Preventive Tax Policy:
Chief Justice Roger J. Traynor's Tax Philosophy

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Roger J. Traynor was appointed to the Supreme Court of California in 1940 and served as its Chief Justice from 1964 to 1970. He is best known today for his judicial innovations in the fields of conflict of laws, product liability, and civil procedure.[1] His decisions on miscegenation, divorce, police searches and product liability were ahead of his time, and led California's legal system into the future. His most significant opinions included rejecting the legal prohibition of inter-

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[1] Adrian A. Kragen, *In Memoriam: Roger J. Traynor: Chief Justice Traynor and the Law of Taxation*, 5 HASTINGS L.J. 801, 802 (1984).

racial marriages, adopting no-fault divorce, restricting police searches and applying a strict standard of liability in product defect cases.[2]

However, few would trace Roger J. Traynor's roots to the field of tax law, where he developed, through academic, administrative, and judicial service, valuable principles that still prevail today. At the University of California, Berkeley, Traynor discovered his passion for tax law and inspired his students to take this path in their professional careers. As an administrator, Traynor served California's tax system tremendously by shaping some of today's most important local tax acts, which were adopted by other states and countries. Later, Traynor became an expert consultant to the Treasury Department and participated in drafting major federal tax legislation. As a Supreme Court judge, Traynor wrote decisions in the field of taxation that remain good law and provide guidance for complicated issues including, for example, computing estate tax marital deductions and the earnings and profits of corporations. What was most unlikely, however, was that Traynor would partner with Stanley Surrey, our nation's foremost authority on federal tax law and the leading proponent of tax reform during his life.[3]

As a Harvard law dean and tax professor once said, Stanley S. Surrey was a *"True Public Servant."*[4] In 1933 he joined the New Deal administration and established himself as a highly ranked legal counsel at the Treasury Department.[5] In 1951, he joined the Harvard Law School faculty, where he remained an active member for 30 years[6] while continuing to serve as a consultant to the United States

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[2] Ben Field, Activism in Pursuit of Public Interest: The Jurisprudence of Chief Justice Roger j. Traynor, xiv (2003).

[3] The Townsend Harris Medal at: http://www.ccny.cuny.edu/townsend_harris/awards/s_z.htm

[4] Erwin N. Griswold, *In Memoriam: Stanley S. Surrey*, 98 Harv. L. Rev. 329, 331 (1984).

[5] Surrey worked in the National Recovery Administration in Washington from 1933 to 1935 and at the National Labor Relations Board from 1935 to 1937. In those positions, Surrey found a meaningful outlet to improving government policies. On the influence of the New Deal on Surrey from his brother, *see* Walter Sterling Surrey, Stanley S. Surrey 1910-1984, Harvard University (1984), a Memorial Service Held Oct. 3, 1984 at Memorial Church, Harvard University.

[6] At Harvard, even as professor emeritus, Surrey continued to participate in many projects, such as the Income Tax Project of the American Law Institute. He

government and as an advisor to the United Nations on international tax projects.[7] However, his best known and most important work was formulating the tax expenditure concept. As assistant secretary for tax policy in the Treasury Department, Surrey promoted the legislation establishing today's tax expenditures section of the government's budget, which enumerates incentives and subsidies granted through the tax system, thus emphasizing their oversized component of the income tax system. His aim was to raise public awareness of the extent to which government subsidizes certain activities. After his retirement, Surrey continued to update and publish volumes of his famous textbooks on taxation, such as "Federal Income Taxation—Cases and Materials" and "Federal Wealth Transfer Taxation—Cases and Materials," books

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organized the International Program in Taxation at Harvard, produced the World Tax Series, and published various tax books and articles. He was the president of the National Tax Association in 1979-1980 and through it published major tax articles. Surrey wrote 20 books and 97 articles, not including legislative records. James Vorenberg, Stanley S. Surrey 1910-1984, Harvard University (1984), a Memorial Service Held Oct. 3, 1984 at Memorial Church, Harvard University.

