of this area came within the scope of the Revenue Act of 1942.11 This Act disposed of the requirement that the insured must have taken out the policy on his own life. In addition, the $40,000 exemption from tax on proceeds payable to beneficiaries other than decedent’s estate was dropped. Most significantly for the purposes of this article, the 1942 Act returned to the 1934 Regulation in resurrecting the alternative tests of payment of premiums or incidents of ownership for proceed inclusion in the gross estate when the beneficiaries are other than decedent’s estate. For the proceeds of the life insurance to be included in the gross estate, indirect payment of the premiums by the insured through a nominal payor would be sufficient. Of equal and independent breadth, the incidents of ownership in the policy at the time of the insured’s death could be exercisable in conjunction with another person to qualify the policy proceeds for estate tax liability. Finally, as to the payment of premium test, where the insured paid only part of the premiums (and possessed no incidents of ownership), only the proportion of the insurance which corresponded to premiums paid by the insured was taxed in his estate. This payment of premium test met with persistent constitutional attack,13 not being finally resolved in favor of its constitutionality until 1960 in United States v. Manufacturer’s National Bank.14

The provisions of the 1942 Act remained intact15 until the current 1954 Code was introduced.16 Again the critical alteration was directed solely to proceeds payable to beneficiaries other than the insured’s estate. For the estates of persons dying after August 16, 1954, the incidents of ownership test was adopted as the exclusive criterion. In sum, with the premium payment test eliminated from Sec. 2042, there are now three

12. Id. at 56 Stat. 944.
15. However, in 1948 a proposal to eliminate the payment of premium test emerged from the House only to be defeated in the Senate Finance Committee. H.R. 6712, 80th Cong., 2d Sess., 104 (1948).
disjunctive determinations for the inclusion of life insurance proceeds in
the insured's gross estate: (1) if the proceeds are payable to the dece-
dent's estate; (2) if the decedent had any incidents of ownership in
the policy at his death, exercisable either alone or in conjunction with any
other person; (3) if the decedent possessed a reversionary interest in
the value of the policy exceeding 5 per cent immediately before his
death. As the first and third classifications are easily avoided by not
naming the estate as the beneficiary of a policy, the gravamen of the
issue involves merely the determination of whether the insured possessed
any incidents of ownership at death. As straightforward as it appears,
implementation of this determination has fostered complexity, confusion
and continuing disagreement.

The Regulations point out that incidents of ownership include certain
powers arising from the language of the insurance contract. These
ownership incidents include: (a) the right to change or designate the
beneficiary; (b) the right to surrender or cancel the policy; (c) the right
to assign the policy; (d) the right to revoke an assignment; (e) the
power to pledge the policy for a loan; (f) the power to obtain from the
insurer a loan against the surrender value of the policy; (g) the power to
change the beneficiary reserved to a corporation of which decedent was
sole stockholder.

Further, the insured may retain the power, either as trustee or other-
wise, to change the beneficial ownership in a policy or its proceeds, or
the time or manner of enjoyment thereof, even though the decedent has
no beneficial interest in the trust. Finally, the insured may reserve
erights to deal with the policy even though the physical possession of the
policy is transferred or he may hold the power to require the nominal
owner of the policy to exercise an incident of ownership.

Most types of life insurance policies are conveniently laid out so that
the insured may rid himself of the incidents of ownership in a policy on
his life by merely complying with the mechanical procedures of signing
the requisite form and sending it in to the particular insurance company.
Physical transfer of the policy to the new owner should follow as a matter
of course. Unfortunately for the insured, if this assignment of ownership
takes place within three years of the insured's death and in contempla-
tion of death, some or all of the premiums paid in that time period or
some proportion or even all of the proceeds may be subject to federal
estate taxation under Sec. 2035.

17. Id. § 2042(1) & (2).
19. Id.
21. For examples of powers held by the insured which have been held not to be
"incidents of ownership" see 111-3rd, Life Insurance, Tax Management A-9, 10
(1973).
22. See text infra, pp. 62 et. seq.
POLICY FACTS AND INCIDENTS OF OWNERSHIP

Notwithstanding Sec. 2035 problems, the issue of whether the insured has relinquished all incidents of ownership prior to his death has manifested itself in heated court battles between "intent facts", those relating to the conduct and understanding of the parties involved, and "policy facts", those revealed by the insurance policy itself. The original source mandating adherence to the policy facts type of determination is Commissioner v. Noel's Estate.

In Noel the insured had purchased two flight insurance policies totaling $125,000. His wife was named beneficiary. Mrs. Noel testified that she paid the premiums of $2.50 each and that her husband then instructed the sales clerk to "give them to my wife. They are hers now, I no longer have anything to do with them." In holding for inclusion of the $125,000 in decedent's gross estate, the Court held the technical "policy facts" to be controlling rather than the wife's testimony. It should be noted, however, that at least one commentator has strongly argued that this interpretation of Noel is completely erroneous and the Court would have probably used the "intent facts" approach if such controversy were specifically before it. This author must take issue with Mr. Eliasburg's view of Noel. Clearly, the Court rejected the assignment to Mrs. Noel simply because there was no written endorsement to that effect on the policies. Accordingly, the insured still retained the power to assign at his death. Finally, the Court dismissed the taxpayer's argument that the power to change beneficiaries was illusory, since it practically could not have been exercised during flight, by stating:

... liability ... depends on a general, legal power to exercise ownership without regard to the owner's ability to exercise it at a particular moment.

It is submitted that this Court intended to and did base its decision on noncompliance with technical and mechanical insurance policy procedures.

The impact of Noel was to overrule lower court decisions which had held that the insured's intent would control over the policy language. The "policy facts" approach was upheld in Kearns v. United States where the terms of the policies indicated the insured retained the right to change

23. See e.g., United States v. Rhode Island Hospital Trust Co., 355 F. 2d 7 (1st Cir. 1966).
25. Id. at 679, 680.
29. 399 F. 2d 226 (Ct. Cl. 1968).
the beneficiary even though Kearn's corporation had possession of the policies and carried them on their books as corporate assets.

In 1972 the Tax Court in the Estate of Walter Dawson 30 handed down a decision in favor of the taxpayer which, on its face, led one to believe that the court had departed from the Noel precedent. Here, the insured and his wife both died as the result of an automobile accident in which Mrs. Dawson, the owner-beneficiary of the policies, died one hour before her husband. The policies became residuary assets of Mrs. Dawson's estate and the insured was named residuary legatee and executor under his wife's will. Accordingly, the IRS argued that the insured acquired a vested interest in the insurance policies at the time of his wife's death, and that such incidents carried with it the requisite incidents of ownership. 31 In spite of this seemingly sound, technical argument, the Tax Court held that the decedent did not possess any of the incidents of ownership in the life insurance policies within the meaning of Sec. 2042. Lest we believe this court departed from the "policy facts" approach for determining incidents of ownership as many taxpayers would desire, a mere examination of the court's language reveals just the opposite. The court cited Noel as controlling in principle:

... the applicable test as depending upon a 'general legal power to exercise ownership.' (Emphasis added) See Comm'r v. Noel's Est., 380 U.S. 678, 684 (1965)....

We approach our decision herein without regard to the physical and mental incapacity of the decedent to exercise whatever power he may be found to have had. 32

The court based its favorable decision on the fact that under New Jersey law the decedent lacked the legal power to exercise ownership. This was so because under New Jersey law the residuary legatee acquires only a qualified equitable right to what remains of the estate after payment of the just debts, funeral expenses, and administrative expenses of the decedent and that this right is inchoate in nature prior to the completion of administration. 33 Clearly, the necessity of reference to state law is imperative and cannot be overemphasized. As demonstrated in Dawson, the effect of local law can be decisive without a judicial dogfight between the policy facts-intent facts controversy.

INCIDENTS OF OWNERSHIP IN THE TRUST FRAMEWORK

The use of the trust instrument in estate planning is, of course, commonplace. Its use in conjunction with life insurance may prove very functional in avoiding the federal estate tax pitfalls of Sec. 2042. However, the trust device has produced its share of controversy. In attempting to avoid inclusion of life insurance proceeds in the insured's gross estate by having ownership of the policy in the trust, the estate planner

30. 57 T. C. 837 (1972).
31. Id. at 840.
32. Id. at 841, n. 7.
33. Id.
must be cautious to see that total incidents of ownership rest unequivocally in the hands of the trustee.34

In the Estate of Sidney F. Bartlett35 the decedent-insured set up a life insurance trust and assigned to it six individual policies and one group policy on his life. The language of the trust instrument irrevocably assigned the policies to the trust. However, the Service argued for Sec. 2042 applicability on the grounds of noncompliance with several policy provisions requiring filing of policy assignments with the company in order for such assignments to be binding. Here also, the Tax Court appeared to skirt the policy facts argument in holding for the taxpayer and denying estate tax liability:

The decedent may have been somewhat careless in informing his insurers about the purpose of the trust agreement, but we do not think his behavior evidences an intent contrary to the express language of the agreement.36

Nevertheless, the court based its holding on the finding that “the insured not only intended to assign the policies, but under Illinois law, did in fact accomplish his intended purpose.”37 Under Illinois law the assignment is made part of the policy despite its nonappearance on the policy's face. Bartlett demonstrates, inter alia, as does Dawson, the impact of state law.

Within the context of discussing life insurance policies vis-a-vis the trust estate planning tool, some special problems resulting in Sec. 2042 tax liability have resulted where the trust in question was created by someone other than the insured. Discussion of these problems is indeed noteworthy at this juncture.

In an early Sec. 2042 case, the insured's wife transferred several life insurance policies on which she was named owner-beneficiary to a trust.38 In addition, she and her husband both transferred certain assets to the trust to cover the premium payments required on the policies. The wife retained major powers over the trust (revoke, alter or amend) which could only be exercised by her in conjunction with the insured and their daughter. In following the argument of the Service, the court held that the insured possessed incidents of ownership over the policies exercisable “in conjunction with” his wife, the original owner of the policy. Accordingly, all of the insurance proceeds were included in the insured's gross estate merely because the settlor had given the insured a power to consent regarding the trust operation. It appears at this point that any

34. See, e.g., Puchner v. United States, 274 F. Supp. 704 (E. D. Wis. 1967); Estate of Powell Crosley, Jr., 47 T. C. 310 (1966); Estate of Newcomb Carlton, 34 T. C. 988 (1960); Estate of Edmund Mudge, 27 T. C. 188 (1956). See also Estate of Louis Richards, 20 T. C. 904 (1953); Estate of Myron Selznick, 15 T.C. 716 (1950), aff'd per curiam, 195 F. 2d 735 (9th Cir. 1952).
35. 54 T. C. 1590 (1970).
36. Id. at 1597.
37. Id. at 1598.
power over the trust instrument by the insured will be treated as ownership over the insurance policy itself. Keep in mind that the insured's power in Karagheusian was a power exercisable "in conjunction with" his wife over the "trust".

In Estate of Fruehauf v. Commissioner the insured's wife owned several life insurance policies on her husband which became part of a trust through her residuary estate under her will. The insured was designated the income beneficiary of the trust, the executor of the estate and the nominated trustee of the trust. The basis for the taxpayer's argument in not including the policy proceeds in the insured's estate was that the insured died before the completion of probate of the wife's estate and in turn before the trust was created. In a broad-axe decision, the Tax Court called for Sec. 2042 tax liability stating the bare fact that the insured being in a fiduciary capacity was sufficient. The Sixth Circuit rejected such a blanket ruling and instead found that proceed inclusion in the gross estate was based on the provisions of the trust instrument which authorized the insured to confer a personal benefit on himself. Consider the result if a local law similar to the New Jersey law in Dawson had been applicable in Fruehauf. Clearly, the taxpayer would have prevailed in spite of the federal policies involved.

Finally, a recent case which perhaps has presented more questions than it has answered is that of Estate of Skifter v. Commissioner. Here the insured had assigned a number of policies on his life to his wife over three years prior to his death. The policies became part of a testamentary trust under the wife's will who happened to predecease the insured. The insured was named trustee under the trust with broad powers over the distribution of income. In addition, he could even terminate the trust by distributing the trust res to the income beneficiary, his daughter. The Tax Court, affirmed by the Second Circuit found that in spite of the broad powers the insured possessed over the trust these did not qualify as "incidents of ownership" solely because such powers could not be used for his own benefit. It may be argued that Skifter established a new test. Namely, where the insured gives up all rights in the policy and later receives a grant of non-beneficial powers over the policy through a transfer in trust such powers do not constitute "incidents of ownership" for purposes of Sec. 2042. As attractive as this mandate appears to the taxpayer, its soundness has been seriously questioned, putting the estate planner on notice that future litigation or legislation on this issue may be anticipated.

40. 50 T. C. 915, 926 (1968).
41. 427 F. 2d at 86.
42. 468 F. 2d 699 (2nd Cir. 1972) aff'g 56 T. C. 1190 (1971).
43. Id. at 704.
44. See Comment, Estate Taxation of Life Insurance Policies Held By The Insured As Trustee — Estate of Skifter v. Commissioner, 32 MARYLAND L. REV. 305 (1972).
Briefly, the grounds for the unstable future of this holding in *Skifter* can be seen by reference to the Commissioner’s arguments. Reliance was placed on Treas. Reg. § 20.2042-1(c)(4) which states that a decedent is to be considered as having an incident of ownership if he has the power as trustee to change the time and manner of enjoyment of the policy or proceeds even though he has no beneficial interest in the trust.\(^{45}\) Nevertheless, the foundation for the court’s holding was that the decedent’s non-beneficial powers were not “retained” but were independently issued to him by the settlor of the trust. This reasoning, however, parallels that of *White v. Poor.*\(^{46}\) Congressional response to *White* came almost immediately as the law was amended to encompass property subject to a power “without regard to when or from what source decedent acquired such a power.”\(^{47}\)

**ALONE OR IN CONJUNCTION WITH ANOTHER PERSON**

Another avenue used by the courts to assess estate tax liability on life insurance proceeds is found in the specific language of Sec. 2042 and has been referred to earlier in *Karagheusian.*\(^{48}\) Tax liability will be found where the insured can exercise incidents of ownership only in conjunction with another person. In *Cockrill v. O’Hara*\(^{49}\) the court held that the decedent could exercise ownership “in conjunction with” the corporate beneficiary of which he was the sole stockholder, thereby making Sec. 2042 applicable to 100 percent of the policy proceeds. As to one of the policies, it was undisputed that the corporation was the owner of all the incidents of ownership from the date of issuance of the policy. The holding was based simply on decedent’s position of control of the corporation as its sole shareholder.

In *Nance v. United States*\(^{50}\) the insured’s wife applied for and was issued a policy on the life of decedent, naming herself as beneficiary. The policy contained a provision providing that the insured could change the beneficiary if he acted in conjunction therewith. The District Court of Arizona held for the taxpayer based on an intent facts argument demonstrating that under the custom and usage of such clauses the insured’s consent would not be needed for the owner to change the beneficiary. On the other hand, the insured did not possess an equal power to

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\(^{45}\) The IRS also cited *Lober v. United States*, 346 U. S. 335 (1953) and United States v. O’Malley, 383 U. S. 627 (1967) holding that a non-beneficial power to control the time of enjoyment causes property transferred in trust by a decedent to be included in his gross estate under §§ 2036 (a) (2) and 2038.

\(^{46}\) 296 U. S. 98 (1935). The trust involved could be terminated by the trustees of whom the settlor was one. She resigned but was later reappointed by the trustees. The Court held no taxation resulted from the possession of such power at settlor’s death.


\(^{48}\) Estate of Karagheusian v. Comm’r, 233 F. 2d 197 (2nd Cir. 1956), rev’g 23 T. C. 806 (1955).


\(^{50}\) 430 F. 2d 662 (9th Cir. 1970).
change the beneficiary alone. The Ninth Circuit reversed based on the convenient "in conjunction with" clause.

In 1972 there emerged a controversial and unanticipated decision favoring the taxpayer in the case of *Estate of Morton v. United States.*\(^{51}\) In 1932 Morton took out a policy on his life with the premiums being paid by other members of his family until his death in 1963. In 1938, Morton executed an endorsement of the policy effecting an irrevocable designation of beneficiaries and mode of settlement. The Fourth Circuit held that this irrevocable designation of beneficiaries and mode of settlement coupled with payment of premiums by another resulted in no incidents of ownership in the insured at his death. These particular circumstances made it legally impossible for Morton to exercise other powers to his economic benefit or to subsequently control transfer of the policy proceeds. The Service argued, however, that the insured could exercise the incidents of ownership in conjunction with the beneficiaries. The court responded by saying that the beneficiaries could effectively act alone to exercise the incidents of ownership under West Virginia Law.\(^{52}\) It is significant that until Morton all emphasis centered around the insured's power only. In other words, it should be irrelevant as to whether the beneficiaries could act alone as to ownership of the policy. All that should be required is that the insured "in conjunction with another" (the beneficiaries) could exercise some policy ownership. In essence, what the Fourth Circuit has done in Morton, in relying on the ability of the beneficiaries to act without the insured, is to avoid use of the policy facts in favor of the intent facts presented. The impact of Morton is to be considered with caution because of its divergence from case law and Regulations regarding emphasis on intent rather than form.\(^{53}\)

**COMMUNITY PROPERTY AND SEC. 2042**

Treas. Reg. § 20.2042-1(c)(5) points out the possibility of having one-half the life insurance policy proceeds included in the gross estate as a result of the decedent qualifying under the incidents of ownership test by way of the community property law of the particular state. There are several recent court decisions in this area whose holdings are of significance to the estate planner.

In *Freedman v. United States\(^{54}\)* decedent obtained a life insurance policy on her life, naming her husband as the "owner" on the policy form. All premiums were paid out of community property. Under these circumstances it seems only natural to argue that none of the insurance proceeds should be included in the insured's gross estate because her

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\(^{51}\) 457 F. 2d 750 (4th Cir. 1972), aff'd 322 F. Supp. 1139 (D. C. W. Va.).

