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REFUNDS IN CONNECTION WITH TRANSFEREE LIABILITY: A LEGISLATIVE PROPOSAL

HENRY D. COLLINS*

The taxpayer forced to return in a later year a sum of money which he had received and included in his income for tax purposes in an earlier year, might reasonably believe that he has a choice between the alternatives of claiming the sum as a deduction in the year of repayment or seeking a refund of the tax attributable to the inclusion of that sum in his taxable income of the earlier year. For an individual, inability to characterize the deduction as one falling within the limits of Internal Revenue Code § 23 (e) may deny him the first alternative. Even a corporate taxpayer may find that alternative impractical when it has insufficient current gross income to utilize the deduction fully, and some courts have been markedly unsympathetic in this respect. The statute of limitations may operate to deny recourse to the second alternative. But the greatest obstacle to employment of the second alternative is the annual accounting period concept which regards each year as a separate, distinct unit for income tax purposes.

The Internal Revenue Code and the Treasury Regulations set forth the annual accounting concept as the basis for the collection and administration of the income tax. But, in spite of the fact that the concept has been in every revenue act since the adoption of the Sixteenth Amendment, its full force and effect was not generally realized and appreciated until the early thirties when the

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1 Int. Rev. Code § 23 (e) limits losses deductible by individuals to those losses, uncompensated for by insurance or otherwise, which are (1) incurred in trade or business, (2) incurred in a profit-seeking transaction though not connected with a trade or business, and (3) losses of property not connected with trade or business which arise from fires, storms, shipwreck, or other casualty, or from theft.

2 St. Regis Paper Co. v. Higgins, 157 F.2d 884, 885 (2d Cir. 1946) ("We are reminded that this decision may result in considerable hardship regardless of whether the appellant may lawfully have been entitled to deduct the repayment for tax purposes and able to do so as a practical matter. That is to be regretted but such a consideration must yield before the firmly established rule that income must be reported and taxed in the year in which as a matter of law it was received.")

3 Int. Rev. Code § 322 (b) (1) requires that a refund claim be filed before the expiration of the longer of two periods: three years from the date of the filing of the return, or two years from the date the tax was paid.


5 U.S. Treas. Reg. 111, Sections 29.41-1, 5, 4; 29.42-1; 29.43-1, 2.
Supreme Court decided *Burnet v. Sanford & Brooks Co.*[^6] and *North American Oil Consolidated v. Burnet.*[^7]. The latter case contained the famous dictum[^8] known as the “claim of right” doctrine:

“...If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.”[^9]

The Court in the *North American Oil* case was not concerned with a refund problem but was deciding in which of three different years the recipient of income from property, the title to which was in dispute, should return it for tax purposes—in 1916 when the property earned the income, in 1917 when a court receiver turned over the 1916 net income to the taxpayer, or in 1922 when the title litigation was finally decided in favor of the taxpayer. In adopting 1917 as the proper year, the Court rationalized its choice by declaring that the corporate taxpayer would have had an equalizing deduction if it had lost the suit and were forced to make a refund in 1922.

Contrary to the general rule that dictum lacks the force of an adjudication, the lower courts, with a few exceptions[^10],[^11] applied the claim of right of doctrine freely to sustain the annual accounting period concept and to deny the taxpayer “transactional” treatment of his ventures for tax purposes. Thus, although the doctrine was originated only to determine when taxable income is received, refunds of taxes for prior years were often denied even though the sum had been returned by the taxpayer, because the original receipt of the money had been under a “claim of right.”[^12] And this “claim of right” was interpreted to mean “personal claim of right”, the “personal” nature of the claim being inferred from the fact that the taxpayer-recipient had treated the money as his own through