[7] Surrey's contribution to the development of international tax systems was vast. He was instrumental in formulating tax treaties between developed and developing countries, and in developing the new tax system that evolved after World War II. For example, he was responsible for the adoption of Resolution A.3 adopted at the conference of Punta del Este in 1961 by which member governments of the Organization of American States explicitly endorsed a program to reinforce tax systems. The Resolution was adopted by The Pan American Union, the Economic Commission for Latin America and the Inter-American Union, Economic Commission for Latin America and the Inter-American Development Bank, in cooperation with the Harvard University Law School International Program of Taxation in August 1961. Milton Katz, Stanley S. Surrey 1910-1984, Harvard University (1984), a Memorial Service Held Oct. 3, 1984 at Memorial Church, Harvard University. Between 1949 and 1950, Surrey participated in planning and developing a new tax system for Japan, as a member of the American tax mission to Japan. Surrey reported his mission was most importantly to devise a simple and progressive system, which was later acclaimed for bringing Japan "dazzling economic performance and rapid growth since World War II." Erwin N. Griswold, In Memoriam: Stanley S. Surrey, 98 Harv. L. Rev. 329, 331 (1984). In 1960, he joined his Harvard colleague Oliver Oldman in a research project on the tax system of Argentina for the government of Argentina through the auspices of the Ford Foundation. Report of a Preliminary Survey of The Tax System of Argentina; Prepared for the Government of Argentina through the auspices of the Ford Foundation by Stanley S. Surrey and Oliver Oldman (Cambridge, Mass., Harvard Law School, 1960).

that are known to every law student as the building blocks of tax education.

Little is known about the strong bond between Traynor and Surrey, who commenced their careers in the field of tax law. Less is known about their enduring mutual impact on the American tax system. Traynor collaborated with Surrey during President Roosevelt's second term, toward the end of the Great Depression, when the top marginal tax rate rose again to its World War I-era maximum of 78 percent.[8] The high marginal tax rates intensified the friction between taxpayers and the government, boosted litigation and multiplied the number of tax disputes.

At this crucial juncture in the late 1930s, Traynor and Surrey called for a substantial transformation of existing mechanisms for settling tax disputes. Traynor and Surrey criticized the inefficient adjudication of tax matters and proposed ways to minimize litigation through what they called a "preventive" tax policy "designed to prevent controversies from arising," and where they cannot be prevented "to reduce the areas in which they occur."[9] Their idea of preventive tax policy entailed reducing the complexity of the tax code and improving the administrative resolution of tax cases, thereby minimizing disputes over tax matters. "Too much law,"[10] they said, caused taxpayers to seek out expensive legal advice in order to "thread their way through the complicated maze of tax law."[11]

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[8] In 1918 the top marginal tax rate was 78 percent, and between 1919 and 1921, it was 73 percent. In the post World War I period the maximum rates declined gradually and their lowest level was 24 percent in 1929. During the Depression period that followed the stock market crash, the top marginal tax rate increased rapidly to 79 percent in 1936 and continued this trend during the Second World War to a top rate of 94 percent in 1945.

[9] Roger J. Traynor & Stanley S. Surrey, *New Roads Toward the Settlement of Federal Income, Estate, and Gift Tax Controversies*, 7 Law & Contemp. Probs. 336, 352 (1940).

[10] *Id.* at 351 (1940). This exact phrase was also used by Justice Robert H. Jackson. He claimed that the elaborate tax system was "too much law, and too many kinds of law, and from too many sources, for tax administration to be simple, or the law clear." Kirk Stark, *The Unfulfilled Tax Legacy of Justice Robert H. Jackson,* 54 Tax L. Rev. 171, supra 97 at 187 (2001).

[11] Roger J. Traynor & Stanley S. Surrey, *New Roads Toward the Settlement of Federal Income, Estate, and Gift Tax Controversies*, 7 Law & Contemp. Probs. 336,

Ultimately, Traynor became Chief Justice of the Supreme Court of California, while Surrey blossomed in Harvard's academy and the executive branch as assistant legislative counsel to the United States Treasury. However, when they proposed their preventive tax policy, they were both Treasury consultants. This paper will explore the joint project of these extraordinary men in its historical context and its implementation in Roger Traynor's understanding of tax adjudication. Through legal-historical analysis, the paper also examines the taxpayer-government relationship in view of changes in politics, economics, and culture in the interwar years.

Following this brief introduction, part II provides a historical overview of the development of the tax system and the administrative problems at that time, as a background for Traynor and Surrey's work. Part III tells the story of Traynor's tax education and how he met Surrey, along with an outline of their proposal to improve the interwar tax system. Part IV describes the success of implementing preventive tax policy in the U.S. tax system, specifically in Traynor's decisions. Finally, Part V summarizes the importance of preventive tax policy at a turning point in history and its effect on today's tax system.

I. INCOHERENT FISCAL PRACTICES AND TOO MUCH LAW

Taxing the income of individuals in the United States began during the Civil War, and appeared inconsistently in various forms until it was constitutionalized in 1913. The first income tax bill was modest, imposing graduated rates with a maximum rate of seven percent and large exemptions.[12] However, wartime expenses associated with World War I turned the government to income tax as an immediate revenue source. In just a few short years the maximum individual tax rate reached 77 percent.[13] From then on, tax policy became a major issue in public and political discourse. Tax legislation became more frequent, contributing to the development of the tax code, as well as

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351 (1940).