\(^{52}\) Id. at 754.


\(^{54}\) 382 F. 2d 742 (5th Cir. 1967).
husband held all incidents of ownership as clearly indicated by a “policy facts” examination. Further, it should be irrelevant that decedent paid one-half the premiums as the payments of premiums test was laid to rest in 1954. Nevertheless, the Fifth Circuit held that the policy was community property under Texas law at the time of decedent’s death and therefore one-half the proceeds were includable in her gross estate. The court stated that even though the husband was the owner according to the policy facts, “the decedent did not perform an affirmative act which would clearly reflect an intention to make a gift of her community share.” (Emphasis added).55

But in *Parson v. United States*56 the court did find that the decedent performed a positive act which clearly reflected an intention to make a gift of his community share of the life insurance policy. As to the specific policy involved, the insured applied for it in Texas at which time he irrevocably assigned all ownership to his wife. While this was clearly indicated in writing on the application form, the court, citing *Prichard v. United States*,57 stated that a court must look to the realities of the situation and give effect to substance over form.58 The remaining policies involved were purchased when the couple lived in a common law jurisdiction. All the proceeds of these policies were includable under Sec. 2042 less one-half the premiums paid out of community funds based on the Texas “inception of title” principles.

In *Bintliff v. United States*59 an important extension was made to the inclusion of community property life insurance proceeds in the gross estate. Here, the wife was owner of the policies on decedent’s life. The Service argued for inclusion of one-half the proceeds based on premium payments from community funds. The district court held that there had been an effective assignment of the policies to his wife, as in *Parson*60 but unlike in *Prichard*,61 and therefore Sec. 2042(2) applicability on these grounds was unjustified.62 On appeal, the IRS raised a new argument that the pledging of one of the policies as collateral for a loan was by itself sufficient to render the policy proceeds includable. The Fifth Circuit concluded:

55. Id. at 747.


57. 397 F. 2d 60 (5th Cir. 1968) where one-half the policy proceeds were included in decedent’s gross estate even though his wife was named owner since the policy was used as collateral for a loan to the decedent. An effective assignment could only be made to the creditor and not to the wife.

58. 460 F. 2d at 232.


60. 460 F. 2d 228 (5th Cir., 1972), rev’d in part 308 F. Supp. 1159 (E. D. Texas, 1971).

61. 397 F. 2d 60 (5th Cir., 1968).

62. One-half of the premium payments over the last three years were includable in decedent’s gross estate under Sec. 2035.
... one-half of the community debt which was secured and repaid by proceeds from the insurance policy is includable in the decedent's gross estate under § 2042(1), ... the assignment of the policy as collateral for a debt 'legally binding upon the other beneficiary' and 'enforceable against the estate' and the creditor's use of the insurance proceeds to satisfy that debt against the estate render the proceeds constructively receivable by the estate and, therefore, taxable to that extent.63

Estate planners must be careful to inform their clients of this estate tax trap where the client may believe he has protected himself from all liability by placing ownership in his wife.64

Two 1973 cases continued to demonstrate the court's position of refusing to follow the IRS's argument of basing Sec. 2042 tax liability on the sole fact of premium payments from community property. In Waite v. United States65 a district court concluded that despite the Texas community property provisions, a husband could exclude insurance proceeds from his estate by an assignment divesting all ownership. The court noted that a clear gift intention would not be vitiated by imputing a reversionary interest in the husband where premiums were paid out of community property. Reliance on intent facts as seen in earlier community property cases was again utilized in Kroloff v. United States.66 Here an insurance policy purchased in Arizona in the name of decedent's husband was held to be the sole property of the surviving spouse. Oral testimony indicated that the decedent intended that the policies, along with the funds necessary for premium payments, be the husband's sole and separate property.

The Service persisted in its argument that community property premium payments confer Sec. 2042 liability in the Estate of Viola F. Saia.67 The Commissioner conceded that the husband as named owner of the policy could exercise all incidents of ownership and the decedent could exercise none. The court followed Catalano v. United States68 which held that in Louisiana life insurance was not governed by the state's civil code. Accordingly, the policies owned by the husband were his separate property and no part of the proceeds were includable in the decedent's gross estate. Estate planners should note that the Tax Court in Saia69 saved the attorney for the estate from committing a tragic blunder. The attorney stipulated the Service's case by agreeing that all the property owned by the husband and the wife was community property, that none was owned separately.

Finally, the Service's argument, consistent with that used in the earlier

63. 462 F. 2d at 408.
64. See also Estate of Max Krischer, § 73, 172 P-H Memo T. C. (1973); Estate of Hilton W. Goodwyn, § 73, 153 P-H Memo T.C. (1973).
67. 61 T. C. No. 57 (1974).
68. 429 F. 2d 1058 (5th Cir. 1969).
69. 61 T.C. No. 57 (1974).
cases, was well-received in *Kern v. United States*. The district court held that one-half of the proceeds of two policies on decedent's life was includable in his gross estate in accordance with Washington community property law.

The Ninth Circuit, however, overruled this decision as to one of the policies holding that a typed provision on the policy, indicating the wife as sole owner, showed an intention that such policy was the separate property of the wife, thereby rebutting a presumption under Washington law that all property acquired during marriage is presumed community property. The case was remanded to the district court as to the other policy, since it lacked the same type of provision. For the time being, estate planners can find solace in these cases upholding the ability of one in a community property state to completely protect himself from Sec. 2042. But at the same time, he must be continually wary of the IRS's course of conduct in challenging such planning.

**INCIDENTS OF OWNERSHIP IN GROUP LIFE INSURANCE**

Group term life insurance is defined by the Regulations as:

... term life insurance protection provided under a master policy, or group of individual policies, which policy or policies, constitute life insurance contracts for purposes of Sec. 101(a) and form a part of the plan of group insurance. It is also possible for the group term policy to provide permanent insurance. Id. at (ii) (a).

Group term life insurance is a common business tool used to provide additional security, tax savings and overall employment attractiveness. Section 79 of the Code permits the employer to provide his employees with up to $50,000 of term life insurance with no income tax liability to them. But what about protection from federal estate tax liability on the proceeds of the group policies? There is no black and white rule for the estate tax problem like that of Sec. 79. Accordingly, it is left to the estate planner to avoid the "incidents of ownership" problems of Sec. 2042 for his client so that he can maximize the benefits of the protection his employer has provided for him.

Revenue Ruling 72-307 was issued to modify Rev. Rul. 69-54 (this 1969 ruling superseding Rev. Rul. 68-334) which had maintained that the insured's power to cancel his policy by merely leaving his job was an

70. 72-1 U. S. T. C. § 12,826 (1972).
71. 74-1 U. S. T. C. § 12,979 (1974).
72. Id.
73. Treas. Reg. § 1.79-(b) (1) (i). It is also possible for the group term policy to provide permanent insurance. Id. at (ii) (a).
74. To take advantage of Sec. 79 under amended Treas. Reg. § 1.79-(b) (1) (ii), where a group policy has a permanent feature to it, only the employee should pay the premiums allocated to the "permanent feature" and the employer should pay only the premium allocated to the "term feature." Also, Rev. Rul. 73-174 has distinguished Rev. Rul. 71-587 where any premiums paid by the employer in excess of $50,000 coverage is gross income to the employee even where all the employee's right to the policy have been irrevocably assigned.
incident of ownership for purposes of Sec. 2042. Revenue Ruling 72-307 is a logical and effectively broad ruling in favor of the taxpayer. Under its provisions, the insured's power to cancel his group term policy by terminating employment is not an "incident of ownership" sufficient to cause inclusion of policy proceeds in his estate. The IRS feels that the power to cancel the insurance policy is just a collateral consequence of a power to terminate a job possessed by every employee. Such a power is distinguishable from the incidents of ownership enumerated in Treas. Reg. § 20.2042-1(c) because those powers directly affect the policy itself or the payment of its proceeds without potentially costly consequences.

The most significant case in this framework to date is Estate of Lumpkin v. Commissioner. Under the policy involved Lumpkin possessed the right to designate an optional method of payment of the policy proceeds. Specifically, he was entitled, upon obtaining the approval of the insurer and the employer, to establish any other scheme he desired for the disbursement of the proceeds once they became payable to a particular relative. In addition to this power the IRS argued that the proceeds could equally well be included in the gross estate because Lumpkin could: (1) cancel the coverage by quitting his job; (2) convert the policy to individual coverage upon quitting his job; (3) assign his rights under the policy. Note that the first power was held by the IRS not to confer ownership by virtue of Rev. Rul. 72-307, discussed above. The Tax Court holding in favor of the taxpayer was reversed by the Fifth Circuit. The Tax Court relied on a 36 year old Board of Tax Appeals case. The Fifth Circuit, however, relied on two cases also cited in Skirter. The Fifth Circuit found in favor of tax liability under Sec. 2042 by a direct analogy to control "retained" under Secs. 2036 and 2038. The court found no difference between Secs. 2036 and 2038 and Sec. 2042 other than a "retained" control on the one hand and a possession of an "incident of ownership" at death on the other. The court went on to say:

... This distinction does not, however, suggest that there is a further difference among these sections... as to the degree of power a decedent must hold over the property in question — whether it be life

75. 474 F. 2d 1092 (5th Cir. 1973), rev'g 56 T. C. 815 (1971).
76. Id. at 1094.
77. The right of a decedent to assign his rights under a group term policy was upheld in Landorf v. United States, 408 F. 2d 461 (Ct. Cl. 1969).
78. Billings v. Comm'r., 35 B. T. A. 1147 (1937) acq. 1937-2 C. B. 3 (acq. withdrawn), holding under the old premium payment test that the right to control time of enjoyment of the policy proceeds was not an incident of ownership.
insurance or some other form of wealth — in order to render its value includible in his gross estate.81

While such reasoning may appear logical to the overall federal estate taxing scheme, this same reasoning was rejected by the Second Circuit in Skitter in 1971. No doubt, the Skitter court believed their interpretation was the one consistent with the overall intent of taxing similar property in the same manner.82

Whether the significant Service victory of Lumpkin will be upheld is uncertain. At this point, estate planners should be advised to avoid attack by urging the insured to divest himself of all power relating to proceeds settlement plans under his group term life insurance policy. The conflict between Lumpkin and Skitter has not been diminished by the recent case of Estate of Hilton W. Goodwyn,83 which did not involve a group term policy. Here certain policies owned by the wife, having been completely transferred to her some years before by the decedent, were assigned to a bank as collateral for present and future loans to the wife as well as the insured. Surprisingly, the proceeds were held excludable from decedent's estate based on the Skitter decision that Congress intended no disparity between life insurance and other forms of property. Specifically, the Goodwyn court stated that if any other type of property were assigned as collateral for decedent's debts it would not be included in his gross estate. Clearly, a Supreme Court mandate is needed to resolve this judicial quagmire as to the relationship between life insurance and other types of property. Until such time, the estate planner is forced to follow hy-brid rules: Skitter84 (Second Circuit) for non-beneficial powers transferred to the insured by another; Lumpkin85 (Fifth Circuit) for the power over optional settlement plans; and Goodwyn86 (Tax Court) for the use of policies owned by another as collateral. It is submitted, nevertheless, that Goodwyn should not be relied on for this proposition, because the reasoning used in Bintliff87 is strong enough to overrule it at any time, notwithstanding Skitter.

"Key Man" Policies and Section 2042

Most assuredly, managerial skill and experience are the most vital assets of a business. Accordingly, it is only a matter of course for a company to protect itself against loss of such an asset through life insurance. Such insurance is often referred to as "key-man" insurance and may be in the

81. 474 F. 2d at 1097. Lumpkin was followed recently in Rose v. United States, 74-1 U. S. T. C. ¶12,965 (1973), where the insured held incidents of ownership in a fiduciary capacity.
82. See text supra pp. 53-4.
84. 468 F. 2d 699 (2nd Cir., 1972), aff'g 56 T. C. 1190 (1971).
85. 474 F. 2d 1092 (5th Cir., 1973), rev'g 56 T. C. 815 (1971).
87. 462 F. 2d 403, 408 (5th Cir. 1972), rev'g in part 329 F. Supp 1356 (E. D. Texas 1971).
form of ordinary whole life insurance or term insurance. Under ordinary life insurance, the policy builds up cash surrender value which is carried as an asset of the corporation and which may be borrowed against to pay the premiums on the policy. 88 Such insurance, while a most necessary investment for the financial security of a business, may have a devastating effect on the estate planning of the insured. This is because the proceeds of this type of policy just may be pulled into the decedent's gross estate where his position in the corporation is one of "control" thereby bestowing on him "incidents of ownership" under Sec. 2042. 89 Historically, this situation proved quite damaging to key members of closely held corporations.

In Cockrill v. O'Hara 90 a policy was included in the insured's gross estate even though it was owned by a corporation who held all the incidents of ownership. This ruling was grounded upon the fact that the decedent owned 100 percent of the corporation's shares. While Cockrill made no reference to the outcome where the decedent owned less than 100 percent of the shares, such a situation was the subject of dicta in Lendorf v. United States. 91 This dicta came in response to the Service's argument for finding incidents of ownership based on the decedent's 50 percent stock interest in the corporate policy owner. The court stated that, while the mere fact of stock ownership is insufficient to establish that the deceased stockholder possessed incidents of ownership, it may be different if it were proved that a particular stockholder had control over a sufficient number of other stockholders to effectuate a change or cancellation at his will. 92

The position of the IRS expressed in Lendorf was made clear in Rev. Rul. 71-463. 93 The Ruling held that the amount of the proceeds of a life insurance policy owned by a closely-held corporation controlled by the insured-decedent through ownership of a majority of its stock is includable in the decedent's gross estate. 94 The effect of this Ruling was simply

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88. Observe, however, that Rev. Rul. 72-609 states that an interest deduction for loans against the cash value of a policy is not deductible where loans are used to pay the first four annual premiums.
91. 408 F. 2d 461 (Ct. Cl. 1969).
92. Id. at 471. In comparison to the Service's position regarding stock ownership see Estate of Infante, 29 T. C. M. 903 (1970), where, under a partnership buy-sell agreement funded by life insurance, the IRS argued that decedent's right to veto any attempt by his partner to alienate the policy was an incident of ownership right. The Tax Court held in favor of the taxpayer.
94. Specifically; "...the regulation is applicable in circumstances where the insured decedent, or his estate, could exercise voting control of the corporation despite the combined votes of all of the other stockholders." Rev. Rul. 71-463.

See, Simmons, How To Handle The IRS's 71-463 Attack On Corporate-Owned Life Insurance, 36 J. TAXATION 142 (1972).
to take all the advantage out of "key man" life insurance investments involving closely held corporations. Fortunately, pressure from the affected group of taxpayers, along with the inconsistency of including the total proceeds when the insured's liquidation rights would be naturally limited to his percentage of ownership, led to the withdrawal and reconsideration of Rev. Rul. 71-463 vis-a-vis Rev. Rul. 72-167.95 As a further alteration of the situation, the Service has proposed Regulations to amend Sec. 20.2042-1 (c) (2).96 Here, the policy proceeds would not be included in the decedent's gross estate to the extent the proceeds were payable to the corporation. Rather, the proceeds would be taken into account in valuing the decedent's stock in the corporation for purposes of Sec. 2031.97

Although not within the scope of this paper, albeit of equal tax consequence, is the includability of life insurance proceeds in the corporation's gross income. Fulfilling the requirement of an "insurable interest"98 in a "key man", proceeds payable by reason of the insured's death are excluded from gross income under Sec. 101 (a). But controversy has arisen where the corporation arguably resembles a creditor of the insured.99 Currently, the cases have established a significantly favorable position for the taxpayer. In M. Lucile Harrison v. Commissioner100 the shareholders of a subchapter S corporation holding a policy on a creditor-associate successfully obtained exclusion of the policy proceeds in spite of the fact that during the litigation, the decedent's note was cancelled. Even more surprising was L. C. Thomsen and Sons, Inc. v. United States101 where the Seventh Circuit not only permitted the proceed exclusion from gross income but also permitted the corporation to recognize a bad debt deduction to the full amount of decedent's indebtedness.102

SECTION 2035 AND THE PAYMENT OF PREMIUMS TEST

With the elimination of the "payment of premium" test under Sec. 2042, it would seem rather logical to believe that an insured could assure himself of keeping his life insurance policy proceeds from being pulled into his gross estate as long as he unequivocally divested himself of all

100. 59 T. C. 578 (1973).
101. 484 F. 2d 954 (7th Cir. 1973).
incidents of ownership prior to his death. Likewise, the fact that the insured continued to pay the premiums after transfer of the policy would be irrelevant. It would seem that the above would leave more than adequate tax liability in favor of the Treasury coffers with the complexities and technicalities of determining “incidents of ownership.” Nevertheless, controversy grew over the Congressionally intended scope of the so-called demise of the premium test, with the IRS naturally claiming it was strictly confined to Sec. 2042. Immediately following the promulgation of the 1954 Code, the IRS issued notice that the payment of premiums test might not yet be in the grave vis-a-vis Sec. 2035 transfers in contemplation of death. With respect to the transfer of a life insurance policy itself within three years of death, Sec. 2035 creates a presumption that such transfer was made in contemplation of death. Accordingly, the total proceeds would be included in the gross estate.