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[^6]: 282 U.S. 359 (1931).
[^7]: 286 U.S. 417 (1932).
[^8]: As late as 1950 the Court of Claims was still referring to this statement as *obiter.* See *Lewis v. United States*, 91 F. Supp. 1017, 1018 (Ct. Cl. 1950).
[^9]: 286 U.S. at 424.
[^11]: Griffin v. Smith, 101 F.2d 348 (7th Cir. 1938); *Schram v. United States*, 36 F. Supp. 1021 (Ct. Cl. 1941); *St. Regis Paper Co. v. Higgins*, 157 F.2d 884 (2d Cir. 1946); *Fleischer v. Comm’r*, 158 F.2d 42 (8th Cir. 1946); *Anderson v. Bowers*, 170 F.2d 676 (4th Cir. 1948); *Haberkorn v. United States*, 173 F.2d 587 (6th Cir. 1949).
the close of the tax year, the end of the annual accounting period, Employment of this subjective test rendered immaterial the fact that there had been a judicial determination in a later year that the recipient was not entitled to keep the money. In conformity with the second requirement of absence of restrictions upon use, the receipt of monies as a mere agent did not give rise to a “claim of right,” unless there was a strong “probability” that the taxpayer would retain them.

The rationale of the rule has been explained on several grounds: (1) the “bird-in-hand” theory, that the Government must take its share presently because the taxpayer might be insolvent when his right to retain the money is finally determined, (2) the “possession is prima facie ownership” theory, that the Government need only look to possession of the money because, as a practical matter, it ought to be able to collect the revenue without taking sides in private controversies, and (3) the “chore boy” theory, that for obvious administrative convenience the determination of tax liability must be made on an annual basis.

The Supreme Court refused to extend the doctrine to tax trust beneficiaries upon the receipt of trust income which was not, as a matter of local law, currently “distributable” even though the state court decree was not rendered until some years after the actual distribution, so that in fact the beneficiaries had possession and unrestricted use of the money in the interval. This apparent deviation has been explained on the ground that the decision “involved an entirely different section of the Internal Revenue Code.” In *Commissioner v. Wilcox*, the Supreme Court, reluctant to give the Government’s tax lien priority over the claim of an embezzler’s employer, found the embezzled funds were not taxable income to the embezzler because state law left title in the

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12 St. Regis Paper Co. v. Higgins, 157 F.2d 884 (2d Cir. 1946).
13 Comm’r v. Turney, 82 F.2d 661 (5th Cir. 1936); National Railway Time Service Co. v. Comm’r, 88 F.2d 904 (7th Cir. 1936).
14 Boston Consol. Gas. Co. v. Comm’r, 128 F.2d 473 (1st Cir. 1942); Chicago R. I. & P. Ry. v. Comm’r, 47 F.2d 990 (7th Cir. 1931).
15 See *Taxing Unsettled Income: The “Claim of Right” Test*, 58 Yale L.J. 955, which finds that three tests have been applied: (1) “personal claim of right” test, (2) “legal title” test, and (3) the “probability” test.
16 See Alamitos Land Co., 40 B.T.A. 353, 364 (1939) (dissenting opinion), rev’d, 112 F.2d 648 (9th Cir. 1940), cert. denied, 61 Sup. Ct. 46 (1940).
19 327 U.S. 404 (1945).
employer and because the embezzler asserted "no bona fide legal or equitable claim"; consequently, both requirements of what the Court of Claims later thought was a new rule on "claim of right" were not met.

The chief exception which a few lower courts have engrafted on the general rule involves resort to the equitable doctrine of "constructive trust". The cases, all involving refund claims, can be categorized factually into two groups: (1) repayment of money to private parties in a year subsequent to the receipt thereof followed by a claim for refund on the ground that the original receipt did not give rise to taxable income; and (2) repayment of some or all of the money in a subsequent year to the Government in satisfaction of transferee liability for the unpaid taxes of the transferor, followed by a claim for refund on the ground that the original receipt of the transferred assets was not taxable income.

In three cases falling within the first category, the Court of Claims found a constructive trust because the original receipt of the money was under a "mutual mistake of fact" so that the taxpayer-recipient never held the money as owner in the economic sense.

The Court of Appeals for the Sixth Circuit reasoned similarly and, in addition, was greatly influenced by the fact that the taxpayer would be unable to equalize his overall tax picture by claiming a deduction in the year of repayment. The Tenth and the Second Circuit Courts of Appeal deemed that a later finding of a constructive trust had no consequences with respect to taxability in the year of receipt because the "personal claim of right" existed in fact through the close of the prior tax year; the recipient's state

20 "... It is obvious that the taxpayer in this instance ... received the money without any semblance of a bona fide claim of right. And he was at all times under an unqualified duty and obligation to repay the money ..." 327 U.S. at 408.


