Volume 67 | Issue 3 Article 14

April 1965

Abstracts of Recent Cases

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ABSTRACTS

Constitutional Law—Discrimination in Interstate Commerce

The defendant was a resident of West Virginia. She went to Maryland and purchased an automobile. The full purchase price was 5,535 dollars, but the defendant traded to the seller an automobile for which she was given an allowance of 3,835 dollars, leaving a balance of 1,700 dollars. She paid a tax to the department of motor vehicles in the sum of 166 dollars, representing three per cent on the full purchase price, for the privilege of effecting a certification of title in West Virginia, pursuant to the West Virginia statutory requirements. The statute provided for a reduction in taxes on motor vehicles purchased within the state by reducing the basis for taxation by the amount of the motor vehicle for which it was traded. W. VA. CODE ch. 17A, art. 3, § 4 (Michie 1961). *Held,* this part of the statute was discriminatory and violative of the commerce clause of the Constitution. U.S. CONST. art I, § 8. *Nuckols v. Athey,* 138 S.E.2d 344 (W. Va. 1964).

The commerce clause has been construed to prohibit a state from discriminating against persons engaged in interstate commerce. *Spector Motor Service v. O'Connor,* 340 U.S. 602 (1951). This is true even though the discrimination occurs after the property which has originated in another state has become commingled with other property within the state. *Park McLain Co. v. Hoey,* 19 F. Supp. 990 (E.D. N.C. 1937). In the *Park McLain Co.* case, a North Carolina statute required a 1,000 dollar bond and a ten dollar fee for the sale of used automobiles purchased outside North Carolina and brought into that state. No such requirement was made as to the sale of other used automobiles. The statute was held unconstitutional as a burden on interstate commerce because of its discrimination in not placing like requirements on automobiles purchased within the state.

Discrimination in interstate commerce may also occur when a state attempts to protect itself against economic competition. In *Polar Ice Cream Co. v. Andrews,* 375 U.S. 361 (1964), the Court held that neither the power to tax nor the police power of a state may be used to establish an economic barrier against competition with the products of labor of another state or its residents. The same principle was applied in *Sonneborn Bros. v. Cureton,* 262 U.S. 506 (1922). In this latter case, a tax was placed upon merchandise purchased solely because of its origin outside the taxing state. The Court struck down the tax as an unconstitutional burden on interstate commerce.

Where out-of-state commercial discrimination occurs upon business privileges as opposed to individual sales, the courts are consistent in striking down discriminatory statutes. In *Westcott & Cunning, Inc. v. Commissioner of Public Health,* 195 N.E.2d 74 (Mass. 1964), a statute requiring an out-of-state manufacturer to pay an annual license fee of twenty-five dollars for each place of business he owned that manufactured harmful drugs shipped into Massachusetts. In-state manufacturers were subjected to a single annual license fee only. The court held the statute to be an unconstitutional burden on interstate commerce because of its being unreasonable and discriminatory.

Federal control over commerce prevails when goods and services are in interstate commerce or affect interstate commerce. In this area of national exertion, the federal power is supreme and plenary. In *Huron Portland Cement Co. v. Detroit,* 362 U.S. 440, 442-444 (1960), the Court summarized the policy of the government on interstate commerce by stating, "In determining whether the state has imposed an undue burden on interstate commerce, it must be borne in mind that the Constitution when 'conferring upon Congress the regulation of commerce . . . never intended to cut the States off from legislating on all subjects relating to health, life, and safety of their citizens, though the legislation might indirectly affect the commerce of the country. Legislation, in a great variety of ways, may affect commerce and persons engaged in it without constituting a regulation of it, within the meaning of the Constitution.' . . . But a state may not impose a burden which materially affects interstate commerce in an area where uniformity of regulation is necessary."

Internal Revenue—Deduction of Items Related to Capital Transactions

S, a stockholder, owned stock in *X*, a company which was engaged in producing motion pictures. *X* contracted with *Y* for the latter to distribute and exhibit three pictures which *X* was to produce. *X* was to receive a specified portion of *Y's* profits from distribution and exhibition. *X* dissolved during a dispute with *Y* over the amount of profits *X* was to receive from *Y*. *S* was given his share of assets plus a claim against *Y*. *S* sought to deduct his legal costs as expenses incurred in perfecting his claim against Y. *Held*, S was allowed to deduct his share of the legal expenses in addition to related fees as ordinary and necessary expenses incurred in the collection of income, although the amount received was taxable as long-term capital gain. *Commissioner v. Doering*, 335 F.2d 738 (2d Cir. 1964).

What the court appears to have done in the principal case is to allow retention of the nature of the expenses from the dissolved company to the shareholder, but to give separate consideration to the capital gains. The court considers the issue as being one of two transactions — the exchange of the taxpayer's stock for a claim and the collection of that claim. The authority cited by the majority is *Naylor v. Commissioner*, 203 F.2d 346 (5th Cir. 1953), which held that legal fees incurred in collecting the amount claimed to be due under a contract of sale qualified for deduction were ordinary expenses even though the sale was of a capital asset. This decision was questioned in *Spangler v. Commissioner*, 323 F.2d. 913, 919-20 (9th Cir. 1963), where the court distinguished legal fees incurred in determining the right to ownership of a claim and legal fees incurred in determining the price to be paid for property. In the former case, the court said the legal fees should be capitalized, but in the latter case they should be treated as ordinary expenses.