In 1967 the IRS unequivocally stated that the premium payment test was alive and well. Revenue Ruling 67-463 dealt with a situation where the insured had transferred ownership of a life insurance policy more than three years prior to death. The insured continued, however, to pay the annual premiums until he died. The IRS would not settle for inclusion of only the last three years premiums stipulated to be made within contemplation of death. Rather, the Service announced that it was going to treat the transfer as one of an interest in a proportion of the whole policy, not a transfer of the premiums. In other words, Rev. Rul. 67-463, culminating in its withdrawal in 1971. The Tax Court in Estate of Inez G. Coleman v. Commissioner found that legislative history clearly intended total obsolescence. Furthermore, the court reasoned that

The courts consistently refused to submit to the position of Rev. Rul. 67-463, culminating in its withdrawal in 1971. The Tax Court in Estate of Inez G. Coleman v. Commissioner found that legislative history clearly intended total obsolescence. Furthermore, the court reasoned that

103. While a complete assignment of the life insurance policy may escape Sec. 2042 liability, its effect on the size of the marital deduction should be considered. See, Rev. Rul. 74-42, IRB 1974-4, 13, stating that a marital bequest is not reduced by life insurance passing outside the decedent’s will unless he expresses such an intended result with specificity.


105. Treas. Reg. §20.2042-1(a)(2) states:
Proceeds of life insurance which are not includible in the gross estate under section 2042 may, depending upon the facts of the particular case, be includible in some other section ...


under Sec. 2035 the focus should be on what the decedent parted with which otherwise would have been included in the gross estate. Surely the proceeds would not have otherwise been included in the gross estate because of the policy assignment prior to the three-year limit. Consistent in rejecting Rev. Rul. 67-463, the Fifth Circuit in *First National Bank of Midland, Texas v. United States* held that the "bundle of rights" under the insurance policy was transferred absolutely to the insured's daughters before the Sec. 2035 three year period. In both cases only the premiums for the last three years were included in decedent's gross estate.

Finally succumbing to the court's mandate, the Service issued Rev. Rul. 71-497 holding that tax liability only encompassed the last three years premiums and revoking Rev. Rul. 67-463. Thus, at least part of the Sec. 2035 life insurance controversy has been put to rest, at least for the moment. It is crucial, however, for the estate planner to remember that this rule applies only to transfers of incidents of ownership in excess of three years before death where the insured pays the policy premiums after the transfer.

Rev. Rul. 71-497 addressed itself to another fact situation which demands equal consideration. Specifically, the situation in which, just nine months before death, the decedent insured purchases and designates his children as owners and beneficiaries of a one year, accidental death term policy, paying the full premium himself. Here the total amount of the policy proceeds is includable in the gross estate if the transaction is in fact found to have been made in contemplation of death. The Service indicated that the transfer was not of the dollar amount of the premium but "the right to insurance coverage for the one-year period of the contract." While this reasoning was essentially the same as that used in Rev. Rul. 67-463, this time the court agreed with the Service in *Bel v. United States*.

In *Bel* the decedent, over three years from death, purchased a one year accidental death policy renewable each year upon payment of the annual premium. The ownership was from the outset in the possession of decedent's children. The Fifth Circuit held that this fact pattern had the same effect as where the decedent purchases the policy in his own name and immediately thereafter assigns it to his children. The court held that the entire proceeds, subject to the spousal share, were includable in decedent's gross estate under Sec. 2035. The amazing aspect of this case which hits the estate planner head-on is that the first policy was purchased (and owned by the children) more than three years prior to

109. 52 T. C. at 923.
111. 1971-2 CUM. BULL. 329.
112. Id. at 330.
the insured's death. This original policy had a renewability element which was, in effect, ignored. Regrettably, the Second Circuit's decision reflects the idea that each renewal creates an entirely new policy upon expiration of the previous term. The Court said that future coverage could only be obtained by payment of the renewal premium. This reasoning is meaningless because all future insurance protection is dependent upon payment of the next premium. Moreover, it is specious reasoning to distinguish between a one-year term policy renewable for five years and a five-year term policy with annual premium payments. The renewability feature of the policy, a fortiori, separates the policy from independent policies because it provides continuing protection without further evidence of insurability. It is argued here that the impact of the Bel case regarding one-year renewable policies flies in the face of Midland Bank where the original policy was purchased over three years before decedent's death. To avoid the precedent of Bel, term policies for periods of five years or more are advisable where obtainable from an insurance underwriting viewpoint.

Of additional interest to the estate planner within the framework of Sec. 2035 is Detroit Bank and Trust Co. v. United States. Here the decedent established a trust that was required to purchase a policy on his life. The trustee was required to use decedent's contributions to pay the premiums. The decedent expired within three years of establishing the trust. The district court held that even if the transfer was in contemplation of death, only the premiums could be includable in decedent's gross estate because he never owned an interest in the policy. The Sixth Circuit reversed on this point and by relying heavily on Bel held that the proper value to be included in the gross estate was the total policy proceeds. This holding seems to be a natural extension of Rev. Rul. 71-497 and within the general premise of Sec. 2035, since the original transfer was made within three years of death. The lingering, troublesome argument is that there was never a policy in decedent's hands to be transferred, only funds to purchase such policy. On remand from the Sixth Circuit the district Court has recently held that neither proceeds nor even

116. 467 F. 2d 964 (6th Cir. 1972).
117. 71-1 U. S. T. C. ¶12,783 (1971).
118. For the position that only the premiums in Detroit Bank should have been taxed see Taxation-Life Insurance-Proceeds Of Policy Owned, By A Trust Are Taxable To Estate Of An Insured Who Paid Premiums Through The Trust, 26 VAND. L. REV. 384 (1973).
premium payments were taxable because the transfer of funds to the trust were life motivated. In any event, the major impact of the Sixth Circuit's language in Detroit Bank is that it is no longer possible to avoid Sec. 2035 by having a trust itself purchase the life insurance policy.

Another avenue used in the past to avoid this Sec. 2035 taxability of the insurance proceeds has been to have the insured's wife initially purchase the insurance. Unfortunately, this approach has been recently rejected by the Ninth Circuit which wholeheartedly adopted the Detroit Bank case. In the First National Bank of Oregon v. United States the decedent's wife applied for two twenty-year term policies on decedent's life. Decedent paid all the premiums. He died within three years from the inception date. The Ninth Circuit held that where life insurance policies are procured at the insistence of the decedent within the presumptive period and where the premiums are paid by the deceased, the gross estate includes the proceeds of the policies. As in Detroit Bank, the taxpayer argued that there had been no policies "transferred." However, by reference to Chase National Bank v. United States and a Harvard Law Review article, the court found that such an argument was anomalous where the decedent transferred all the premiums. The court stated that the transfer of the premiums in contemplation of death, when pulled back into his estate, should be valued as all other Sec. 2035 property, i.e. at date of death. And, therefore, the value would be the proceeds of the policy. Finally, in response to the taxpayer's argument against resurrection of the "premium payment" test the Ninth Circuit at last adopted the Service's position that the old test was only intended to be eliminated under Sec. 2042 and may indeed be used under Sec. 2035. It is suggested that, in light of Detroit Bank and First National Bank of Oregon, the safest way to avoid estate tax liability is not only to have the beneficiary purchase the policy but also to have him pay the premiums himself with funds that cannot be easily traceable to the insured.

In summary to this point the rules making Sec. 2035 applicable appear to be: (1) premiums of last three years includable where policy is transferred at least three years before death; (2) proceeds includable where policy is transferred within three years of death; (3) proceeds includable where the policy is purchased by another within three years of death providing the insured pays all the premiums. As if this isn't enough complexity, the Estate of Morris R. Silverman adds another

120. 74-1 U. S. T. C. ¶12,966 (1973).
121. Id. at 8836.
122. 278 U. S. 327, 337 (1929).
124. See note 88 supra. It has been suggested that such reasoning could even pull in proceeds under Sec. 2035 where the policy was transferred over three years before death if the decedent paid all the premiums. Key Life Estate Planning Maneuver Upset By Circuit Court, Tax Coordinator, Jan. 11, 1974 at 1, 2.
125. 61 T. C. No. 37 (1973).
variation. At least this one may be of significant benefit to the taxpayer. Under Silverman, the Tax Court introduces a qualification for the second rule. The Tax Court hereby rejects total inclusion of policy proceeds where the premiums are paid by someone other than the insured after transfer. They will now exclude from the insured's estate that portion of the policy proceeds allocable to the premiums not paid by the insured after the transfer. Clearly, this could result in substantial tax savings if the policy involved is young with minimal cash surrender values at the time of transfer. While this is welcome relief for the taxpayer, it is at the same time another hybrid payment of premiums test thrown into the melting pot of the "premium payment" controversy at a stage in federal estate tax history when we were content to believe that the exclusive test regarding life insurance was "incidents of ownership".

In attempting to avoid tax liability under Sec. 2035, flight insurance presents perhaps the heaviest burden of all. In Commissioner v. Noel's Estate the total proceeds of the flight insurance were included in decedent's gross estate because he retained the power to assign the policy at his death according to the mechanical requirements of the policy form. While incidents of ownership was the determining factor in Noel, there will be problems even when a proper assignment is made. Liability for the policy proceeds in Berman v. United States was based on Sec. 2035.

Here, the Fifth Circuit said that the estate's burden was not to prove that Berman expected to live or intended to live, as counsel for the estate argued, but that the assignment was dominantly motivated by the expectation of continued life. It is not enough to show good health. Section 2035 is not limited to gifts causa mortis made in anticipation of a certain event.

Thus, as to flight insurance, the burden under Sec. 2035 may be more onerous, requiring the taxpayer to prove an affirmative life expectation rather than merely demonstrating that the assignment was not prompted by the thought of death.

CONCLUSION

It is rather apparent that determinations involving includability of life insurance proceeds in the decedent's gross estate are continually becoming more complex and confusing. Accordingly, the estate planner must be responsive to the fluctuating and inconsistent rules of the various circuit courts and the Tax Court. Like Pandora's box, problems in determining whether there has been adequate assignment of the incidents of ownership must be handled by the estate planner with caution. But that alone is not enough, for Sec. 2035 contains a substantially equal number of danger signs. Both Sec. 2042 and Sec. 2035 must be regarded with

127. 487 F. 2d 70 (5th Cir. 1973).
128. Id. at 73.
equal respect when planning for tax avoidance. Finally, while there are some areas currently amenable to successful exclusion of proceeds of life insurance from decedent-insured's gross estate, the estate scheme must be periodically reviewed to respond to the unpredictable changes in the law. The next alteration of these laws may come from Congress, where the House Ways and Means Committee has expressed an intent to investigate tax shelters in the gift and estate tax area.\footnote{Chairman Mills Concerned About Tax Shelters, Gifts & Estate Taxes, Tax Coordinator, Feb. 8, 1973 at 1.}
TENANCY BY THE ENTIRETY: OHIO'S NEW ESTATE

By James V. Magee, Jr.*

I. INTRODUCTION

Effective February 9, 1972, Ohio Revised Code § 5302.17 authorized the creation of an estate by the entirety by deed. This legislative enactment completely reversed the existing judicial attitude in this state toward that ancient common law estate known as an estate by the entirety. It has been amended once, effective November 22, 1973, so that it now reads:

Sec. 5302.17. Estate by the Entireties

A deed conveying any interest in real property to a husband and wife, and in substance following the form set forth in this section, when duly executed in accordance with Chapter 5301. of the revised code, creates an estate by the entireties in the grantees, and upon the death of either, conveys such interest to the survivor, his or her separate heirs and assigns.

"Estate by the Entireties
With Survivorship Deed

.... (Martial status), of .... county, .... for valuable consideration paid, grant(s), (covenants, if any), to .... and ...., husband and wife, for their joint lives, remainder to the survivor of them, whose tax-mailing address is ...., the following real property:

(Description of land or interest therein and encumbrances, reservations, and exceptions, if any)

Prior instrument reference: Volume ...., Page ...., wife (husband) of the grantor, releases all rights of dower therein.

Witness .... hand this .... day of ...."

(Execution in accordance with Chapter 5301. of the revised code)

A husband and wife who are the sole owners of real property as joint tenants or tenants in common, may create in themselves an estate by the entireties in such real property, by executing a deed as provided in this section conveying their entire, separate interests in such property to themselves.

A spouse who is the sole owner of any real property may create in himself or herself and the other spouse an estate by the entireties in such real property, by executing a deed as provided in this section conveying his or her entire interest in such property to themselves.

The provisions of this paragraph shall be applied retroactively to cover transactions occurring on or after February 9, 1972.

When an estate by the entireties vests in a surviving spouse, the transfer of the interest of the decedent spouse may be recorded by

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presenting to the county auditor, and filing with the county recorder either a certificate of transfer as provided in Section 2113.61 of the Revised Code, or an affidavit or certificate of death, reciting the names of the spouses, the residence of the surviving spouse, the date of death of the decedent spouse, and a description of the property. The county recorder shall make index reference to any certificate or affidavit so filed in the record of deeds.  

Originally introduced to create a "statutory form for joint tenancy with survivorship," the bill was renamed to revive a medieval estate long held anathema and "adverse to the understandings, habits and feelings of the people." Such an estate has been termed "an extreme example of a feudal remnant in modern law." This casual change from a statutory joint tenancy to a tenancy by the entirety has had anything but a casual effect upon those practitioners whose legal forte lies in the areas of real property, estate planning, probate, debtor-creditor, and domestic relations. The statute itself is anything but a draftman's dream, replete with contradictions. What has complicated matters even more is the fact that no indication of legislative intent or comment accompanied the bill. Thus the judiciary is left to set legal precedent in an area in which the supreme court itself has refused to enter with authority since 1826.  

This vagueness as to how this new statute is to be construed in Ohio has prompted the writer to delve into the myriad of problems, or rather incidents, of this estate from which problems have arisen, in an effort to formulate some concrete basis for decision should these problems arise, as they inevitably will, in Ohio.

II. TENANCY BY THE ENTIRETIES: GENERALLY

A. Creation:

The tenancy or estate by the entirety is that form of concurrent ownership of property by married couples which evolved at common law. It is that estate created by either a conveyance or devise to a husband and wife of property, either real or personal. It is a peculiar estate

6. See pp. 82-86 and n. 67-84 infra.
8. O. R. C. §5302.17 only permits the creation of an estate by the entirety in real property and recognizes only those created by deed.
TENANCY BY ENTIRETY

held by a husband and wife by virtue of title acquired by them jointly after marriage whereby each is seized per tout at non per my. There is but one estate and in contemplation of law it is held by one person, i.e., by reason of the legal unity of marriage. The husband and wife together take the whole estate as one person. Neither has a separate estate, share, moiety, divisible part or interest in the property, but each has the whole estate.9

Under modern entireties theory the husband and wife are viewed as but one person and take the whole estate as one person through their legal unity of marriage. Likewise, at early common law the husband and wife were viewed as one, but the husband was that one. As such, the husband's control over the concurrent estate was absolute during coverture, and he could use or alienate it as he wished during the joint lives of himself and his wife. The wife's interest was considered only an expectancy.10

This chauvinistic characteristic of the early entireties doctrine has been done away with in most jurisdictions that still retain estates by the entirety by the enactment of married women's acts, which are construed to provide for separate estates for married women without abolishing estates by the entirety.11 Such acts are generally construed as abolishing the husband's rights, jure uxoris, in such an estate and as giving each spouse equal rights therein.12

It is essential for the creation of an estate by the entirety that the male and female conveyees or devisees be in fact husband and wife at the time of the conveyance or at the time the devise vests.13 The courts do permit a locally valid common law marriage to suffice.14 Most problems arise, however, where property is conveyed to two persons as husband and wife and it is later discovered that they were not legally married. What estate or interest do they hold in the property so conveyed?15 Three possible alternatives exist: (1) that the conveyance was

ineffective; (2) that a tenancy in common was created; or (3) that a joint tenancy resulted. The first alternative has seldom been applied, unless fraud is evident. Which of the others is chosen depends on a variety of factors. The most important of these is the intention of the grantor, as evidenced by the language of the instrument read in the light of the relevant extrinsic circumstances, and the policy of the particular jurisdiction toward the right of survivorship, usually expressed for or against joint tenancy and right of survivorship. When a deed has not expressly provided for the creation of a particular estate but has simply referred to the grantees as husband and wife, the courts have had no difficulty in concluding that the grantees took as tenants in common where they were in fact not legally married. As a basis for this holding, courts have stated that a tenancy in common necessarily resulted because (1) the absence of a valid marriage precluded an estate by the entirety and (2) since there was no survivorship intent expressed, there was inadequate compliance with statutory requirements necessary to create a joint tenancy rather than a tenancy in common under the modern rule favoring such tenancies over joint tenancies. It should be noted, however, that an erroneous attempt to create an estate by the entirety does not necessarily result in a tenancy in common when the grant contains some language indicative of the parties' intent to provide for survivorship. Besides the unity of person between husband and wife, there are four other requisites for the creation of an estate by the entirety. They are the unities, of time, title, interest and possession. In order to have an estate by the entirety all five unities must coexist.


18. Cases cited supra n. 17.

20. Some jurisdictions have relaxed their strict adherence to the unities of time and title; see cases cited at Annot., 44 A. L. R. 2d 595 (1955).
The concept of the five unities has existed unchanged since the 17th century. The five are still valid requirements for the creation of such an estate in a majority of jurisdictions. In addition to being husband and wife, the owners must be made tenants by one and the same act, that is, whenever a husband and wife are at the same time tenants of land by grant, but not by the same grant, they are not tenants by the entirety, but tenants in common. Also, husband and wife must have entire possession of the whole of the land that is granted to them. For example, a husband and wife will not be tenants by the entirety where A grants to B and C, husband and wife, 100 acres, to hold 50 acres undivided to B and 5 acres to C. Likewise, husband and wife, to hold an estate by the entirety, must enjoy one and the same estate. A cannot convey to B for life remainder in fee to C, the wife of B. Finally, the estate must vest in the husband and wife at one and the same time. The husband and wife must have one and the same interest, conveyed by the same act or instrument, to vest at one and the same time and each must have the entire possession of every parcel of the property held between them.23

B. Termination:

A tenancy by the entirety originated in the common law concept of spousal unity and as such this tenancy continues only during the coverture of the spouses and may be terminated by a joint conveyance thereof to third persons24 or, in some jurisdictions, by a conveyance of his or her interest by one spouse to another.25

By the very nature of this estate, it is dissolved by the death of one of the spouses, and the whole estate held by husband and wife continues in the surviving spouse, not because he or she is vested with any new interest, but because each originally took the whole or entirety to continue to the survivor.26 The heirs of the deceased spouse inherit no part of the property thus held.27 Nor is such property subject to the claims of creditors of the deceased spouse or to the administration of his or her estate.28 Since the entire estate remains solely to the surviving spouse, that spouse may convey or encumber it despite any provision to the contrary in the will of the deceased spouse.29

The courts have had no difficulty handling dissolution by death. Problems do arise, however, in dealing with the mode of death. In other words what happens when one spouse murders the other, or when the spouses die simultaneously?