23 This was an abrupt departure from the traditional North American Oil view applied to the constructive trustee by the Court of Claims in the earlier case of Schramm v. United States, 36 F. Supp. 1021 (Ct. Cl. 1941).

24 Knight Newspapers v. Comm'r, 143 F.2d 1007 (6th Cir. 1944).

25 The taxpayer was a personal holding company and the Court pointed out "a surtax of some 65 or 75% is involved, and this cannot be recovered by a deduction for loss claimed in a subsequent year, since tax savings would then be limited by application only of the normal income tax rate." 143 F.2d 1007, 1010. A similar argument could be made on behalf of the taxpayer every time the subsequent year's tax rates were lower than those in the year of receipt.

26 Saunders v. Comm'r, 101 F.2d 407 (10th Cir. 1939).

27 St. Regis Paper Co. v. Higgins 157 F.2d 884 (2d Cir. 1946).
of mind in the prior year, as evidenced by showing the sum as taxable income on his return, was the important test. A judicial determination of a later period could not reach back to change that state of mind.

In *Lewis v. United States*, the Supreme Court struck down the "mutual mistake" constructive trust line of decisions of the Court of Claims. It reversed the Court of Claims' finding that a taxpayer was entitled to a refund of 1944 taxes upon return of a portion of his 1944 bonus under compulsion of a state court judgment which found that a mutual mistake of fact had occurred in computation of the bonus. The Court of Claims had relied on its two previous decisions involving similar facts, had rejected the Government's *North American Oil* language argument because that language was mere *obiter*, and had interpreted the *Wilcox* case language of "unqualified duty and obligation to repay" to mean that if in law such an obligation existed at the time of receipt, though unrecognized or denied by the taxpayer-recipient, it was not an item of taxable income. In addition, *Freuler v. Helvering* was relied on "to discount very heavily the idea that the finances of the nation would be thrown into disorder" by following the Court of Claims' solution in allowing the Government "to tax as income only that which is, in fact, income to the taxpayer, and not that which only seems to be income because he is mistaken as to his right to keep it".

In the very short *Lewis* opinion, after repeating the familiar *North American Oil* language, Justice Black stated:

"... Nothing in this language permits an exception merely because a taxpayer is 'mistaken' as to the validity of his claim. Nor has the 'claim of right' doctrine been impaired, as the Court of Claims, stated by *Freuler v. Helvering*, 291 U.S. 35, or *Commissioner v. Wilcox*, 327 U.S. 404. The *Freuler* case involved an entirely different section of the Internal Revenue Code, and its holding is inapplicable here. 291 U.S. at 43. And in *Commissioner v. Wilcox*, supra, we held that receipts from embezzlement did not constitute income, distinguishing..."

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31 291 U.S. 35 (1934).
32 This argument seems weak in view of the small percentage of total income tax revenue derived from the taxing of estates and trusts.
North American Oil on the ground that an embezzler asserts no 'bona fide legal or equitable claim'. 327 U.S. at 408.

He went on to describe the "claim of right" interpretation of the tax laws as having "long been used to give finality" to the annual accounting period and as being "deeply rooted in the federal tax system". In conclusion, he made it clear that "an advantage or disadvantage to a taxpayer" which might result from the "claim of right" doctrine was not a sufficient reason for the Court to depart from it and remarked that the suggestion that it would be more "equitable" to reopen the prior year's return "could not be adopted as a general solution because, in many cases, the three-year statute of limitations would preclude recovery."