[12] Revenue Act of 1913, ch. 16, II.B, 38 Stat. 166-167 (1913).

[13] Scholar John F. Witte aptly summed up the atmosphere of the period when he said, "the need for revenue ruled the discussion over progressive arguments." John F. Witte, The Politics and Development of the Federal Income Tax 83 (1985).

the growing complexity of the tax system.

As tax rates increased, the stakes became higher, escalating the friction between taxpayers and the government. This led to higher rates of tax evasion and multiplied the number of tax disputes between individuals and the government. The growing number of tax disputes underscored the need for reform of administrative and judicial settlement procedures. It was clear at that time that compliance levels had declined, and the relationship between taxpayers and the government had deteriorated. This spurred a shift in tax legislation; whereas previously officials had cited a need to raise revenue or a desire to make the tax system more progressive. The tax acts of the late 1930s marked the beginning of complex and frequent tax revisions enacted in response to tax evasion. As a result, taxpayers increasingly sought advice from tax lawyers, and the courts were faced with a high volume of tax disputes.

Incoherent fiscal practices as well as inefficient institutional structures overloaded the interwar tax system and created substantial delays in resolving disputes. Those delays weakened the efficiency of the tax system, created uncertainties and confusion, and threatened the Treasury's ability to raise the necessary revenue.

A first attempt by the Treasury to reduce tax disputes came with the establishment of the Board of Tax Appeals ("Board") in 1924 as an independent agency within the executive branch of the government.[14] The Board was composed of seven members who were tax experts appointed by the president. It had parallel jurisdiction with the District Courts and the Court of Claims in suits for refund and it was subject to appellate review by the Circuit Courts of Appeal.

Among the Board's weaknesses was the fact that taxpayers could choose from three courts that possessed original jurisdiction over

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[14] Revenue Act of 1924, Pub. L. No. 68-176 §900, 43 Stat. 336 (1924). Theodore Tannenwald described the circumstances surrounding the decision to establish the Board as a period of general public discomfort with the Bureau of Internal Revenue, which experienced difficulties coping with administrative problems produced by the relatively new broad-based income and profits tax. Theodore Tannenwald, Jr., *The United States Tax Court: Yesterday, Today and Tomorrow: Erwin N. Griswold Lecture before the Annual Meeting of the American College of Tax Counsel, San Antonio, Texas, January 23, 1998,* 15 Am. J. Tax Pol'c 1, 4 (1998).

tax cases,[15] which led to forum shopping. Many taxpayers opted for the Board of Tax Appeals because, as opposed to other courts, it did not require prepayment of tax liability. Moreover, although the Board of Tax Appeals was based in Washington D.C., it had jurisdiction throughout the United States.[16] Therefore, it had to accumulate enough cases to justify visiting a certain location, creating huge delays. As a result, the Board faced serious overload.[17]

When the parties finally attended their long-awaited Board hearing, they were often surprised to learn about new issues not mentioned in the initial deficiency letter. Taxpayers' inability to provide complete details in the petition to the Board and the failure of the Bureau of Internal Revenue to demand full disclosure of the facts created further delays in the judicial branch, which now had to waste time compiling the necessary information. The constant delays in resolving tax disputes impaired tax collection, increased the likelihood of taxpayer default, and resulted in a substantial revenue loss for the government.

The interwar tax system also produced high levels of confusion and uncertainty. Typically, six years passed between the date of the return and the decision of the Board of Tax Appeals. Further complicating matters was the fact that the Board's decision-making lagged behind the legislative code. For example, when Congress solved problems from previous tax acts and enacted the revenue act of 1939, the judiciary was still interpreting the revenue acts of 1932

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[15] The taxpayer had the liberty to file a refund claim through the District Court or the Court of Claims, or a petition with the Board of Tax Appeals.

[16] A study in 1934 showed that over 90 percent of the Board cases were outside of Washington; seven states accounted for 59.5 percent of the cases, another seven states accounted for 16.9 percent, and the remaining 23 percent accounted for 34 other states, which emphasized the geographical spread of tax disputes before the Board. Roger J. Traynor, *Administrative and Judicial Procedure for Federal Income, estate, and Gift Taxes- a Criticism and A Proposal,* 38 Colum. L. Rev. 1394, 1405 (1938).