The situation of the murder of one spouse by the other has generally been dealt with as a part of the law of constructive trusts. A constructive trust can be utilized to prevent the wrongdoer's unjust enrichment, but the utilization of this principle requires first a decision as to what the wrongdoer's interest was before the wrongdoing occurred. On this problem the answer differs from state to state, varying according to the extent that the state in question has changed the traditional content of this type of tenancy.

Where the land is held by husband and wife as tenants by the entirety, some jurisdictions have ruled that the survivorship rights are unchanged by the fact that one spouse intentionally murdered the other, since the murdering spouse's estate vested by operation of law and not by will or inheritance. Other jurisdictions have not been willing to go as far as permitting the murdering spouse to continue in the entire interest in the property, and have decided that, while such a willful killing should not deprive that person of all interest, he should only retain a one-half interest or some other interest less than the entirety. One author has suggested that the frequency of murder of tenants by the entirety is suggested by the abundance of recent cases.

Another problem which has been discussed is what happens in the case of the simultaneous death of the spouses who hold property as tenants by the entirety? In all but a few states this question is answered by the Uniform Simultaneous Death Act:

Section 3. JOINT TENANTS OR TENANTS BY THE ENTIRETY. Where there is no sufficient evidence that the joint tenants or tenants by the entirety have died otherwise than simultaneously the property so held shall be distributed one-half as if one had survived and one-half as if the other had survived. If there are more than two joint tenants and all of them have so died the property thus distributed shall be in the proportion that one bears to the whole number of joint tenants . . .

Thus in the case of simultaneous death of both tenants by the en-

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33. POWELL §624.
tenancy, it is the majority opinion that their interests in the property descends the same as if they had been tenants in common. 35

The Uniform Simultaneous Death Act has not been adopted in Ohio and there is no known definitive authority on the subject in this state; however, it has been submitted that when spouses holding land by the entirety die leaving no evidence of which survived the other, the first sentence of § 2105.21 Ohio Revised Code should be applied: 36

Sec. 2105.21. When there is no evidence of the order in which the death of two or more persons occurred, no one of such persons shall be presumed to have died first and the estate of each shall pass and descend as though he had survived the others.

Nevertheless, the question still remains as to what interest in entirety passes to the heirs of the respective deceased spouses. The Supreme Court of Tennessee has held that a statute similar to the one in Ohio causes the entirety property to pass to the individual heirs of the simultaneously stricken spouses as though the spouses held the property as tenants in common. 37 Given the fact that the Uniform Simultaneous Death Act has not been adopted in Ohio, the construction of the Tennessee Court is compelling.

Another question which constantly arises in dealing with the dissolution of an estate by the entirety is what becomes of the estate when one spouse is declared incompetent? In some states permanent insanity of one of the spouses is ground for a court decree changing the estate to a tenancy in common. 38 In other states, statutes have been enacted terminating an estate by the entirety upon the established incompetency of one of the spouses. 39

Spousal unity ceases with a divorce of the parties, since... "one legal person has been resolved by judgment of law into two distinct, individual persons, having in future no relations to each other; and with this change in their relations, must necessarily follow a corresponding change of the tenancy dependent upon the previous relation." 40 Generally, the change that occurs is that the tenancy by entirety becomes a tenancy in

38. Kilgore v. Templer, 188 Ind. 675, 125 N.E. 457 (1919).
39. See F. S. A. §745.15 (1973) (Florida statute providing for sale, and division of proceeds, one-half to the guardian of the incompetent and one-half to the other spouse); 11 Burns Annotated Indiana Statutes §§32-4-4-1, 32-4-4-2 (1961) (changing the tenancy by the entireties to a tenancy in common); 2 A General Statutes of North Carolina §36-14-18 (1966) (permitting sale or mortgage on a showing of desirability) Purdon's Pennsylvania Statutes Annotated §1783 (1962, Supp., (1974) (subjecting the tenancy for support of an insane spouse); 15 Vermont Statutes Annotated §634 (1974) (when divorce on ground of insanity land may be sold for support of sane spouse). Contra 60 Okl. St. Ann. §74 (1971, Supp. 1973) (holding adjudication of insanity of an incompetent does not terminate the tenancy).
40. Freeman 76.
common. 41 However, a small number of states hold that divorce does not terminate a tenancy by the entirety. 42 This reasoning seems to be limited to those cases where divorce is granted on a fault basis, since there is "... no reason in holding that a husband or wife can, by violation of the marital obligations, obtain an interest in land which he or she does not possess while fulfilling such obligations." 43

Likewise, a termination of the estate will not be granted when a foreign divorce (ex parte) does not convert tenancy by the entirety property in the non-foreign state to a tenancy in common, at least where the correspondent in the action has not remarried or otherwise relied on the degree; 44 and the same would follow where the foreign divorce is not entitled to full faith and credit in the local jurisdiction. However, when the foreign divorce is entitled to full faith and credit such tenancy by entirety will be destroyed and a tenancy in common will be created. 45

Divorce and other transformations of an estate by entirety into a tenancy in common raise a further problem — the power of the court to hand over to one spouse the other spouse's interest in such tenancy. It is generally held that there can be no severance of such estate by the act of either spouse alone, except in those jurisdictions which allow one spouse to convey his or her interest in the estate to the other; hence neither can convey or dispose of any part of it to effect such a severance, though they may terminate the estate by a joint conveyance of the property. 46 Also, it is generally held that unless such partition is authorized by statute, an estate by the entirety cannot, during the existence of the marital relation, be severed or partitioned by a judicial decree in a proceeding for partition, for general statutes of partition are not applicable to such estate. 47

Courts have, however, dismissed this reasoning apparently on the ground that it destroys such estate's essential and peculiar unity of person and at the same time destroys the estate, thus permitting partition. 48

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42. THOMPSON §1792.
Where the judicial decree is for a separation or limited divorce, the
tenancy by the entirety survives except where the court exercises the
power of partition.\textsuperscript{49}

C. Divergent Views:

While the majority of legal scholars and jurists agree that an estate
by the entirety vests title in husband and wife \textit{per tout et non per my},
there are various ways of construing this premise. Two approaches have
arisen.

Under the majority view, an estate by the entirety is a separate and
totally different estate from any of the other more commonly applied
estates in property. It is a sole, and not a joint tenancy. There are no
moities, and each spouse holds the entirety. They are one in the law
and their estate one and indivisible. If one spouse alien, suffer a recov-
ery, or be attained, none of these will affect the right of the other spouse
if he or she survives. Under such an estate the \textit{jus accrescendi}
does not exist, there being no such thing between the two spouses.
They have the whole from the moment of a conveyance to them and the
death of either cannot give the survivor more. Such an estate is not a
joint tenancy, either in form or substance. Further, at common law, a
husband and wife are tenants by the entirety, unless the conveyance
to them indicates an intention to create a different estate. Such remains the
law in those states where it has not been changed by statute.\textsuperscript{50}

An estate by the entirety originates in the marital relation and although survivor-
ship presents the greatest form of resemblance to joint tenancy, instead
of founding the estate by the entirety upon the notion of joint tenancy,
the overwhelming majority of authorities refer to the established effect
of a conveyance to a husband and wife independent of any principles
which govern other cases.\textsuperscript{51}

Under the decidedly minority view, tenancy by the entirety is seen
as a species of joint tenancy which permits the incident of survivorship
between husband and wife.\textsuperscript{52} Hence tenancy by the entirety is described
as a modification of joint tenancy altered by the common law theory
that husband and wife are one person. As a modification of joint tenancy
it arises where the estate is conveyed to a husband and wife under cir-

\textsuperscript{49} Oxley v. Oxley, 159 F. 2d 10 (D.C. Cir 1946); Brownley v. Lincoln County, 218
Or. 7, 343 P. 2d 529 (1959); Schafer v. Schafer, 122 Or. 620, 260 P. 206 (1927).

\textsuperscript{50} See F. S. A. §689.15 (1969, Supp. 1974); Burns Annotated Indiana Statutes,§32-
1-2-8 (1961, Supp. 1973); K. R. S. §381.050 (1969); M. C. L. A. §554.43-45 (1967);
Mississippi Code Annotated §834 (1956, Supp. 1972); V. A. M. S. §442.450 (1949,
Supp. 1974); N. Y. E. P. T. L. §6.2-2(b) (McKinney 1967); Tenn Code Ann. §64-109
(1955).

\textsuperscript{51} Whyman v. Johnson, 62 Colo. 461, 163 P. 76 (1917); Columbian Carbon Co.
v. Knight, 207 Md. 203, 114 A. 2d (1955); Bowden v. Bowden, 264 N.C. 296, 141 S.E.
2d 621 (1965); CASNER §6.6; FREEMAN §64.

\textsuperscript{52} CHALLIS 314 (Lord Coke speaks of cases in which "the husband and wife shall
have no moieties:" he regards tenancy by the entirety as being a species of joint tenancy,
i.e., the distinguishing characteristic is that it confers no power of severance).
c unstances which would simply create a joint tenancy if the convey-
ance were to be made to two persons other than a husband and wife. 
Agreeing with the majority view that the spouses are not seized of 
moities but of entireties, this minority view also misconceives the basis 
of possession and postulates the right of survivorship as the same in 
other cases of joint tenancy, i.e., via *jus accrescendi*.

This misconception may be exemplified by the following legal logic 
espoused by an early English author:

> If A grants to B and C 100 acres in joint-tenancy, he conveys to 
B and C to hold jointly. If A grants to D and E his wife, 100 acres 
(not to hold in common), he conveys to D and E his wife, to hold 
jointly.

> B is a tenant and C is a tenant. So it is apprehended, D is a tenant 
and E is a tenant.

> B with C and C with B are seized of the whole 100 acres; are 
seized *per tout*. D and E are each seized of the whole 100 acres; 
are seized *per tout*.

> B and C are jointly tenants to the praecipe. D and E are jointly 
tenants to the praecipe.

> Survivorship takes place between B and C. Survivorship takes place 
between D and E.

> In these points, there appears not to be a shade of difference 
between the tenancy of B and C, and the tenancy of D and E his 
wife. B and C are joint-tenants; then why are not D and E? That 
which distinguishes a tenancy by entireties from the common joint-
tenancy is this: that tenants by entireties are not seized *per my*. They 
are seized *per tout* only. But because they are not seized *per my*, does 
it follow that they are not joint-tenants? The common joint-tenants 
are seized *per my*; but would they be less joint-tenants if not seized 
*per my*? What is it that constitutes a joint tenancy? A joint seisen 
*per tout*. It is not seisin *per my* which makes a joint-tenancy. Without 
that, the common joint-tenants would still be joint-tenants. Because 
tenants by entireties are not seized *per my* is surely no reason to make 
them not joint-tenants. A learned writer says, tenants by entireties 
'have not either a joint-estate, a sole or several estate, nor even an 
estate in common'. With great submission, it may be contended, that 
the joint-estate is precisely the estate which they have. The estate of 
tenants by entireties is more a joint-estate than the estate of the 
common joint-tenants; for whereas, the common joint-tenants are 
seized *per my et per tout*, tenants by entireties are seized *per tout* only. 
If tenants *per my et per tout* have a joint-estate, *a fortiori* tenants *per 
tout* have.

Husband and wife have been considered to be tenants by entireties 
because they are one person in law. But this doctrine is questionable.

53. Sergeant v. Steinberger, 2 Ohio 305 (1826); 2 T. McDermott, Ohio Real 
McDermott]; 1 R. Preston, Preston on Estates, 131 (1820); Tiffany §430; 1 E. 
Washburn, A Treatise on the American Law of Real Property 706 (1902): 
It has been attempted to prove that tenants by entireties are joint-tenants. It is now proposed to show that they are not tenants by entireties, because the husband and wife are one person. There is certainly a maxim of law, that husband and wife are one person. Its application to show, that husband and wife are tenants by entireties, because they are one person, may be justly questioned. It is an established principle of tenancy by entireties, that the husband cannot sever the tenancy without the concurrence of his wife. The husband and wife are one person; but if so, the act of one is the act of the other. If the husband and wife are to be considered as one person, it seems inevitably to follow, that the husband may sever the tenancy without the separate consent of his wife. It may be said, if one person, then one mind. In this case, the consent of the wife cannot but accompany the act of the husband. Tenants by entireties are, perhaps, not seized per my but only per tout, because the husband and wife are one person in the law. Joint-tenants, who are not tenants by entireties, are seized per my et per tout. Tenants by entireties are seized per tout, but not per my. To some intents, the common joint-tenants are seized per my. So far they are tenants in common. But apply the rule that husband and wife are one person, and it is evident they cannot be tenants in common. A sole tenant cannot be a tenant in common. He is seized per tout, and not per my. So husband and wife, one person, cannot be tenants in common; they cannot be seized per my. Here it should seem the rule applies. Tenants by entireties are not seized per my, because the husband and wife are one person in law. The rule was probably adopted in this case, in favour to the wife. Alone, (the husband) is not able to sever the tenancy. To effect this, he must have the concurrence of his wife, whose consent would be unnecessary, provided like common joint-tenants, tenants by entireties were seized per my as well as per tout. It remains to observe, that these tenants appear to be called tenants by entireties, because the husband is seized per tout, and the wife per tout. But let the husband and wife be considered as one person, and there can no longer, it is presumed be entireties. A union of seisin seems necessarily to follow a union of persons. If the persons of these tenants are one, there seems to be an inconsistency in calling them tenants by entireties. One person can have but one seisin, one entirety.

The view taken of a tenancy by entireties is shortly this:
That the husband and wife are joint-tenants.
That their tenancy is a species of joint-tenancy.
That like other joint-tenants they are seized per tout.
But unlike other joint-tenants they are not seized per my.
As seized per tout, that their persons are several.
As not seized per my, but one only.

That they are joint-tenants and tenants by entireties because each is seized per tout.
That they are called tenants by entireties to distinguish them from the joint-tenants seized per my et per tout.
That they are not seized per my, through the application of the rule,
that husband and wife are one person, adopted probably in favour to the wife, to prevent the husband from severing the tenancy without his wife's consent.54

It is evident that the early judicial decisions in Ohio were influenced by this axiom and it might be important to note that the determining case in Ohio regarding the future of an estate by the entirety came in 1826, the year following the publication of Ram's treatise.55

III. TENANCY BY THE ENTIRETIES: OHIO

A. Early Decisions:

In 1826, the Supreme Court of Ohio, simultaneous with its abolition of joint tenancy, eliminated the tenancy by entirety as an estate at law.56 Discussing that peculiar form of joint tenancy between husband and wife, the Court refused to distinguish between joint tenancy and tenancy by the entirety and held:

... the right of survivorship (under tenancy by entirety) was the same as in the other cases of joint tenancy and in the case of husband and wife, is at much at variance with our laws and usages, as in the common case (of joint tenancy).57

Thus while refusing to recognize tenancy by the entirety as an estate distinct from that of joint tenancy, the Court reasoned that the jus accrescendi was not founded on principles of natural justice nor in any reasons of policy applicable to our society or institutions, and was in fact adverse to the understandings, habits and feelings of the people.58

Since an estate by entirety owes it distinctive qualities to the common law fiction of the oneness of husband and wife, and since under Ohio statutes59 a husband and wife were clearly separate entities, this statutory abrogation of that fiction resulted in the refusal to recognize such an estate. In subsequent cases the question of the existence of an incident of survivorship seemed to be primarily a problem of recognition of joint tenancy, whether the contenants were husband and wife, or parties not married to each other.60

In Lewis v. Baldwin,61 it was held that a wife could transmit her separate estate, through the intervention of a trustee, to her husband and

55. Id.
56. Sergeant v. Steinberger, 2 Ohio 305 (1826).
57. Id., at 307.
58. Id., at 306. But see Whitlock v. Public Service Co., Inc., 239 Ind. 680, 159 N.E. 2d 280 (1959) (wherein the Indiana court held public policy strongly approves the essential characteristics of an estate by the entirety which devolves upon the surviving spouse the ownership of the property free and clear of the indebtedness of the other spouse).
60: Lewis v. Baldwin, 11 Ohio 352 (1842); In re Hutchinson, 120 Ohio St. 542, 166 N.E. 687 (1929).
61. 11 Ohio 352 (1842).
that a conveyance to A and B, their heirs and to the survivor of them and to the heirs of such survivors, vested in the survivor an estate in fee. Here, because the grantees were husband and wife, the five unities essential to the creation of an estate by the entirety existed. However, the Court did not indicate in its opinion whether the estate created by the deed was a joint tenancy or a tenancy by the entirety. It might have been either, as the essential unities for the creation of both were present.

The same problem arose with In Re Estate of Hutchinson.\textsuperscript{62} In that case it is difficult to determine the class of tenancy the Court held was created given the particular fact situation. James and Letitia Hutchinson, husband and wife, had an account in the Cleveland Trust Company in the names of both, with the stipulation in the passbook and on the signature card: "Either may draw part or whole, in case of the death of either, account is payable to the survivor."\textsuperscript{63}

The question arose as to the nature of their tenancy when James withdrew a sufficient sum to purchase twenty-five shares of stock in Cleveland Illuminating Company and the ownership clause of the certificate read: "This is to certify that James and Letitia Hutchinson, as tenants in common, own an undivided equal interest for their respective lives, remainder in the whole and the survivor is the owner of twenty-five fully paid non-assessable shares." When James died, did his widow become the absolute owner of the whole twenty-five shares of stock, or did one-half of the stock belong to her and the other one-half to the devisees of James by his last will and testament?