The controversy stems from the meaning of expenses incurred for the collection of income under § 212(1) of the Internal Revenue Code of 1954. Where an item which ordinarily is deductible as an expense is paid in connection with a transaction involving the purchase or sale of an asset, the courts seem uncertain as to the proper treatment. Thus, *Hirshon v. United States*, 116 F. Supp. 135 (Ct. Cl. 1953), permitted a trader in securities to deduct federal stamp taxes paid on the sale of stock instead of adding them to the cost of the stock on the ground that the taxes were an ordinary and necessary business expense. The Internal Revenue Service does not seem to follow this view. In *Maytag v. Commissioner*, 32 T.C. 270 (1959), stamp taxes were required to be offset against the selling price rather than as a deduction as an ordinary business expense. The court did recognize, however, that the commissions paid had to be capitalized. *Megibow v. Commissioner*, 218 F.2d 657 (3d Cir. 1955), refused to permit a taxpayer who used the standard deduction to capitalize current taxes and mortgage interest on his residence so as to increase its basis when sold as a profit. Another case similar to the *Hirshon* case is *United States v. Pate,* 254 F.2d 480 (10th Cir. 1958), which permitted a taxpayer to deduct as an expense legal fees incurred in a suit to recover damages on the destruction of a building, which damage would under the circumstances be treated as a capital gain. The Commissioner had urged capitalization of the legal fees as a cost in obtaining the damages. In *Munson v. McGinnis,* 283 F.2d 333 (3d Cir. 1960), a sale of stock and assets to a creditor of a company in receivership was found to have resulted from fraud. The matter was reopened. The stockholders were granted an additional sum for their stock, and legal fees for services rendered in reopening the matter were treated as capital expenditures.

The majority opinion in the instant case relies upon *Campagna v. United States,* 290 F.2d 682, 684 (2d Cir. 1961), which held that property distributed in liquidation having no ascertainable value was to be taxable as capital gains since the transaction was considered open for tax purposes. However, in a similar situation, *Isaac G. Johnson & Co. v. United States,* 149 F.2d 851 (2d Cir. 1945), litigation concerned only the determination of the fair market value of compensation required in a condemnation proceeding and the court held the expenses to be capital expenditures and not deductible as business expenses for tax purposes.

Although the Commissioner seems firm in his position that expenses should be capitalized where capital gains treatment is given to income, the courts do not appear to be in agreement. Perhaps the question should be resolved according to whatever method clearly reflects income. Thus, if an attorney represents his client in the acquisition of a capital asset, his fee will be capitalized for tax purposes as part of the cost of the property; however, if the matter is personal and not related to the earning of income, the fee cannot be used either as a current deduction or an adjustment to basis. INT. REV. CODE of 1954, §§ 262, 263(1), 106(a)(1). Capitalization of attorney's fees incurred in property transactions could properly be allocated to the years in which their value extends. But, all other large legal expenses which are not deductible under sections 162 or 212 should be currently deductible through a formula similar to that provided for medical expenses. 74 HARV. L. REV. 1409 (1961).

Wills—Weight of the Evidence in Proving Undue Influence

T, a testator, bequeathed property to *D*. *P*, *T's* heir, brought an action to impeach the will on the ground that the bequest was not made as a reponsible act of the testator. *Held*, the burden of proving undue influence is upon the party who alleges it, and mere suspicion, conjecture, possibility or guess that undue influence has been exercised is not sufficient to support a verdict impeaching the will. *Frye v. Norton*, 135 S.E.2d 603 (W. Va. 1964).

The court in the principal case, at page 611, held that "[W]hile undue influence may be proved by circumstantial evidence, such finding must be consistent with the exercise of undue influence and inconsistent with any theory other than undue influence." This holding does not indicate that West Virginia has changed the weight of evidence required where fraud or undue influence is to be proved. In light of prior case law and the context of the instant case, it appears that West Virginia adheres to the requirement of clear and convincing evidence in sustaining the burden of proof to impeach a will because of undue influence on the testator.

In *Thornton v. Thornton*, 141 Va. 232, 126 S.E. 69 (1925), the court ruled that an attack upon the validity of a will on the ground of undue influence, to be successful, must be sustained by proof that is clear, cogent, and convincing. The West Virginia Supreme Court has held that fraud must be proved clearly and distinctly by either direct or circumstantial evidence. *LaFollette v. Croft*, 122 W. Va. 727, 14 S.E.2d 917 (1940).

Clear and convincing proof is a commonly applied requirement in weighing evidence in cases of undue influence. 9 WIGMORE, EVIDENCE § 2498 (1940). In *Ritz v. Kingdon*, 139 W. Va. 189, 79 S.E.2d 123 (1953), the court held that in a trial by jury on the responsibility of a testator's act, a verdict which is without evidence to support it or is against the clear preponderance of conflicting evidence will be set aside.

In light of the total context in which the phrase "inconsistent with any theory other than undue influence" was made, it does not appear that circumstantial evidence beyond that which is clear and convincing is required in cases to impeach a will. The court clearly states that, although proof may be based upon circumstantial evidence, such proof must amount to more than mere suspicion or possibility that undue influence has been exercised, the court's decision appears to be consistent with prior West Virginia cases.

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