[17] In fiscal year 1937-1938 the percentage of cases closed by Board decision after trial was only 19.1 percent (1,108 cases out of 5,799). At the close of fiscal year 1938-1939 there were 7,864 pending tax cases involving $456,974,846. By the end of fiscal year 1938-1939, there were 6,574 cases before the Board of Tax Appeals. Roger J. Traynor & Stanley S. Surrey, *New Roads Toward the Settlement of Federal Income, Estate, and Gift Tax Controversies*, 7 Law & Contemp. Probs. 336, 338 (1940).

and 1934.[18] Many cases continued appellate litigation in the Circuit Courts for another two years, while others made it to the Supreme Court for another year. That meant it could take up to nine years for a tax dispute to finally be settled. In the meantime, both taxpayer and government remained uncertain of the tax consequences.[19] Before his appointment to the United States Supreme Court and while serving as general counsel at the Bureau, Traynor's friend and supporter Robert H. Jackson criticized the interwar tax system, stating: "Some of the complexity, conflict and confusion in the tax law is due to the number of cooks who make the broth. . . ."[20]

With those problems in mind, Traynor partnered with Surrey and prepared a comprehensive reform proposal. Its principles are described in the next section. However, in order to understand Traynor's influence in the field of taxation, first we have to understand how he came to the study of tax law and to collaborate with Surrey. An outline of Traynor's life story and his acquaintance with Surrey will be presented, followed by a detailed discussion of their idea of preventive tax policy.

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[18] Roger J. Traynor, *Administrative and Judicial Procedure for Federal Income, Estate, and Gift Taxes- a Criticism and a Proposal*, 38 Colum. L. Rev. 1394, 1398 (1937).

[19] Id. For similar criticism of the interwar tax system see Theodore Tennenwald, The Tax Litigation Process: Where It Is and Where It Is Going, 44 Rec. Ass'n B. City of N.Y. 825, 827 (1989). An example of the confusion inherent in the system was the inverted pyramid of multiple appellate reviews that produced opposite opinions in similar federal tax matters. Taxpayers filing a tax claim could choose among the Board of Tax Appeals, the District Courts, and the Court of Claims. While the Board was the most popular choice, the other tribunals had equal precedent power and were subject to an appellate review by 11 Circuit Courts that sometimes issued contradictory decisions, causing vagueness until the Supreme Court settled the matter (if at all). Taxpayers and their counsels used this lack of uniformity in devising tax schemes. They reviewed the latest decisions in each tribunal, and chose to litigate in a specific tribunal if they thought it would rule in their favor. The Bureau was not free from those considerations, and there were situations in which the main reason for its assertion of a deficiency was to foster a circuit split.

[20] Robert H. Jackson, *Equity in the Administration of Federal Taxes*, 13 Taxes 641, 643 (1935).

II. PREVENTIVE TAX POLICY

A. Traynor's Tax Education and His Encounter with Stanley Surrey

"There is no sounder currency in the courts across the country than a Traynor opinion."[21]

Roger J. Traynor was born on February 12, 1900, the son of Irish immigrants who settled in the small town of Park City, Utah.[22] He received both his Ph.D. in political science and J.D. in the spring of 1927.[23] While studying law, Traynor discovered his passion for tax law and, soon thereafter, received an appointment as a tax law professor at Boalt Hall. Traynor taught a course called "Principles of Income and Inheritance Taxation," using a unique method of combining "dry law" with complex tax policy and jurisprudence considerations, exposing students to both the practical and philosophical aspects of taxation. His influence over his students encouraged many of them to pursue careers in the field of taxation.[24]

As a man of many interests, Traynor enjoyed putting his practical knowledge of tax law to use in the public service. In 1932, Traynor advised the California State Board of Equalization on devising methods of local taxation to raise additional revenue. He helped in drafting the retail sales tax, the use tax, the Bank and Corporation Franchise Tax Act and the Personal Income Tax Act of 1935. Those state taxes survived battles challenging their constitutionality, and served as mod-

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[21] Walter V. Schaefer, *A Judge's Judge*, 71 Calif. L. Rev. 1050, 1051 (1983).

[22] He nostalgically described his small-town life as like being in a melting pot that accommodated immigrants from all over the world, enriched by noble teachers who inspired him to choose the academic path. Traynor loved this environment of provincialism, "land of Bohunks and Micks and Krauts and Cousin Jacks" surrounded by mountain landscape, which he later compared to the path of a judge. Elizabeth Roth, *The Two Voices of Roger Traynor,* 27 Am. J. Legal Hist. 269, 288 (1963).