In the light of this decision, it is well to examine the second category of cases, which adopts the constructive trust theory in transferee liability cases to reopen the prior year's return and recompute tax liability upon the supposition that the fund transferred to the transferee was not taxable income to him. To concretize the transferee problem, assume that a corporate officer is charged with transferee liability for unpaid corporate taxes by application of the provisions of Internal Revenue Code § 311 because the corporation has been rendered insolvent by the payment of what is later determined to be "excessive" compensation or because the corporation was insolvent prior to such payment. Disallowance of the deduction to the corporation would increase its tax liability and cause assertion of a deficiency against it. However, because the corporation was insolvent prior to, or was rendered insolvent by, the transfer of a part of its assets, in the form of compensation, to the officer, he would be liable for the additional corporate tax as a transferee. The Government has two methods of enforcing this liability. The commissioner can send the transferee a regular 90-day letter notice of deficiency just as though he were asserting a deficiency against the transferee with respect to the latter's own taxes, or the Government can resort to its common

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34 Int. Rev. Code § 311 (a) permits the liability, at law or in equity, of a transferee of property of a taxpayer, in respect to the tax imposed upon the taxpayer-transferor, to be assessed, collected and paid in the same manner as if a deficiency were being asserted against the transferee with respect to his own taxes. Thus a transferee has the right to avail himself of the Tax Court procedures and jurisdiction for a determination of the deficiency.
35 However, there is one important difference in the transferee-liability Tax Court procedure in that the Commissioner has the burden of proof. Int. Rev. Code § 1119 (a).
law right as a creditor to enforce an equitable lien against the 
assets of the insolvent debtor-transferor (the corporation) in the 
hands of the transferee (the corporate officer paid excessive com-
ensation). The legal theory underlying both methods is that 
the transferee holds the assets as "constructive trustee" for all credi-
tors of the insolvent debtor-transferor.

Prior to North American Oil, the Board of Tax Appeals 
declared that a stockholder-recipient of liquidating dividends, against 
whom transferee liability was asserted, could rely on the theory of 
constructive trust to treat such dividends as being nontaxable in-
come, because they were impressed with a trust from the instant 
receipt. O. B. Barker permitted the taxpayer-stockholder to 
reduce the amounts received in liquidation in 1917 by the amount 
returned in 1923 in payment of the taxes of the corporation. J. G. 
Tomlinson allowed a stockholder receiving a liquidating dividend 
in 1920 to reduce a deficiency asserted against him upon another 
matter in his 1920 return by the amount he was required to pay in 
1924 because of transferee liability. And the Board had respectable 
support for its view in the pre-"claim-of-right" days.

In 1941 the Board of Tax Appeals held that the North Ameri-
can Oil decision had overruled the O. B. Barker line of cases. 
Nevertheless, the Tax Court has recently revived the "constructive 
trust" doctrine in the transferee liability situation of the corporate 
officer receiving "excessive" compensation from an insolvent cor-

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36 The procedure provided by the Code is cumulative and not exclusive, so that a suit in equity is still a proper action to collect taxes from the transferee of a dissolved corporate taxpayer. Leighton v. United States, 289 U.S. 506 (1932).

37 Transferees of corporate assets, other than bona fide creditors or pur-
chasers, take the assets charged with a trust in favor of creditors, including the United States claim for taxes. United States v. Union County Trust Co., 38-1 USTC Par. 9253 (N.J. 1938); Brooks v. Driscoll, 39-1 USTC Par. 9249 (W.D. Pa. 1939).

38 3 B.T.A. 1180 (1926) (Aq. V-2 CUM. BULL. 1).
40 The Second Circuit Court of Appeals then thought that inasmuch as the Commissioner was seeking equitable relief in a suit against a transferee, he ought to do equity and allow a credit by way of recoupment to the transferee measured by the amount his personal income tax had been increased by reason of inclusion of the transferred assets in his taxable income in the prior year. See United States v. Klausner, 25 F.2d 608, 611 (2d Cir. 1928). The same sug-
gestion was made in 1933. Comm'r v Renyx, 66 F.2d 260 (2d Cir. 1933). But United States v. Tillinghast, 55 F.2d 279 (R.I. 1932) refused to allow such recoupment on the ground that the Government's remedy ought to be simple and direct and because the applicable statutes of limitation would be violated by opening up the prior year's return.