The lower court gave effect to the first eighteen words of the ownership clause which asserted they held as tenants in common and considered the survivorship clause as surplusage. On appeal to the Supreme Court, the decision was reversed and the Court not only gave effect to the survivorship clause but regarded it as the controlling clause in the certificate. In doing so the Court implied that what was created was either a joint tenancy or a tenancy by the entirety, as the right of survivorship can be created only in these two classes of tenancy. However, there is nothing in the reported decision to indicate which tenancy the Court felt was created.

Again, the essential unities for both tenancies were present, but all the Court stated is that a tenancy in common was not created. In dicta the Court hinted that a tenancy by the entirety was created when it reasoned "if this was an agreement supported by an adequate consideration, with complete mutuality, and if neither could have revoked or recalled the grant during their lifetime without the consent and concurrence of each other, then a very different question is presented for our

\textsuperscript{62} 120 Ohio St. 542, 166 N.E. 687 (1929).

\textsuperscript{63} The issue in this case involved personality. Under the common law personality could be held by the entirety. Under the present statute, however, only realty is provided for.
determination." Yet, the syllabus would lead one to believe that a joint tenancy was created: "While joint tenancy with the incidental right of survivorship does not exist in Ohio parties may nevertheless contract for a joint ownership with the right of survivorship and at the death of one of the joint owners the survivor succeeds to the title to the entire interest, not upon the principle of survivorship as an incident to joint tenancy, but by the operative provisions of the contract." 

Again, there is a failure to distinguish between joint tenancy and tenancy by the entirety. Further, the dicta of the Court supports the holding in Lewis v. Baldwin that as the right of survivorship is nonexistent in Ohio, neither can a joint tenancy or tenancy by entirety be existent except that joint tenancy with right of survivorship may be provided for contractually. Such has been the plight of tenancy by the entirety in Ohio — a non-existent tenancy spoken on with no authority since 1826.

B. O. R. C. § 5302.17 — Tenancy By The Entirety In Ohio?

As has been mentioned earlier, the new statute is anything but a draftman’s dream. Upon careful reading of the statute in light of our foregoing discussion, one finds himself questioning whether Ohio did in fact adopt a statutory tenancy by entirety or simply reinforced, by statutory enactment, the common law survivorship.

The statute’s first paragraph states that "upon the death of either (spouse, the deed) conveys such interest to the survivor . . .", while the statutory form gives the "remainder" to the survivor. This apparent contradiction evidences confusion as to the nature of an estate by the entirety, for such terminology is hardly apt to describe the whole estate which is retained by the survivor in an entireties situation. Further, the last paragraph of the statute characterizes the transaction upon the death of one spouse as a vesting of the estate in the surviving spouse, when in reality the survivor takes no new interest or estate.

Further ambiguities arise when the original statute as adopted in 1971, effective February 9, 1972, is compared with the present statute.

64. In re Hutchinson, 120 Ohio St. 542, 546, 166 N.E. 687 (1929).
65. Id., at 542.
66. Id., at 550.
68. Upon the death of one spouse the entire estate belongs to the other, not by virtue of survivorship, but by virtue of the title that vested under the original limitations.
as amended effective November 11, 1973. Under the amended statute, the right to create an estate by the entirety inures only to "a spouse who is the sole owner of any real property." What if the spouse is sole owner of an undivided one-half interest in real property as a tenant in common with another tenant in common who is not the spouse's husband or wife? Can he or she create an estate by the entirety in that undivided one-half interest by executing a deed conveying his or her undivided one-half interest to himself or herself and the other spouse? It has been held that where the grantees were two married couples, each husband and wife held one-half as tenants by the entireties as between themselves, but as tenants in common with the other couple. And where a deed conveyed land to a husband and wife and a third person, the court held the husband and wife held one-half interest as tenants by the entirety with the third person named who held as a tenant in common with the married entity. And it has been held that where realty is conveyed to a husband and wife and their son, husband and wife hold one-half by the entirety and their son is a tenant in common with them as to the other half, in absence of words in the deed that the parties are to hold otherwise.

These are some of the anachronisms and questions which have been raised by attorneys and titlemen since the passage of the statute, yet in the considerations that went into this legislation neither the state bar association nor title associations were asked to approve or even consider the statute. Since then, the one thing that has been considered by both of these groups is the repeal or amendment of the statute.

However, before this statute is amended again, consideration must be given to what the amendment should include, i.e., not only must it be one which corrects the contradictions of the old statute but one which is procedurally and substantively suitable for use in Ohio. As there are about twenty-six jurisdictions, including the District of Columbia, which

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69. By O. R. C. §5302.17, effective February 9, 1972, it was provided that a deed conveying any interest in real property to a husband and wife, and in substance following a statutory form, shall create an estate by the entireties in such grantees. Additionally, by such original statute, a husband and wife, as co-owners, can create in themselves an estate by the entireties by executing such statutory form of deed. The amendment to O. R. C. §5302.17, effective November 22, 1973, further declares that a "spouse who is the sole owner of any real property may create in himself or herself and the other spouse an estate by the entireties in such real property, by executing a deed" in the statutory form. This amendment applied to all such transactions occurring on or after February 9, 1972.

70. Dennis v. Dennis, 152 Ark. 187, 238 S.W. 15 (1922).
73. Sams, Observations on Ohio Estate by Entireties, 3 TITLE TOPICS 4 (1972); Baker 1665; McKinney 14.
74. MCDERMOTT 39.
at present accept estates by the entirety in one form or another, Ohio should have no problem in adopting the best of these to meet its own needs.

One of the first problems that must be resolved is whether one spouse, being the sole owner of an interest in real property, may create an estate by the entirety in that interest by a conveyance to himself or herself and the other spouse. To an extent this question has been recognized by the recent amendment effective November 22, 1973, but the drafters of this amendment have not proceeded to the best of their capabilities.

The general view that has been taken is that no estate by the entirety exists where one spouse conveys to himself or herself and the other spouse because the required unities of time and title are not present. However, a number of states have cured this anomaly by statutes and judicial decision. This relaxation by these states has been in part due to the realization that adherence to the strict principles and requirements of the common law only aid and abet the layman's criticism of the profession as engaging in purposeful obfuscation for the sole purpose of making the law incomprehensible to those unschooled in it; in part to their realization that such circuitous conveyancing, through the use of a straw man, has no apparent substantive value; and in part based on the rationale that the spouse is not conveying the property to himself or herself and the other spouse, as such, but is conveying to a legal entity composed of the husband and wife. For these reasons, it is submitted that a spouse who is the owner of an undivided interest in real property may create an estate by the entirety in that interest by conveying to himself or herself and the other spouse as tenants by the entirety. The flaw in the recent amendment is that it should read: A SPOUSE WHO IS THE SOLE OWNER OF ANY INTEREST IN REAL PROPERTY AS A TENANT IN COMMON . . .

Another area of concern voiced by the profession is the statute's limitation permitting creation of the estate by the entirety by grant in a deed only. Why not permit the creation of such an estate by devise since it seems illogical to allow an estate when created in one type


78. In re Klatzl's Estate, 216 N. Y. 83, 110 N.E. 181 (1915); Note, Real property — Conveyances between Spouses — Creation and Dissolution of Estates by the Entirety, 34 N. C. L. Rev. 571 (1956).
document and not to recognize a clear effort to create the estate by another means? The author has searched the treatises and reported decisions seeking to uncover some well-founded conclusions for not permitting the creation of such estate by will and has found none. An estate by the entirety is the estate created at common law by a conveyance or devise of property to husband and wife. As a general rule in jurisdictions that recognize the existence of such estate, the estate will arise from a conveyance to husband and wife or a devise to husband and wife, even where the deed, will or other instrument does not express how they are to take, or refer to their marital relationship, and though at the time of taking, they have no intention in fact as to what technical estate they are taking.

Another question raised in connection with an amendment to the statute is: do present grantees under survivorship deeds enjoy any additional immunities under such estate, i.e., are the rights of present grantees under joint and survivorship deeds affected? It is generally stated that a statute which does not on its face expressly purport to act retrospectively will not be given that construction by implication. This is because a retrospective law, in the legal sense, is one which takes away or impairs vested rights acquired under existing laws, and hence is generally reprehensible, unjust, oppressive and dangerous from a legal and ethical point of view. Accordingly, such retrospective operation, being looked upon by the courts with disfavor, will not be given, unless the intent of the legislature to such effect is clear. But, it may be argued that a retrospective operation of Ohio's entirety statute does not take away or impair vested rights acquired under a joint and survivorship estate; but rather that it enhances such estate. Such an assertion is unwarranted, as it must be remembered that a joint tenancy is not statutory but by the operative provisions of the contract entered into by the grantees to such conveyances.

The preceding discussion has attempted to clarify some of the thought-provoking questions raised by those interested in remedying the present


83. Williams v. First Presbyterian Soc., 1 Ohio St. 478 (1853); Sergeant v. Steinberger, 2 Ohio 305 (1826).

84. In re Hutchinson's Estate, 120 Ohio St. 542, 546, 552, 166 N.E. 687 (1929).
statute. The next logical step, under such circumstances, is to present for perusal this author’s remedial statute.

C. Remedial Statute:

AN ACT
To amend section 5302.17 of the Revised Code to provide for a statutory creation of an estate by the entirety by conveyance or devise to husband and wife of real property; to provide for a statutory creation of an estate by the entirety where one spouse holding title to real property in his or her own right conveys that interest to himself or herself and the other spouse as tenants by the entirety; and to provide for the creation of an estate by the entirety in fee, for life, for years or other chattel real, in possession or in remainder, in husband and wife.

Sec. 5302.17. Any grant or devise conveying or devising any interest in real property to a husband and wife an in substance following the forms set forth herein, and in the case of a deed duly executed in accordance with Chapter 5301 of the Revised Code, creates an estate by the entirety in the grantees or devisees, and upon the death of either spouse, the surviving spouse continues in the entirety, not by virtue of survivorship, but by virtue of the title that vested under the original limitations.

A) By deed from grantor other than grantees themselves know all men by these presents, that __________ of the State of __________ County of __________, grantor, in consideration of __________ dollars to __________ paid by __________, husband and wife, of the State of __________ County of __________, grantee, the receipt whereof is hereby acknowledged, do (does) hereby grant, bargain, sell and convey to the said grantee, __________, husband and wife, jointly for life and to the survivor of either, his or her heirs and assigns forever, the following described real estate:

(Description of Real Estate)
The intention of the grantor is to convey to the said grantee an estate by the entirety in the above described premises. To have and to hold said premises, with the privileges and appurtenances thereunto belonging to the said grantee, jointly for life, and to the survivor of either, his or her heirs and assigns forever.
And the said grantor __________ for himself (herself or themselves) and his (her or their) heirs and assigns do (does) hereby covenant with the said grantee, __________ husband and wife, his or her heirs and assigns, that he (she or they) is (are) lawfully seized of the premises aforesaid: That the said premises are free and clear from all incumbrances whatsoever and that he (she or they) will forever warrant and defend the same, with the appurtenances, unto the said grantee his or her heirs and assigns, against the lawful claims of all persons whatsoever.
(Execution in accordance with Chapter 5301. of the Revised Code)

B) By deed from husband and wife to themselves as tenants by the entirety.
Know all men by these presents, that ______ and ______, husband and wife, grantors, being owners as tenants in common (joint tenants) of the real estate hereinafter conveyed and desiring to hold said real estate as a tenancy by the entirety in consideration of the sum of one dollar received by each of us from the said ______ and ______, as husband and wife, the grantee, the receipt whereof is hereby acknowledged do hereby grant, bargain, sell and convey to the said ______ and ______ as husband and wife, jointly for life, and to the survivor of either, his or her heirs and assigns forever, the following described real estate:

(Description of Real Estate)

The only intention and purpose of this instrument is to convert the interest of said grantors in said real estate from a tenancy in common (joint tenancy) to a tenancy by the entirety. To have and to hold said premises with the privileges and appurtenances thereunto belonging, to the said grantee, jointly for life, and to the survivor of either, his or her heirs and assigns forever.

And the said grantors, do for themselves and their heirs and assigns hereby covenant with the said grantee, ______ and _______, husband and wife, his or her heirs and assigns, that we are lawfully seized of the premises aforesaid; that said premises are free and clear from all incumbrances whatsoever and that we will forever warrant and defend the same with the appurtenances, unto the said grantee, his or her heirs and assigns forever against all claims of all persons whatsoever.

(Execution in accordance with Chapter 5301. of the Revised Code)

C) Estate in Entirety By Devise

I give, devise and bequeath to ______ and _______, husband and wife, jointly for life, and to the survivor of either, his or her heirs and assigns, an estate by the entirety in the following described real estate, to wit:

(Description of Real Estate)

A husband and wife who hold title to any like interest in real property may create in themselves an estate by the entirety in such real property by executing a deed as provided in this section conveying their entire separate interests in such property to themselves as tenants by the entirety.

A husband or wife who holds title to any interest in real property as a tenant in common may create in himself or herself and his wife or her husband an estate by the entirety in such real property by executing a deed as provided in this section conveying his or her interest in such property to himself or herself and his or her spouse as tenants by the entirety.

When one spouse predeceases the other spouse the right of the surviving spouse to the whole estate is considered not as arising from a new estate but from a continuation of the old estate by the entirety. Notice of the death of one spouse may be recorded by presenting to the County Auditor and filing with the County Recorder an affidavit or certificate of death reciting the names of the spouses, the residence of
the surviving spouse, the date of death of the decedent spouse and a
description of the real property. The County Recorder shall make
index reference to any affidavit or certificate so filed in the record
of deeds.

It is the intent of this statute to provide for an estate by the entirety
in fee, for life, for years or other chattel real and such may be in
possession or in reversion or remainder.

It is evident that the above statute is not all inclusive, for there are
certain areas such as creditors’ rights and probate which will present
novel issues as the statute is applied in these fields. It is best that the
statute is not rigorously structured, since the common law in Ohio leaves
little precedent for legislators to choose from in binding the courts to
decisions on these topics. It is in these areas that the courts will have to
construe the entirety theory based on the foregoing discussion of this
estate and their own insight into the law. In two specific areas it may
be wise to delve deeper into the precedents of other jurisdictions in-

IV. MAJOR PROBLEM AREAS
volving creditors’ rights and probate considerations.

A. CREDITORS’ RIGHTS IN TENANCY BY THE ENTIRETY:

There are a number of rules which have been applied by the courts
in determining the rights and remedies of creditors in property owned by
husband and wife as tenants by the entirety. These rules are best
categorized under four headings: 1) the common law rule; 2) the all
interests reachable rule; 3) the no interests reachable rule; and 4) the
right of survivorship reachable rule.

As noted earlier, the husband, at common law, was entitled to com-
plete control and use of the concurrent estate, held by the husband and
and wife as tenants by the entirety, during coverture; and as he could
use his interest as a present base for credit, his creditors could reach
his entire interest in the estate. The wife’s interest, more substantial
than dower, was essentially a contingent interest. To take any beneficial
interest, she had to survive her husband, for all she possessed was a
mere expectancy of speculative value.

Upon surviving her husband, the wife’s right in the estate was not
liable for his debts and could not be defeated by any process or sale
upon execution against him; nor would her right in the estate be subject
to claims of an administration of his estate.

Massachusetts appears to be the only jurisdiction continuing to pre-

85. CONWAY 37; PATTON §236; THOMPSON §1790; 41 Am. Jur. 2d, Husband
and Wife §§74-76; Annot., 75 A. L. R. 2d 1174 (1961); Huber 197.
86. Flairclaw v. Forrest, 76 App. D. C. 197, 130 F. 2d 829 (1942), cert. denied,
87. Authorities cited supra n. 10.
serve this pure common law concept of the tenancy. It has adopted the above rule with its obvious corollary that the wife’s creditors can reach no part of the tenancy during coverture. But before Ohio decides to give this rule strong consideration, it is necessary to point out that a strange anomaly arises when the above rule and corollary are followed. If a husband and wife have obligations which are several as well as joint, or merely several the result at common law, is that the husband’s, but not the wife’s interest can be reached. However, if their obligations are joint, it would seem that the entire tenancy would be exempt on the ground that to reach it all would require reaching the wife’s interest which is exempt.

In those jurisdictions which hold a tenancy by the entirety to be the same as a tenancy in common for the joint lives of the spouses with an indefeasible right of survivorship in each other, absolute equality of rights exist in both the husband and wife. Under this rule, each spouse not only has a right to take the whole as a survivor, but also has a present possessory interest with control and income rights. This has been deemed sufficient to give a creditor of either spouse the right to go against property held in entirety to the extent of the debtor-spouse’s interest. A creditor thus proceeding becomes a tenant in common with the non-debtor-spouse. As such, the creditor is entitled to the entire property if the debtor-spouse survives and conversely loses all rights if this order is reversed.

In those jurisdictions abiding by this rule, since each spouses’ interest can be reached by his or her individual creditors, their interests could be reached as a unit if they were liable to creditors jointly, severally, or jointly and severally. However, this rule would be objectionable in Ohio under the statute proposed herein, because as worded, no interests would be reachable by the very nature of the estate conveyed.