41 John T. Furlong, 45 B.T.A. 362 (1941).
poration. In *Hall C. Smith*,\(^{42}\) which was followed in *Gordon W. Hartfield*,\(^{43}\) upon identical facts, the Tax Court reasoned that, inasmuch as it had already been determined that the corporate officer was liable in equity as a transferee and because that liability rested upon the trust fund doctrine, the officer received the salary with a trust impressed upon it from the very beginning. Thus he did not have the "beneficial use" of it necessary to make it taxable income under the "use and benefit" theory of *Eisner v. Macomber*.\(^{44}\) As in the Court of Claims decision in the *Lewis* case, reliance was placed upon the second requirement—"absence of a definite, unconditional obligation to repay"—set forth by the Supreme Court in the *Wilcox* case. *North American Oil* was distinguished on the ground that presence of transferee liability caused a definite legal restriction to attach to the use of the excessive compensation the instant it was received. In addition, the Tax Court pointed out that the Commissioner was obviously inconsistent and unjust in his position of seeking to tax the taxpayer-transferee on income to which he, the Commissioner, had successfully laid claim on the ground that it was never the taxpayer-transferee's income by right. The Sixth Circuit Court of Appeals\(^{45}\) has also refused to permit the Government to adopt the inconsistent position of seeking to enforce transferee liability upon a stockholder-transferee of a liquidated corporation after the Board of Tax Appeals had sustained a deficiency in the personal tax liability of the stockholder predicated upon treating the entire profit realized upon the distribution as taxable income without any allowance for transferee liability. In upholding the dismissal of the Government's bill in equity after the Commissioner's complete Board of Tax Appeals victory, that Court said: 

"... The same amounts could not at once constitute income to the taxpayer and also be charged with a trust in favor of the Government. The Government could bring the transferee action on the theory of trust, or in the alternative, it could claim that all of the liquidating dividends constituted personal income to the taxpayers. It could not pursue both courses."

The *Hall C. Smith* result would appear quite reasonable and satisfying in its equities if it were universally applied by the Tax

\(^{42}\) 11 T.C. 174 (1948) (Non-Aq. 1948-2 CUM. BULL. 6).

\(^{43}\) 16 T.C. 200 (1951) [Non-Aq. 1951 INT. REV. BULL. No. 14 at 1 (1951)].

\(^{44}\) 252 U.S. 189 (1920).

\(^{45}\) United States v. Brown, 86 F.2d 798 (6th Cir. 1936).

\(^{46}\) 86 F.2d at 799.
Court to the transferee's peculiar predicament. But apparently only the Commissioner is denied permission to be inconsistent in this respect. The transferee, as the Tax Court case law now stands, is not so handicapped. When he is required to satisfy his transferor's tax liability in a subsequent year, he has a deductible loss in the later year and it is an ordinary loss even though the gain realized upon the transfer in the year of the transfer might have been a capital gain. Thus in Stanley Switlik a stockholder realizing capital gain upon the receipt of corporate assets in liquidation was allowed to deduct as an ordinary loss in a later year the amount of unpaid corporate taxes for which he was held liable as transferee. He was not required to reopen the prior year's return to reduce his capital gain by the amount of the transferee tax liability. No mention was made of constructive trust. The fact pattern coincides too closely with the North American Oil ideal of includibility upon receipt and deductibility upon repayment to cause judicial concern over this patent inconsistency of treatment accorded the transferee. The Commissioner conceded that payment of transferee liability was not a sale or exchange and that the loss was deductible only in the year that liability was satisfied, but he unsuccessfully contended that the character of the loss should be determined by a relation back to the original capital gain. In upholding the Switlik decision, the Court of Appeals for the Third Circuit accepted the Tax Court's reasoning that the North American Oil concept of a single year as a unit of taxation forbids reopening the prior year's return and the satisfaction of transferee liability is not a sale or exchange to qualify for capital loss treatment. Prior decisions of the Courts of Appeals of the Third, the Sixth and Second Circuits had set too strong a precedent in favor of the Tax Court's interpretation of the single taxable year concept to allow the Commissioner's theory of relation back to prevail.

The present situation is that the Tax Court has been sustained in treating the transferee's payment as an ordinary loss deduction in the year of payment, but its constructive trust doctrine which allows reopening of the prior year's return has not been subjected to appellate scrutiny. However, courts of appeal of two different

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47 13 T.C. 121 (1949).
48 184 F.2d 299 (3d Cir. 1950).
49 Freihofer Baking Co. v. Comm’r, 151 F.2d 383 (3d Cir. 1945).
50 Haberkorn v. United States, 173 F.2d 587 (6th Cir. 1949).
51 St. Regis Paper Co. v. Higgins, 157 F.2d 884 (2d Cir. 1946).
circuits will be given an opportunity to pass on the Tax Court's application of the constructive trust doctrine in the *Hall C. Smith* and *Gordon W. Hartfield* decisions.\(^{52}\) Thus it is appropriate to consider (1) whether the recent *Lewis* decision in the Supreme Court definitely closes the door to a continuation of the Tax Court's relaxation of the "claim of right" doctrine in favor of the transferee, (2) the extent of this relaxation and the equities favoring it, and (3) whether the present extraordinary statutes of limitation, designed to relax the rigors of the annual accounting period concept in particularly equitable circumstances, do, in fact or theory, justify any exceptional treatment of the transferee.

Application of the "rule of decision" principle to the *Lewis* decision results in the reasonable conclusion that the constructive trust device can no longer be used to permit judicial erosion of the "claim of right" levee erected by the *North American Oil* language to restrain tax disputes within the single channel of the taxable year. The Supreme Court is going to abide by the "*personal claim of right*" doctrine to find taxability in the earlier year of receipt if the recipient has any semblance of a "bona fide legal or equitable claim". It is submitted that a transferee *qua* trustee has a legal title. It is elementary that a trustee must have legal title to the *res*. Only a complete absence of title at the time of receipt will suffice to escape taxability. Except in those rare instances, as exemplified by embezzlement, where it is possible to obtain possession of funds without any semblance of a bona fide legal or equitable claim, the subjective test will still apply and we shall look to determine if the recipient actually did claim the fund as his own through the close of the taxable year of receipt. And that search will be cursory in most instances, for we have only to look to his tax return for the year of receipt. If he returned it as income, without any qualifying collateral circumstances,\(^{53}\) he thereby made a "claim of right" to the fund. Equitable considerations in favor of the taxpayer which might normally be evoked by the Commis-

\(^{52}\) *Hall C. Smith* was appealed to the Sixth Circuit Court of Appeals, 5 CCH 1952 Fed. Tax Rep. page 44,060; and *Gordon W. Hartfield* was appealed to the Second Circuit Court of Appeals, 5 CCH 1952 Fed. Tax Rep. page 44,055.

\(^{53}\) Cf. Sohio Corporation v. Comm'r, 163 F.2d 590 (D.C. Cir. 1947) (oil company under compulsion of state law was required to collect a 3% tax from producers of oil and was permitted to retain 2% of such amounts as reimbursement for costs of collection, the latter sum being included in its return as taxable income pending adjudication of its action in state court contesting the constitutionality of the tax.
sioner's inconsistency will be disregarded because they afford no "general solution" in view of existing statutes of limitation. The Supreme Court appears intent on avoiding further judicial tinkering with statutes of limitation to do equity in the particular case, mindful no doubt of the "vexatious, perplexing, and confusing" situation brought about by its previous intertexture of equitable recoupment and the statutes of limitation. In addition, it should be pointed out that the Tax Court reasoning in Hall C. Smith is now suspect in so far as it is grounded upon the assumption that the Wilcox case formulated a different claim of right test; it commits the same error as did the Court of Claims. Moreover, its reliance on the Eisner v. Macomber "use and benefit" theory to find that the transferee-trustee had no "beneficial use" of the fund is quite unrealistic, in view of the recent trend to predicate taxability upon enjoyment of actual economic benefits. It is submitted that the transferee enjoyed the actual economic benefits of the fund throughout the year of receipt in most instances.