90. Huber 200.


Under the third rule and by far the majority rule, creditors cannot reach either the husband's or the wife's interest. This results from the theory that there is a unity of husband and wife under tenancy by the entirety. There are no moities, only entireties; each spouse takes nothing individually, but together they take the whole. Neither spouse, individually, can receive the income and profits, since there is no individual right to use and control. To permit a creditor of a debtor-spouse to reach the interest of that spouse would interfere with the rights of the other spouse in the enjoyment of the whole property during the continuance of the estate. While land held by husband and wife as tenants by the entirety can be subjected to the lien of a creditor of one spouse, such interest of the creditor can be circumvented by a conveyance of the property by the two spouses during coverture. However, when a lien is against both tenants by entirety jointly, the creditor may reach the interests of both spouses and obtain a right to the entirety. This right is founded on the theory that as the lien is against the husband and wife as a unity, that unity may be subjected to creditors.

Under the fourth rule, the right of survivorship is treated as a separate interest and can be transferred by one spouse without in any way affecting the rights of the other. Both spouses retain their present possessory interests during coverture and if the non-transferring spouse survives the transferring spouse, that spouse will have the entire estate. Thus where the right of survivorship is transferable by one spouse acting without the consent of the other spouse, creditors of each spouse are permitted to reach their respective interests. The transferee or creditor obtains no immediate right to possession but gets the estate in fee simple in the event the debtor-spouse survives the other spouse and the creditor cannot be defeated by any intermediate conveyance made by both spouses.

Where the spouses are jointly obligated it follows that their creditors can reach their entire interest in the property so held by the entirety, but


94. Chandler v. Cheney, 37 Ind. 408 (1871); Hertz v. Mills, 166 Md. 492, 171 A. 709 (1934); McCurdy v. Canning, 64 Pa. 39 (1870); Beihl v. Martin, 236 Pa. 519, 84 A. 953 (1912); Freeman §74; Powell §623; 41 Am. Jur. 2d, Husband and Wife §75 (1968).


96. Powell §623.
where the spouses are only severally liable, only their individually transferable survivorship interests can be reached. 97

Mechanics lienholders are generally treated the same as other creditors, although some courts hold that where one spouse has notice of the other's acts authorizing construction and makes no objection, the lien may be imposed against the non-contracting spouse also. 98 Sometimes it has been determined by the courts that one spouse acted as the agent of the other. 99

When a tenancy of the entirety runs afoul of the bankruptcy statute some special problems have to be faced. The complete immunity from the claims of creditors given tenants by the entirety in the majority of states is an expression of the policy generally favoring marital property and property interests over commercial and creditor interests. 100 Section 70a (7) of the Bankruptcy Act 101 is aimed directly at this immunity:

a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of filing . . . to all of the following kinds of property wherever located . . . (7) contingent remainders, executory devises and limitations, . . . , and like interests in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and . . .101

Thus, if the non-bankrupt spouse dies within six months, the property and title to it vests in the trustee. 102 When both spouses individually become bankrupt, by the device of consolidating proceedings, the entirety will pass to the trustee in bankruptcy. 103 In the absence of consolidation, it has been held that the full value of the property is listed as an asset in the estate of each bankrupt for the determination of solvency on the date pertinent to the vesting of a creditor's lien. 104

As mentioned earlier, 105 while land held by husband and wife as tenants by the entirety can be subjected to the lien of a creditor of one spouse, such interest of the creditor can be defeated by a voluntary conveyance of the property by the two spouses. Can the interest of a trustee in bankruptcy be similarly defeated, i.e., would a bona fide purchaser for value of property take title free from the claims of the trustee

97. Huber 205.
98. Wilson v. Logue, 131 Ind. 191, 30 N.E. 1079 (1892).
100. Huber 205.
105. Cases cited supra n. 91.
when both spouses convey to him, one of the spouses being a bankrupt and the other not, and the non-bankrupt spouse dies within six months? There appears to be no reported authority on this question. However two authors have taken apposing views.  

B. Consequences At Death:  

Ohio's estate tax includes in the gross estate one half of the value of the joint property where the holders are husband and wife. However under the common interpretation of an estate by the entirety both husband and wife have the whole, that is, there are no moieties or divisible parts. Since they each own the whole from the beginning of their estate, it is evident that absent some legislation, this is a fertile area for litigation if Ohio's taxing authorities continue to treat this estate like a survivorship tenancy in common.  

The general rule, and the rule applied under federal law and those jurisdictions which have copied the Federal law, is that the entire value of the jointly owned property is included in the decedent's gross estate. The logic in the rule lies in statutory provisions designed to prevent tax avoidance on the part of the decedent, for it is apparent that if joint estates were not subject to the estate or succession tax, an owner of property could avoid the tax by having his property transferred to himself and his wife as tenants by the entirety. Thus, the fictions of the common law concerning the nature of the title held by persons who own property jointly with right of survivorship or as tenants by the entirety do not affect the validity of the provisions of an estate or succession tax concerning such property.  

Such a rule in effect amounts to a rebuttable presumption that any property held by the entirety is taxable in the estate of the first to die. The burden is upon the surviving spouse to prove that he or she contributed to the purchase of the property and that the contribution made did not originate in the deceased spouse. This burden of proof usually poses extreme difficulties and the courts have been divided as to the  

107. O. R. C. §5731.10(b) (1968).  
108. There has yet to be any reported decision in Ohio as to how the courts or taxing authorities view entireties property as a taxable asset. See generally Zuber, Ohio Estate Taxation, 14th Annual Federal Taxation Conference, Ohio Legal Center Institute, Columbus, February 2, 1973, at 1.07.  
112. Tyler v. United States, 281 U.S. 497 (1930); DuBois' Adm'r v. Shannon, 275 Ky. 516, 122 S.W. 2d 103 (1938); In re Cowan's Estate, 98 Utah 393, 99 P. 2d 605 (1940).  
TENANCY BY ENTIRETY

precise requirements for rebutting this presumption in those cases. Thus while taking property as a tenant by the entirety has its advantages in other areas of the law, the disadvantage presented here may in some instances offset other benefits.

V. CONCLUSION

The enactment of Section 5302.17 has been criticized as being retrogressive, anachronistic, elusive and obnoxious to women’s liberation while the estate itself has been widely and frequently questioned. In other jurisdictions this estate has been abrogated by statute or repudiated by the courts while other jurisdictions have never recognized it because it was incompatible with the basic theory of the community property system of a conjugal partnership in acquisition and gains. The fact remains, however, that the estate by the entirety remains a popular and flourishing form of co-ownership in several states.

In Ohio we are left with two choices: repeal or amend. To repeal the statute would not be a satisfactory approach, for during the short time that the statute has been in existence there have been numerous conveyances creating such an estate.

The solution then is to amend the statute. By careful and reasoned considerations and with the aid of other jurisdictions’ thinking on the subject, Ohio can effectively shape its estate by the entirety into a viable form of concurrent ownership in real property. Like any other estate, an estate by the entirety has its disadvantages. But a cautious practitioner will be aware of these when advising a client as to which form of tenancy to take title by, or convey or devise; and he will weigh the advantages against the disadvantages to meet his client’s needs. The protection of marital property against the rights of creditors is one of these advantages, although such holdings have been criticized as being against equity and justice. Used intelligently, this estate can serve as a beneficial form of transfer of property in Ohio’s jurisprudence.

However, until the present statute is remedied or amended an air of caution should be taken by those who practice in the areas affected by

118. See Casner §6.6(d); Powell §621.
119. See, Casner, §7.9 n. 9; C. Moynihan, Introduction to the Law of Real Property 230 (1962).
120. This statement is based on a random survey of attorneys in Hamilton, Butler, Warren and Clermont counties.
121. Wilkerson, Creditors’ Rights Against Tenants by the Entirety, 11 Tenn. L. Rev. 139 (1933).
this estate, for as pointed out herein, much is left in doubt as to the intention of the drafters of the present statute, and until these ambiguities are clarified, the use of this estate may result in unwanted and unnecessary litigation.

This article has attempted to expose some of the problems encountered in dealing with estates by the entirety while at the same time to answer some of the thought-provoking questions asked by those in the profession. By suggesting possible courses for future decision and presenting a remedial statute, this author hopes that such can serve as a basis for needed legislative revision to rectify the ambiguities hindering the smooth transition into this new estate for Ohio.
I. INTRODUCTION

To the profound distress of civil libertarians and much of the American public, recent Watergate-related events have once again shown a tendency by governmental authorities to justify invasions of fundamental constitutional rights on the basis of national security. Although the discussion of individual rights versus governmental authority has long been with us, recent disclosures of Administration excesses provides ample reason to reflect on the current status of government surveillance and First Amendment rights.

The widespread advocacy of politically unpopular causes of the sixties greatly increased the surveillance of political dissidents as a routine practice by all levels of law enforcement.¹ This political intelligence gathering, defended as a necessary response to the overt and covert activities of militant dissidents, poses significant constitutional problems.² With this increased number of new surveillance targets, law-abiding citizens, expressing their views on the wisdom and course of governmental policy, have often become the subject of police scrutiny and dossier building, despite the legality of their conduct.³ Although there is some justification for certain types of information collection that are directly relevant to national security, the fact that dossiers are created on the politically active, regardless of the lawfulness of their activity, could deter individuals from exercising their First Amendment rights.⁴

This article will first attempt to show the extent of modern political surveillance and computerized filebuilding and its inhibiting effect on the First Amendment freedoms of speech and association. Next, this article will discuss whether a subject-plaintiff would have the requisite standing to litigate a constitutional challenge to this surveillance activity and, if so, whether, under present First Amendment standards this activity should be found to be unconstitutional.

II. EXTENT OF MODERN POLITICAL SURVEILLANCE

The extent to which federal agencies, as well as state and local governments, are collecting, storing and exchanging information about activities of private citizens is rapidly increasing. The federal government dominates the area of political surveillance, engaging some twenty agencies in intelligence gathering. Among them are the F.B.I. (with an estimated 2,000 agents on political investigative assignments and thousands of undercover informers), the C.I.A., the Internal Revenue Service, the Secret Service, the Task Force Division of the State Department, and the Intelligence Division of the Post Office. This surveillance has not been confined to the orthodox law enforcement agencies, but has been practiced by numerous branches of government. We have all read how the United States Army intelligence units have been systematically keeping watch on the lawful political activity of various groups and preparing incident reports and dossiers on individuals engaged in a wide range of lawful protests. Although the Army's domestic surveillance was allegedly curtailed in 1970, other intelligence systems flourished, seemingly unchecked. For example, we have learned of the Department of Housing and Urban Development's Adverse Information file, the National Science Foundation's databank on scientists, the Custom Bureau's databank on "suspects", the Civil Service Commission's investigative and security files, the Justice Department's databank, and the Secret Service's dossiers on "undesirables, activists and malcontents."

The agencies' data gathering activities are just the front end of a very sophisticated system of political intelligence. This surveillance has resulted in the creation of "dissident databanks", a term used to designate computer storage of intelligence gathered on known or potential dissidents. The computers enable the various agencies to collect, store, retrieve and disseminate great quantities of information in a fast and efficient manner. Thus, the computer and the related science of cybernetics has afforded government officials the ability to conduct what has

6. Davis, supra note 1 at 105; Donner, supra note 1 at 27.
7. Davis, supra note 1 at 105-06.
9. Id at 1427.
11. Miller, supra note 5 at 3-4.
12. "Intelligence" has been defined as "a body of techniques for collecting political information about a "subject" (physical surveillance, photography, electronic eavesdropping and informers—planted or recruited "in place"—and other deceptive or clandestine practices), the products of these activities (files and dossiers) and a set of political assumptions (the intelligence mind)." Donner, supra note 1 at 27, n. 1.
13. Davis, supra note 1 at 111 n. 46.
been dubbed "dataveillance", the review of presently stored information on
a particular subject. 15 Because this activity has usually been conducted
in an unpublicized manner, the extent to which these agencies maintain
computerized dossiers that include political information is unknown,
and not readily accessible to legal challenge. 16 However, it has been
claimed that the Department of Defense has fourteen million life his-
tories in its security files, the Civil Service Commission eight million,
and the F.B.I. an unknown number (although it admits to some 100,000
files on communist "sympathizers" alone). 17 The Secret Service is said
to have 50,000 names of "persons of interest" on file and the Civil Serv-
ice Commission said to carry 15 million names of "subversive activity"
suspects. 18

Intelligence operations also flourish on the state level. For example,
the Massachusetts Division of Subversive Activities, a central repository
for its state's data on subversion, revealed in its Annual Report for 1969
that:

A file is kept of peace groups, civil rightists and other such groups
where, due to their enthusiasm, they might have a tendency to adopt
or show a policy of advocating the commission of acts of force or
violence to deny other persons their rights under the Constitution . . . .
Members of the Division attended demonstrations conducted in the
area by various groups. Note was made of their leaders and organiza-
tions participating, occasionally photographs are taken, the persons
identified and a file made. 19

The Ohio Highway Patrol is said to have informers on every college
campus in the state, with Maryland and Illinois deploying similar intel-
ligence units. 20 The pervasive scope of the New Jersey state intelligence
gathering system, indicative of the response given political dissent at
other state levels, was examined in Anderson v. Sills. 21 There it was
shown that the State Attorney General had ordered local law enforce-
ment officials to fill out security forms on protest groups at any rally,
protest, march or demonstration within the state and to forward basic
personal data of the participants to the central agency. 22

Local surveillance parallels state and federal activity. Known as
"red squads," 23 these intelligence units have multiplied greatly in the

15. Davis, supra note 1 at 111.
16. As a general matter, the investigatory and intelligence files of federal agencies
are considered "privileged" executive records and are not subject to public access under
17. Westin, supra note 1 at 159.
18. Davis, supra note 1 at 106.
19. Donner, supra note 1 at 28.
20. Id.
22. Id.
23. Donner, supra note 1 at 28.
late sixties and are a standard tool in local police practice.24 In both Chicago and Philadelphia, it is claimed that there are more police on political intelligence assignments than are engaged in fighting organized crime.25

By and large, most of these surveillance activities were implemented to achieve well-intended and socially desirable objectives. In the law enforcement field, the object of computerized filebuilding is said to be the elimination of organized crime and the preservation of law and order.26 Moreover, it is theorized that individuals and organizations engaging in dissent from existing governmental policies cause the illegal civil disorders that police seek to prevent, and that the creation of dossiers on lawful protestors will aid in the prevention of these disorders.27 Similarly, the F.B.I. justifies its intelligence operations in terms of combatting subversion or quelling campus riots and riots in our urban centers by knowing whom to watch or seize in time of strife.28 In fact, the various federal and state commissions created to analyze and report the causes of civil disorders of the sixties encourage law enforcement agencies at all levels to set up and maintain intelligence groups.29 The Report of the National Advisory Commission on Civil Disorders specifically called for intelligence units to be established to "gather, evaluate, analyze, and disseminate information on potential as well as actual civil disorders."30

One can hardly question the government's right to inform itself of potential crimes and acts of violence. The resort to bombing as a political tactic, such as the destruction of the University of Wisconsin Mathematics building in August of 1970, and the destruction that surrounded the urban riots and campus uprisings of the last decade, obviously creates a justification for intelligence to forestall such practices. But the evolving intelligence system described above has clearly exceeded these limited objectives and has become repressive for many of its subjects and totally inconsistent with our American tenets of political freedom. To learn that in this country literally millions of people are systematically suffering invasions of privacy, and are forced to exercise their rights of free expression and assembly under fear of surveillance, is frightening.

III. Harm Of Political Surveillance

... the charge is that the purpose and effect of the system of surveillance is to harass and intimidate the respondents and to deter them from exercising their rights of political expression, protest, and dissent "by invading their privacy, damaging their reputations, adversely af-

24. Id. at 28-29.
25. Id. at 28, n. 5.
26. Miller, supra note 5 at 4.
27. Akin, supra note 4 at 198.
28. Senate Hearings, supra note 8 at 1315.
30. Id. at 78.
fecting their employment and opportunities for employment and in other ways." Their fear is that "permanent reports of their activities will be maintained in the . . . databank, and their 'profiles' will appear in the so-called 'Blacklist' and that all this information will be released to numerous federal and state agencies upon request. 31

So goes just one of many challenges by a subject-plaintiff against just one of the many surveillance systems previously described. Those who walk submissively will contend that there is no cause for alarm. But those who do not walk so submissively, those who exercise his or her right to orderly and peaceably dissent against government action, do have cause for alarm. The large scale emergence of these dissident information systems magnifies the threat to personal privacy and the potential chilling effect of surveillance. When a citizen knows that his conduct and associations are being put on file and that the information might someday be used to harass him, he may become more concerned about possible content of that file than with asserting his rights of expression. 32 This, in turn, may encourage private citizens to keep politically silent.

The immediate philosophical objection is that this activity is redolent of a police state, with the government maintaining a record of the political ideas and activities of its citizens. The memory of McCarthyism is still fresh, as is the silent generation that followed.

The extensive Senate hearings held by Senator Samuel J. Ervin, Jr. (D-N.C.) on the extent of government surveillance, disclosed that most private organizations and individuals under watch neither advocated nor precipitated criminal or subversive action, and many opted for a politically neutral stance simply in an attempt to avoid conflict with police or other governmental agents. 33 Thus, this threat of future reprisals causes a not wholly imaginary fear among surveillance targets. As one of the documents stolen from the F.B.I. office in Media, Pennsylvania, on March 21, 1971, shows, visible surveillance was advocated to "enhance the paranoia endemic in these (dissident) circles and will further serve to get the point across that there is an F.B.I. agent behind every mailbox." 34 Thus political activity is plagued by an intelligence "presence" which demoralizes, intimidates and frightens many of its targets and is clearly intended to do so.