Sentiments of equity would doubtless be readily evoked in favor of the transferee were it possible to ignore the Tax Court's disparate handling of the transferee tax payment and the election that affords the transferee. This election to offset the payment against the earlier year's income or to deduct it as a current ordinary loss, seems unjustifiable and positive at first glance. But it is not such a free election as would be supposed. If he satisfies the transferee liability deficiency without appeal to the Tax Court, the transferee is limited to a deduction in the year of payment. If he were to file a timely refund claim grounded upon the theory that the original receipt was not income, the Commissioner has indicated that he would reject such a claim. And the fact pattern of the transferee does not fall within any of the categories of Internal Revenue Code § 3801 (b) so as to enable the transferee to take advantage of the Commissioner's inconsistent position that that section was intended in part to prevent. Therefore, it is only when the transferee resorts to the Tax Court procedure that he has the opportunity to have the prior year's return reopened under the provisions of Internal Revenue Code § 322(d). That sec-

64 See American Light & Traction Co. v. Harrison, 142 F.2d 639, 644 (7th Cir. 1944).
66 The nonacquiescence indicated supra notes 42 and 43.
tion is applicable because the deficiency relates to the same taxable year as that in which he received the excessive compensation. However, this route is by no means always open. To be entitled to a Tax Court finding of an overpayment in respect to the same taxable year as that pertaining to the deficiency, the transferee must have filed a refund claim for his personal income taxes paid for that same year. In general, there is incorporated into Internal Revenue Code § 322 (d) the same statute of limitations on filing of refund claims as is found in Internal Revenue Code § 322 (b) (1). Thus the three-year period ordinarily granted the taxpayer might have expired before the Commissioner asserts a deficiency based on transferee liability, for the Commissioner has a one-year edge on the transferee in this respect. Even when the prior year's return is opened, the entire amount of the tax attributable to the receipt of the transferred assets is not refunded. The maximum refund possible is limited to the amount of the deficiency asserted against the transferee.

In spite of the fact that the transferee has only a limited election, the co-existence of the two divergent Tax Court methods of treating satisfaction of transferee liability conflicts with the ideal symmetry of the federal income tax system. Eradication of this distortion of the ideal symmetry should be effectuated by legislative rejection of the Stanley Switlik result. The likelihood that the transferee's particular plight will be brought to the attention of the Supreme Court is so remote that the only certain method of assuring equity to the transferee is to be found in further legislative relaxation of the statute of limitations; but this relaxation should be accompanied by elimination of the transferee's present election

57 See note 3, supra.
58 Int Rev. Code § 311 (b) extends the statute of limitations for assessment of transferee liability for one year after the expiration of the period of limitation for assessment against the original taxpayer, in the case of the initial transferee, and, in the case of a transferee of a transferee, for one year after expiration of the period of limitation against the preceding transferee. Thus a three-year period of limitation applies to the transferee's claim for refund, but the Commissioner has at least four years in which to assert transferee liability assuming the transferor's taxable year ends at the same time as the transferee's.
59 "We agree with the Commissioner in his argument that all excessive compensation is excludible in 1945 but only that part subsequently actually used to satisfy transferee liability." Gordon W. Hartfield, 16 T.C. 200, 203 (1951).
60 The Tax Court continues to follow its Switlik decision in allowing current deductibility as ordinary losses of the sums paid to satisfy transferee liability. See Seth M. Milliken, 15 T.C. 243 (1950).
61 The 1950 term heard only one income tax case.
to deduct the transferee liability as an ordinary loss in the later year of payment. Internal Revenue Code § 3801 indicates legislative disapproval of the use of the statutes of limitation as a defense by one who seeks to take inconsistent positions, as the Commissioner has done in these transferee cases, but that section was designed to cover inconsistent positions taken with respect to different taxable years. In the transferee cases, the Commissioner is taking an inconsistent position with respect to the same taxable year. Therefore, the proper legislative relief is not to be found by amendment to Internal Revenue Code § 3801. Such an amendment would confuse the theory of that section. Rather the amendment should be to Internal Revenue Code § 322(d) by making it possible and mandatory for the transferee to obtain a refund of the prior year's taxes to the extent of the transferee liability found against him, it being understood that the maximum refund of the prior year's taxes would be limited to the amount by which those taxes were increased by reason of the inclusion of the transferred assets in the transferee's income.