The surveillance activities of the police have also been used for the purpose of harassment of the dissident. Harassment may come in the form of notifying dissidents regarding the collection of data, the dissemination of such data to other agencies or organizations, or the augmentation of existing dossiers. 35 Other sanctions are improvised to punish

31 Laird v. Tatum, 408 U.S. 1, 25 (1972).
32 Miller, supra note 5 at 6.
33 Davis, supra note 1 at 102-103.
34 Donner, supra note 1 at 27.
35 Davis, supra note 1 at 102.
politically objectionable subjects, allegedly including press leaks, prosecution on drug charges, blacklisting, illegal searches and seizures and raids on pretexts. For instance, Lee Otis Johnson, former head of Houston's Student Non-Violent Coordinating Committee is now serving a thirty-year jail sentence for the sale of a single marijuana cigarette to a Houston undercover agent. Mayor Joseph Alioto of San Francisco, a vocal critic in many political areas, found that unevaluated intelligence files, compiled by federal and urban agencies, full of smears and unverified rumors, were released to the press and became the basis of an article that threatened his political career. Of more recent date are the alarming disclosures from the Watergate investigations, where it was revealed that an “enemies list” was prepared on a variety of individuals opposed to the Nixon Administration's policies, and that IRS harassment of the individuals was contemplated.

There are many more examples of how surveillance has become a kind of punishment for the exercise of constitutionally protected First Amendment freedoms of speech, association, and press. For example, CBS Newsman Daniel Schorr, after a series of articles critical of the Administration, found himself to be the object of a full-scale investigation by the F.B.I.. These thorough investigations normally include past and present associations, activities, employment and the like. Friends, acquaintances, colleagues, employers, and former employers are telephoned and interviewed by F.B.I. agents. Such investigations are extremely damaging in themselves. Commenting on Mr. Schorr's F.B.I. investigation, Senator Ervin, a vehement and long-time opponent of political surveillance, said

when this sort of governmental prying into the private lives of individuals is used as a deterrent to the exercise of such constitutionally protected freedoms, as freedom of the press, it involves a double evil: Not only is individual privacy invaded; that very invasion of privacy is used to punish or prevent the exercise of other rights. 39

Another area of harm to the subject occurs by the fact that the information in the dossiers is often gathered from secondary sources such as government records, associates and acquaintances, neighbors, business contacts and relatives. Much of this information is often inaccurate and misleading and the absence of access to the file, even if the subject knew of its existence, makes the challenge impossible. Also, since the information is notoriously subjective, there is no separation of accurate from biased information. 41

In any discussion of political surveillance, it is critical to inquire into

36. Donner, supra note 1, Section VIII.
37. Id. at Section X.
38. Id. at Section XII.
40. Davis, supra note 1 at 115.
41. Donner, supra note 1 at section IV.
the standards and statutory authority set for the collecting agency itself. There are, in fact, no effective standards that data gathering agencies must follow in selecting subjects, for the techniques used, or for the data they develop. Each agency or unit claims its own authority to deal with "subversive activity," a term that means whatever the agency, in its own unfettered discretion, wants it to mean. For instance, the head of Chicago’s unit admitted that his squad maintained surveillance over "any organization that could create problems for the city or the country." The F.B.I. uses an obscure 1939 Congressional directive to "identify individuals working against the United States, determine their objectives, and nullify their effectiveness" to justify their virtual autonomy in intelligence activity. The usual standard for subject selection is claimed to be the actuality or likelihood of acts either criminal in nature or detrimental to national security, which means little more than the agency’s own arbitrary policy of self-restraint.

As one can imagine, the surveillance units’ national security justification, a bastard form of the "probable cause" standard as used in criminal law, offers little safeguard to an individual that is politically active. We will all agree that, under this national security standard, an individual or organization, which has had a prolonged history of violent action, like firebombing, or with a systematic philosophy predicated upon violent means of maximizing social change, would without a doubt, deserve close governmental surveillance. But what about the other pole, a group of political dissidents, whose members have no history of violence or other criminal conduct, and has a philosophy that rejects violence as a tool for social change? Does the state, in this latter case, have a sufficiently compelling state interest to carry on political surveillance and to create and augment dossiers on its members? Could the individuals of this pacifist group challenge the government's monitoring as violating its First Amendment rights? Could a dissident college professor, as a leader of the group, a speaker at a few Vietnam teach-ins, and a participant in a few peaceful protests for prison reform, successfully litigate a Constitutional attack to enjoin further governmental surveillance and have his existing dossier destroyed? Such is only a hypothetical case but it may be interesting to ponder upon a review of the present scope of First Amendment protection.

42. Id. at section IX.
43. Id.
44. Id.
45. Davis, supra note 1 at 113.
46. Id.
47. For the sake of this discussion, it is assumed that our hypothetical dissident organization and its leaders are the subject of one of the federal, state or urban intelligence units and do have knowledge of the surveillance and the existence of a dossier. Because law enforcement uses the intelligence "presence" as a deterrent and because of the existence of dissident pipelines to police sources, this is not unreasonable to assume. See Donner, supra note 1 section XI.
IV. GOVERNMENT SURVEILLANCE AND THE FIRST AMENDMENT

In a subject-plaintiff's constitutional challenge to a political intelligence system, two issues must be faced: first, does the plaintiff possess the requisite standing to litigate a claim; and, if so, does the intelligence system impermissibly restrict his First Amendment rights?

Standing

Under the traditional standing doctrine a court will generally not pass upon constitutional questions unless the party raising the claim is actually injured by the statute or government action complained of. If the claimant does not show such injury he has no standing to raise the issue. The pivotal question in our discussion is whether or not our hypothetical dissident could allege a particular and tangible harm or threat of harm resulting from the surveillance. If no tangible harm could be shown, a court need not pass on the merits of the case. The allegation of a tangible harm shows the "personal stake in the outcome of the controversy to insure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for the illumination of difficult constitutional questions."

It is contended that standing should exist for our hypothetical dissident and his organization. The harmful effect is the deterrence of free expression to the claimant and others by the maintainence of the recording system. The deterrence evolves from the fear that future dissemination of information may effect his present or future employment through public disclosure of political or social affiliations or beliefs that may be "unorthodox, unpopular, or even hateful to the general public". In *Talley v. California* the Court invalidated a requirement that the names of the writer and distributor be printed on political handbills, holding that "identification and fear of reprisal might deter perfectly peaceful discussion of public matters of importance." Compelling a dissident to, in effect, register himself in a police dossier, is no less a burden than compelling the handbill distributor.

Aside from the actual or presumed harm to the claimant, a greater injury occurs to society as a whole from the system's "immeasurable effect upon those who intend to adhere to the most orthodox and uncontroversial views and associations in order to avoid a similar fate."

54. 362 U.S. 60 (1960).
55. *Id. at 64-65*.
56. Askin, *supra* note 4 at 201.
This theory, loosening the requirement of standing and thereby decreasing the burden of proving a tangible harm by the claimant, has come to be called the "chilling effect" doctrine. This doctrine, extending the reach of First Amendment protections, was developed in Dombrowski v. Pfister, \(^{58}\) where the rights of free expression and association were recognized to be "of transcendent value to all society and not merely to those exercising their rights". \(^{59}\) The injury to be remedied is not only personal to the complainant, but also societal; it must be gauged by the impact on those who will not complain to the courts because of the very nature of the industry. \(^{60}\)

The "chilling effect" doctrine was applied in Lamont v. Postmaster General. \(^{61}\) Here, a federal statute authorized the Postmaster General to detain unsealed "communist political propaganda". \(^{62}\) The Post Office would mail a notice to the addressee, who then had to request delivery of the material on a reply card. The addressees who acknowledged their willingness to receive the mail were placed on a list of persons who had requested "communist political propaganda." Although the Post Office had stopped maintaining the list by the time Lamont reached the Supreme Court, the request card was found to be an unconstitutional abridgement of the addressee's First Amendment rights. The court held the reply card requirement "is almost certain to have a deterrent effect, especially as respects those who have sensitive positions." \(^{63}\) The injury alleged and upheld was presumed to exist. No personal injury to their First Amendment rights could have been shown; only probable injurious effects on society as a whole. \(^{64}\)

One commentator has neatly summed up this emerging doctrine of "chilling effect" as follows:

Two important procedural effects flow from the expansion of the doctrine. The requirements of both standing and justiciability are loosened, thereby decreasing the burden of proof of the plaintiff. For example, plaintiff need no longer establish that he is directly 'hit' by the action complained of, or that an injury has actually been sustained. The courts lowered the procedural barriers so that they could proceed to the merits and determine the impact of the governmental action which elicited the complaint. Substantively, the doctrine protects pure speech, association and action which falls between speech and speech-plus, and gives the court permission to look to the detriment, or the

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58. 380 U.S. 479 (1965).
59. Id. at 486.
60. Askin, supra note 4 at 202.
61. 381 U.S. 301 (1965).
63. 381 U.S. at 307.
64. Askin, supra note 4 at 204.
Thus, this doctrine would provide access to the courts for our hypothetical dissident and his organization. They should have standing to adjudicate the constitutional infringement on those rights permitting dissent, because unless they could be linked to violent activity or illegal public disruption, the surveillance would be undertaken in a speculative and arbitrary fashion. However, to date, this doctrine has had only limited success in the proscription of political intelligence gathering.66

Applied to political surveillance and the compilation of dossiers on dissidents, this doctrine has not met with wide acceptance. In *Vietnam Veterans Against the War v. Nassau County Police Department*,67 police attended a march and meeting and gathered information, including photographs, to be filed in dossiers on the group and its leaders. A request for a preliminary injunction was denied for a want of showing irreparable harm to petitioners First Amendment rights. The court placed the burden of proof on the veterans to show that they were chilled, not on the police to show that the data was necessary to a legitimate governmental purpose.68 This seems to ignore the burden recently placed on the state, requiring it to demonstrate a "compelling interest" to justify its action when fundamental freedoms are curtailed.69 Thus, the court would not use the "chilling effect" theory to decrease the burden of proof or assume a tangible harm.

In *Anderson v. Sills*,70 where, as previously mentioned, the Attorney General of New Jersey ordered local law enforcement to gather data on any group at any protest, a lower court's finding that the dissidents were significantly chilled by the mere knowledge that files were being kept on them was reversed. Holding that "the constitutional issue was presented in a hypothetical way within a aura of surmise and speculation,"71 the Supreme Court of New Jersey failed to find a significant "chill" because the directive "imposes no liability or obligation or restriction whatever upon the citizen."72 It concentrated on the "absence of proof of bad faith or arbitrariness"73 of the local police instead of its probable detriment to free speech. The plaintiff alleged that knowledge that the record would include information about the individuals and their affiliations,

65. Davis, *supra* note 1 at 121.
67. 10 Crim. L. Rptr. 2152 (E. D. N. Y. 1971).
68. Davis, *supra* note 1 at 122.
72. Id. at 220, 265 A. 2d at 684.
73. Id. at 229, 265 A. 2d at 688.
associates, employment and family would deter future political activity.\textsuperscript{74} Knowledge that the existence of the dossier might mean future public harassment, a stamp of disloyalty, discouragement of membership in its organization, and difficulty in finding employment was not sufficient enough chill for the New Jersey Court.

In \textit{Laird v. Tatum}\textsuperscript{75} the data gathering system of the Army, involving "surveillance of lawful civilian activity" was under attack. Alleging the same harms as the plaintiffs in \textit{Sills}, the petitioners filed a class action seeking declaratory and injunctive relief from the Army intelligence system. The district court's dismissal because it found no justiciable claim for relief was reversed by the Court of Appeals.\textsuperscript{76} The Court of Appeals held that the present existence of the system of data gathering and distribution constituted an impermissible burden on petitioners' First Amendment rights and did present a justiciable controversy. However, the Supreme Court, in Chief Justice Burger's majority opinion, held that the petitioners' "speculative apprehensiveness that the Army may at some future date misuse the information . . . are not an adequate substitute for a claim of specific present objective harm or a threat of specific future harm."\textsuperscript{77} A four-man dissent agreed with the Court of Appeals that the surveillance system was a "present inhibition of lawful behavior and of First Amendment rights"\textsuperscript{78} and the chilling effect of the system should at least give the petitioners the opportunity to prove the merits of their claim.

In \textit{Fifth Avenue Peace Parade Committee v. Gray}\textsuperscript{79} the Court followed \textit{Tatum} in rejecting plaintiffs' claim that the F.B.I.'s overbroad and unauthorized intelligence activities at a Moratorium demonstration in Washington had a "chilling effect" upon the exercise of their First Amendment rights. Holding that plaintiffs were unable to point to any direct injury or immediate threat of harm, standing was denied. However, Judge Oakes, in his dissent said:

Moreover, in the light of recent reports of Watergate-allied events, and the Senate Report . . . by Senator Ervin's Subcommittee . . . indicating that the \textit{Tatum} majority seriously underestimated the size and scope of Army intelligence activities which included gathering public and private information on hundreds of thousands of "politically suspect" persons, one wonders also whether the \textit{Tatum} case might not be qualified today. Thus, I would decide the question of justiciability in the plaintiff's favor and also give them standing.\textsuperscript{80}

It is contended that standing should be found in these cases, if not

\textsuperscript{75} 408 U.S. 1 (1972).
\textsuperscript{76} 444 F. 2d 947 (1971).
\textsuperscript{77} 408 U.S. at 13-14.
\textsuperscript{78} 408 U.S. at 38-39 (Brennan, J. dissenting).
\textsuperscript{79} 480 F. 2d 326 (2d Cir. 1973).
\textsuperscript{80} Id. at 336-337 (Oakes, J. dissenting).
from the specific present and future harms alleged, that of possible police harassment, social ostracism and economic loss from the dissemination of the data, then at least because of the fact that failure to find standing might prevent the system from ever being constitutionally tested. "Where asserted violations of the First Amendment are in issue, a particular plaintiff . . . may be found to have standing because to deny it might effectively foreclose judicial inquiry into serious breaches of the prohibitions of the First Amendment."81

**Modern Constitutional Tests**

By using the "chilling effect" doctrine, it has been alleged that the government surveillance and dossier system has adversely affected our hypothetical dissident's First Amendment freedoms. But not all government action that impedes the free exercise of First Amendment rights is unconstitutional.82 The doctrine is, in its procedural sense, only a tool to allow the court to move on to the merits of the claim; the mere existence of a chill has not automatically invalidated government action.83 It is necessary, therefore, to look at the substantive standards by which we can distinguish the unconstitutional from the constitutional impediments.

One such standard, known as the balancing test, weighs the probable effects of the statute or governmental activity upon the free exercise of the right of speech and assembly against the conduct likely to cause harm.84 In explaining the doctrine, Chief Justice Vinson wrote:

> When particular conduct is regulated in the interest of public order, and the regulation results in an indirect, conditional, partial abridgement of speech, the duty of the court is to determine which of these two conflicting interests demands a greater protection under the particular circumstances presented.85

Thus, under the Vinson Court, so long as the existence of some nonspeech end is considered sufficient to give governmental action a claim of legitimacy that is then to be balanced against the impact on the First Amendment rights, the latter received little protection.86

But this balancing doctrine did not receive universal acceptance.87 Justice Black consistently argued against its use, claiming that a legitimate government interest was irrelevant when its effect was a direct abridgement of the protected rights of the First Amendment.88 But it

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85. Id.
86. Askin, *supra* note 4 at 206.
was not until near the end of the Warren Court that a willingness to move toward Black's position emerged. In United States v. Robel\textsuperscript{89} a federal statute that required defense plant employees to quit their jobs once they had received knowledge that any organization of which they were a member had been designated as a "communist action" organization by the Subversive Activities Control Board, was under scrutiny. In rendering the statute an unconstitutional restriction on First Amendment rights, the court did not deny the legitimate governmental purpose of protecting defense facilities against sabotage. However, it refused to balance this governmental interest when protected First Amendment rights were at stake. Chief Justice Warren explained the new position, asserting that:

In making this determination we have found it necessary to measure the validity of the means adopted by Congress against both the goal it has sought to achieve and the specific prohibitions of the First Amendment, but we have in no way "balanced" those respective interests. We have ruled only that the Constitution requires that the conflict between congressional power and individual rights be accommodated by legislation drawn more narrowly to avoid the conflict.\textsuperscript{90}

For the first time, the court approached the Black view that the government could not act on the protected areas of expression and association merely because it was reasonably-related to the unprotected.\textsuperscript{91} If the government fears saboteurs in defense plants, its legislative response must be directed at saboteurs, not at holders of constitutionally protected political beliefs which might make them likely to engage in sabotage.\textsuperscript{92}

It is convincing that the Robel test should require that where the government surveillance activity conflicts with protected areas of speech and assembly, it too, must be drawn more narrowly to avoid the conflict. It follows that even though the state has the power to act upon some nonspeech aspects, such as violence or large-scale public disruption, other speech-plus activity is entitled to absolute protection where the state acts on it in a way not narrowly related to its specific state interest.\textsuperscript{93} Thus, where the government seeks to protect against such criminal conduct, it must limit its surveillance to individuals and organizations with a past history of such conduct. It cannot spread its web so wide as to inhibit the First Amendment rights of the peaceful, nonviolent dissident in the name of public order and national security.

Another standard, developed in the years between the heyday of the balancing test and the introduction of the Robel test, has become known

\textsuperscript{89} 389 U.S. 258 (1967).
\textsuperscript{90} Id. at 268 n. 20.
\textsuperscript{91} Askin, supra note 4 at 209.
\textsuperscript{92} Id.
\textsuperscript{93} Id. at 211-212.
as the nexus test. In this test, the nature of the organization's activity has been found to be relevant in determining whether the state has sufficient interest to justify the deterrent effect certain action may have on the exercise of the constitutionally protected rights of association. The court, in *Gibson v. Florida Legislative Investigation Committee* found the test to be as follows:

It is an essential prerequisite to the validity of an investigation which intrudes into the area of constitutionally protected rights of speech, press, association and petition that the state convincingly show a substantial relation between the information sought and a subject of overriding and compelling state interest.

The court searched for the substantial relation or link between the organization, the object of state investigation and the criminal activities the state was seeking to expose. "Absent such a relationship . . . the Committee has not demonstrated so cogent an interest in obtaining and making public the membership information sought to justify the substantial abridgement of associational freedom which such disclosures will effect."

How strong must this nexus between the individual or organization and the state interest be in finding a nexus for data-gathering on the political dissident? It is contended, as in the discussion of balancing, that there be found an individual or organizational history of violent action and social disruption before the state can show a strong enough link to its interest in public order. Absent this link, surveillance must fall as an unconstitutional inhibition of speech and association. This systematic violent action standard formulates a rigid standard for government authorities. Minor illegal action, such as criminal trespass arrests in peaceful demonstrations, should not be sufficient to form the nexus required. As one commentator stated:

To permit the State to create and maintain files, where the basis for those files are minor offenses, and where the threatened future harm is likewise minor, while the deterrence to political expression and association is demonstrably clear, does not carry the burden of showing a sufficiently compelling state interest. The determination in each case should depend upon the extensiveness and seriousness of past criminal behavior, the capacity to base future predictions of harmful conduct on the past, and the extent to which state action can be said to deter expression and association.

Another standard, the right to privacy, has been defined as the "claim of individuals, groups or institutions to determine for themselves when,

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96. *Id.* at 546.
97. *Id.*
how and what extent information about themselves is communicated to others." This standard has been weak in practice because of its broad embrace and lack of a constitutional profile. It has been inferred from the First Amendment, from the First and Fourth combined, and from the Bill of Rights read as a whole. But it has been successful in reinforcing other standards. For instance, the notion of inviolability of privacy in group association has been found an element to consider in many First Amendment challenges. In *Sweezy v. New Hampshire*, Justice Frankfurter noted that “the inviolability of privacy belonging to a citizen’s political loyalties” had an “overwhelming ... importance to the well-being of our kind of society.” In *Talley v. California*, the privacy of the political handbill writer and distributor was protected. Again, in *Gibson v. Florida Legislative Investigation Committee*, the court found that the First Amendment “encompasses protection of privacy of association in organizations.” It will be alleged that once an individual or organization engaged in public political action, its behavior and beliefs become public information. But the key remains that the individual controls the personal information, and, although they seek to make their views known to the public, they also seek to prevent the outflow of information concerning or describing themselves.

Lastly, the substantive barriers of the “chilling effect” doctrine, much the same as the doctrine’s procedural effects described in our discussion of the standing question, seem to reinforce the constitutional claims of nonviolent dissidents. The substantive theory of the doctrine was accurately applied in the aforementioned case of *Lamont v. Postmaster General*. “Inhibition as well as prohibition against the exercise of precious First Amendment rights is a power denied to government.” At the core of this analysis is the finding that the First Amendment rights are of insurmountable value to both the claimant and society as a whole and any burden placed on these rights that might reasonably be expected to interfere with their exercise will be struck down as an impermissible infringement.

The fact that this discussion is dealing with an overbroad government
intelligence system instead of statutes that threaten criminal prosecution should not be distinguishable. In DeGregory v. Attorney General, the court said "The First Amendment may be invoked against infringement of the protected freedoms by law or by lawmaking... Investigation is a part of lawmaking and the First Amendment... stands as a barrier to state intrusion of privacy." One commentator has suggested that:

If government can use backdoor means to restrict the people from exercising this freedom, the prohibition against frontal abridgements would be nullified. A repressive government has no need to jail its critics if it can frighten them into silence.

V. CONCLUSION

A nonviolent political activist or his organization should be allowed to attack an intelligence system which maintains files on them. The use of the emerging doctrine of the "chilling effect" should give them standing to present their claim to the courts; and with the combined use of the Robel standard of overbreadth, the nexus text, the right of privacy and the substantive barriers against governmental encroachment of Lamont, a meritorious challenge would seem to exist. Though prior piecemeal attacks on various surveillance systems have met with little success, it is the obligation of the courts to adopt and implement such First Amendment applications for the protection of the innocent. And even though, if judicially adopted, they would amount to only an ex post facto remedy, such is better for the dissident than no remedy at all.

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114. Id. at 829.
115. Askin, supra note 4 at 218.
BOOK REVIEWS


Watergate has become, to citizens who read the news, listen to it, or try to ignore it, the key word that summarizes personal feelings about politics in general, and Richard Nixon in particular. It needs no further definition to stand either for corruption, fraud, and high crimes and misdemeanors, or conversely, a valiant effort against forces attempting to destroy our national security. A book about Watergate — another book, one might say, even at this relatively early date — will be valuable to the extent that it explains or chronicles the events, persuades readers to one or the other viewpoint, or theorizes on the historical, social, and political atmosphere that made Watergate possible, and questions the effect it will have on our national future. To the many people whose attitudes on Watergate are already formed, Frank Mankiewicz's Perfectly Clear; Nixon from Whittier to Watergate will not succeed as a new explanation, will not change minds, and will offer little in the way of serious political and social theory. It will be either a pat on the back or a thorn in the side; it will entertain or it will enrage.

Frank Mankiewicz is a member of the California Bar whose involvement in politics goes back to an attempt, in 1950, to gain a seat as a Democrat in the California legislature. He served on the Los Angeles Democratic Central Committee, and was Robert Kennedy's press assistant. In the last presidential election he codirected George McGovern's primary campaigns. As a lawyer and a journalist Mankiewicz has learned to use words well; he writes in a strong, incisive style calculated to leave the reader, through the force of blunt language and repetition, no recourse but acquiescence. Mankiewicz's thesis is presented at the beginning of the book, with journalistic flair and editorial flourishes: Watergate is the culmination of "the unbroken series of frauds and deceptions that have marked a quarter-century and more of what will now be called "Nixon politics." The game of words is on, this time Mankiewicz's words against Nixon's.

The book is loosely constructed, first comparing the extent of "dirty tricks" played by Nixon's men to the mild jokes and intelligence-gathering from newspapers done by McGovern's; then analyzing Nixon's earlier campaigns for patterns of fraud and corruption; commenting on the spread of militarization and "CIA-ization" that allowed Nixon's techniques to flourish; and finally discussing the Watergate burglary and associated accusations that have been made against the President and
his staff. This is Mankiewicz's brief against Nixon, and he attempts to outline each point objectively and offer evidence to support it. He sometimes uses the question-and-answer tactic of the Ervin committee (What did the President know? When did he know it?). Elsewhere he uses typographical features to set off points of evidence. Mankiewicz does not use these techniques consistently, and at times slips into rhetoric and harrangue, exposing a lack of objectivity: "After Nixon's election in November [1950], Downey resigned in order to give his successor an edge in seniority and to get an early start on his new vocation as a lobbyist for the oil industry." Mankiewicz's argument is not enhanced by slurs such as these.

Perfectly Clear was finished in September of 1973. There are no new revelations or exposes, though Mankiewicz's theories — such as the connection between Nixon's raising the milk price in 1971 and the milk cooperatives' large campaign pledge — are constantly being borne out by further investigations. Mankiewicz does not use all the information at his disposal, such as Nixon's pardon of James Hoffa in time to help in the reelection effort, American Airlines' illegal campaign contribution, and Donald Segretti's operations; he concentrates on what he feels is most damaging, and what best illustrates the continuity of Nixon politics.

Mankiewicz's unabashedly anti-Nixon stand, though entirely different in tone, echoes an earlier, more measured political analysis, The Ordeal of Power, by Eisenhower advisor Emmet John Hughes. Writing in 1963, Hughes characterized Nixon in Cabinet meetings as "crisp and practical and logical: never proposing major objectives, but quick and shrewd in suggesting and refining methods — rather like an effective trial lawyer... with an oddly slack interest in the law." Hughes felt that Nixon's flaws stemmed from "a single essential source: a want of resolution — a chronic personal incapacity for commitment — on the gravest political issues of the day." Mankiewicz emphasizes Nixon's desire to win as important beyond all else, and recalls his ideological about-faces on the Soviet Union, China, and various economic policies. Mankiewicz follows the lead of James Reston in comparing the blind loyalty demanded by Nixon of his associates with the Fuehrerprinzip of Nazi Germany. Though he points out that Nixon politics is not synonymous with Nazism, he draws what parallels he can between the totalitarianism, isolation of the leader, and lack of ideological commitment in the two governments. The conclusions Mankiewicz reaches from these observations have been voiced by many since the release of the Nixon tapes: Nixon's personal knowledge of the Watergate burglary or its coverup becomes irrelevant in the face of such overriding amorality.

Congressional Quarterly editors, in their Chronology of a Crisis, state that "Watergate resembles nothing so much as a medieval morality play, acted out in 20th century terms..." The embodiments of evil and
corruption are shown us, if not absolute good and truth. Having examined the language Nixon used in speeches even before his smear campaign against Helen Gahagan Douglas in 1950, Mankiewicz writes Nixon a long speech as one possible ending for this morality play. It is, in its distillation of Nixon's oratorical style, amusing—there are the "perfectly clears," the "what's right with America," the hesitations and poorly-drawn, irrational conclusions. It is farce, with some good throwaway lines at Ron Ziegler's expense. The speech is what Nixon would have said if he had told America the truth before the election of 1972, still offering us his administration as the paragon of decency and rightness. As amusing as it might be, this parody is embarrassing set in the middle of an otherwise earnest text, and it tends to diminish Mankiewicz's strength as a political observer. It moves the book, unsettlingly, from polemic to entertainment.

Do we need more Watergate entertainment in books like this one, or do we need more thought about important questions Mankiewicz does not consider? One question is short-range, and applies directly to the theory of Watergate as the culmination of Nixon politics: why did Nixon, the generally popular incumbent facing a divided opposition, feel it necessary to mount—or give his associates the impression it was necessary to mount—the campaign of fraud whose dimensions grow almost daily with new revelations? A longer-range question which will undoubtedly take greater time to answer, can also be formulated now: will Watergate show our present system of government to be inadequate, and will it lead to fundamental changes and reforms; Mankiewicz's sense of rage and frustration, expressed in either reasoned accusation, cataloging of "White House horrors," or parody, may help us define our own feelings about Nixon and Watergate, but we must go beyond this—beyond concern with words, even words like ethics and morality—to find strength in the answer to this important question.

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Fundamentally, Palmer's *Constitutional Rights of Prisoners* is a lexicon for litigation, intended to provide prison administrators with "a basic introduction" to the risks of litigation, as well as to provide them with "a useful guide and reference manual." It is a journeyman's analysis of the current state of the law with cautious definitions of administrative duties and discretion as well as prisoners' rights. No sophisticated administrator who is part of the "correctional" process today, it seems prudent to observe, can afford to be without this information. Professor Palmer's book, even upon first reading, fulfills this purpose sensibly and intelligibly.

Chapter by chapter, the author examines, albeit briefly, the status of force and punishment, isolated confinement, disciplinary procedures, parole, matters of visitation and mail, legal services, rights to treatment (rehabilitation), medical aid, and to life (non-capital punishment), and civil and criminal grounds for the liability of administrative officials. In support of his examination, the author reports the text of leading cases, often unabridged, as well as A Model Act to Provide for Minimum Standards for the Protection of Rights of Prisoners prepared by the National Council on Crime and Delinquency, and the United Nations' Standard Minimum Rules for the Treatment of Prisoners and Related Recommendations.

Paradoxically although the bulk of the book consists of reports of well-selected cases, the author professes to see their practical limitations: "Meaningful reform in a correctional system is brought about as a result of legislation and administrative rule-making, i.e. the political process. Judicial decisions themselves may lead to administrative changes, but they do not themselves result in broad-based reform." Query whether this is so. See *Jones v. Wittenberg*, 323 F. Supp. 93, *affd sub. nom. Jones v. Metzger*, 456 F.2d 854, 330 F. Supp. 907; *Holt v. Sarver*, 309 F. Supp. 362, *affd* 442 F.2d 304, where reform was "broad-based," indeed.

The author is, of course, seeking to emphasize the need for administrative reform. For, on several occasions, he observed: (1) "The substandard conditions that exist in many American detention facilities and the courts' growing awareness that needed changes are not being initiated by the prison administrators would seem to indicate that more decisions such as the one in *Jones v. Wittenberg* are imminent." (2) "With the current concern for penal reform, judicial intervention in prison administration will probably continue to grow. Federal and state correctional officials should therefore initiate administrative reforms before the courts are called upon to do it for them."
Fortunately, the author's analysis of current cases has dutifully distinguished between the Scylla of penal sanctions and the Charybdis of charitable reforms. His synthesis of the cases, however, has demonstrated that he has not directed his full attention to Constitutional questions concerning the right to and the responsibility for rehabilitation. Clearly this right, more than any other, and its correlative duty, if made Constitutionally explicit, will prove to be the heart of meaningful reform in our post-conviction institutions.

Professor Palmer is well aware that we are far from a universal recognition of any due process right or duty with respect to rehabilitation. *Ab assuetis non fit injuria* — from what has grown customary no legal wrong can arise. But, query whether a Constitutional right is nevertheless evolving despite presumptions as to the propriety of official conduct, the alleged needs of institutional discipline and prosecutorial syndromes. Over a hundred years ago, in 1870, the American Prison Association perceived that, "A system of prison discipline, to be truly reformatory, must gain the will of the prisoner . . . The prisoner's self-respect should be cultivated to the utmost, and every effort made to give back to him his manhood. There is no greater mistake in the whole compass of penal discipline than its studied imposition of degradation as a part of punishment." Today, however, as Mr. Justice Blackmun recognized in *Jackson v. Indiana*, 406 U.S. 715 (1972), "At least due process requires that the nature and duration of commitment bear some reasonable relation to the purposes for which the individual is committed."

"Perhaps," as suggested by the National Advisory Commission on Criminal Justice Standards and Goals, "the lack of an affirmative, legally enforceable responsibility to provide (rehabilitative) services accounts for the extreme inadequacy of rehabilitative resources that has plagued American corrections for decades." Even if true, as Professor Palmer's reports disclose, a "reasonable relation" between "commitment" and "correction" is now being discovered, and tested, case by case, which is the way of our law. Accordingly, accurate reports along the way are needed to apprise us of "direction" and "distance." Practicing lawyers should, therefore, welcome reports of current developments that are timely and temperate, and so should the law students of the new generation. Such reports are, of course, indispensable to the responsible members of related professions.

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President Lyndon B. Johnson announced June 26, 1974 that Mr. Chief Justice Earl Warren intended to resign his seat on the Supreme Court and that Associate Justice Abe Fortas was to be the nominee to succeed him. Events then ensued which would focus the attention of the American public on the Supreme Court more closely than at any time since the "Court-packing" battle between Franklin D. Roosevelt and the United States Senate in 1937. The political drama did not end until December 10, 1971 when the Senate confirmed William H. Rehnquist's nomination for Associate Justice of the Supreme Court. In the meantime three nominees had been rejected by the Senate.

Startling as these rejections seemed, Henry J. Abraham points out that in an historical context they were not unique. Since 1789, twenty-six of the one hundred thirty-six nominees formally sent to the Senate for approval have failed to gain it. During the nineteenth century one out of three candidates was rejected.

Abraham explores the intricacies of Presidential decision-making and has prepared a scholarly, readable account which attempts to explain how and why each President made his nominations for the Supreme Court. He also examines any confirmation problems the nominees encountered, and addresses himself to the nominees' work on the Court both in terms of Presidential expectations and of his own evaluation of each Justice's performance.

The account is arranged chronologically. For each President there is an introductory paragraph summarizing the issues faced in his administration and rating his performance. Following the summary is an analysis of that President's nominations for the Supreme Court. The analyses of the Presidential administrations are so sketchy that they are superficial; therefore, they should have been omitted except where they are necessary to help explain why a President wanted a particular type of individual on the Supreme Court.

Abraham's research was extensive. He has constructed one hundred thirty-six stories that are accurate, considering the difficulties in reconstructing motives of historical, political figures. He makes some generalizations from his data: The most important factors influencing Presidential nominations have been (1) objective merit; (2) personal friendship; (3) geographic and ethnic balance; (4) political and ideological compatibility. The reasons that twenty-six nominees were rejected by the Senate usually involved more than one of the following: (1) opposition to the nominating President, not necessarily to the nominee; (2) the
nominee's involvement with a visible or contentious issue of public policy (3) opposition to the record of the incumbent Court which, rightly or wrongly, the nominee has presumably supported; (4) lack of approval by one of the Senators from the nominee's home state; (5) a perceived political unreliability of the nominee; and (6) the evident lack of qualifications or limited ability of the nominee.

Of particular interest is Abraham's analysis of the increasingly important role that the A.B.A. plays in determining who is qualified to serve on the Supreme Court. While he believes that the A.B.A. can provide useful information for the President and the Senate to consider, he maintains that it would be unfortunate should a negative rating by the A.B.A. ever become tantamount to a veto. Noting that the A.B.A. represents a relatively narrow segment of the legal establishment, that it employs rigid standards in its rating system (anyone without trial experience is automatically unqualified), and that some of the Justices rated among the greatest have been mavericks who probably would not have received a high rating from the bar of their day, he concludes that a private interest group should not be permitted to exercise such total power.

The most disturbing aspect of the book is that Abraham makes so many assertions without supporting evidence. In rating the Justices, he relies heavily on a survey of sixty-five law school Deans, Professors of law, history, and political science, who were asked to categorize all the Justices who had ever served into one of five headings ranging from "great" to "failure." His book is full of such sentences as "Justice so and so was rated average but deserves to be one category higher", but often Abraham fails to reveal the reasoning process he used to reach such a conclusion. Abraham labels Salmon P. Chase, one of President Abraham Lincoln's appointments, "ruthless, stubborn, self-seeking, perhaps even malicious" but fails to supply evidence necessary to support such a characterization. While extensive documentation was beyond the scope of this short book, most of the vagaries could have been eliminated had Abraham added a sentence or at most a paragraph per Justice.

Despite this type of oversight, the book is quite valuable. It serves as a good review of Constitutional history, but more important is its utility as a reference tool. Now, not only short biographical material, but also every nuance about the appointment and confirmation of all Supreme Court Justices is available in a well-organized, one volume book.

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