[23] His academic life began in 1919, when Traynor received a scholarship for undergraduate studies at the University of California, Berkeley, and continued his graduate studies for a Ph.D. in philosophy in the political science department. Inspired by Thomas Reed Powell, his constitutional law professor, Traynor decided to pursue a law degree while working on his dissertation and teaching in the political science department.

[24] Adrian A. Kragen, *In Memoriam: Roger J. Traynor: Chief Justice Traynor and the Law of Taxation*, 5 Hastings L.J. 801, 802 (1984).

els in many states and countries as central sources of local revenue. In 1937, while Traynor was a tax counsel to California's Board of Equalization, he was appointed consulting expert in the federal Office of the Secretary of the Treasury.[25]

During his federal service, Traynor met Stanley Surrey, then a young and eager tax professor and assistant legislative counsel at the Treasury Department, and chose him as a reliable co-author and collaborator. One of their mutual projects was to review the effort to prevent taxpayers' misuse of the statute of limitations on deficiencies and refunds.[26] Their recommendations were incorporated in section 820 of the 1938 Revenue Act,[27] as the two continued to develop a critical analysis of contemporary tax problems. Their goal was to create what they called a "preventive tax policy," that is, tax policy aimed at both preventing tax disputes from arising and reaching the judicial system by improving the predictability, clarity and unity of the tax code (ex ante prevention), as well as producing a more effective administrative and judicial procedure for the swift resolution of those that do arise (ex post treatment).

B. Ex Ante Preventive Tax Policy

As a first step toward avoiding tax disputes, the two urged making the tax code clearer. Complex regulations without proper guidelines or clarification force taxpayers to construe them at their peril. Predictability of the law is essential for society, they declared, as taxpayers who are overwhelmed by the scope of the law cannot act according to

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[25] Since there were provisions of the Executive Order of 1873 prohibiting federal employees from holding office under any state, territorial or municipal government, President Roosevelt had to use his vested authority and sign a waiver to permit Roger Traynor to hold this position. Exec. Order No. 7708, 2 Fed. Reg. 2167, (Sept. 16, 1937).

[26] Traynor collaborated with Professors John M. Maguire and Stanley S. Surrey and proposed a complete revision of the administrative provisions of the income tax system. The three professors wrote a series of articles explaining this reform and the remaining loopholes that needed to be closed. John M. Maguire, Stanley S. Surrey & Roger J. Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 509 (1939); Maguire, Stanley S. Surrey & Roger J. Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 719 (1939).

[27] Revenue Act of 1938, Pub. L. No. 75-554, § 820, 52 Stat. 447, 581-83.

it. Moreover, as new circumstances arise over time, complicated tax rules create greater difficulties. Taxpayers seek certainty when planning their business and family affairs; any vagueness results in tax litigation.

The next step, Traynor and Surrey emphasized, is to improve the function of preliminary administrative negotiations between the taxpayer and the local revenue agent. The two stressed the need for competent and fair handling of initial negotiations in order to provide the taxpayer with an informal, non-judicial and inexpensive opportunity to settle the matter. If necessary, a case of particular importance could be further clarified by a conference of tax experts at the Bureau of Internal Revenue. If the matter was not settled in the conference, the commissioner would notify the taxpayer regarding the proposed deficiency, and the taxpayer could reply by filing a detailed protest to the commissioner. Traynor and Surrey suggested using the protest letter to demand taxpayers' full disclosure of the facts and provide a statement of all the transactions involved. Failure to file would result in a deficiency letter. The proposed protest should be in writing, they said, under oath, and it should contain all the information and documents relevant to the case. The two emphasized that the purpose of this statement was to make clear all factual issues and to restrict any remaining controversy to legal questions.

Further thinking on ways to improve dispute resolution between the government and taxpayers led Traynor and Surrey to propose the practice known today as the private letter ruling. The proposal suggested forming an agreement between the commissioner and the taxpayer, approved by the Secretary of the Treasury, which would end all disputes related to the fact at hand. The agreement should relate to either a particular transaction at present or future tax consequences, whether an issue of fact or law. This mechanism would not only inform taxpayers of the Bureau's position on certain tax issues, but also would allow them to rely on this binding agreement, and to plan ahead whether to take the risk of litigating this matter.

C. Ex Post Tax Policy

After a tax matter had already reached the doorstep of the judicial branch, reducing the time required for a resolution was the primary

concern for Traynor and Surrey. When given the choice between two identical procedures, taxpayers opted for the one that deferred their tax liability and did not involve prerequisite payment. Subsequently, Traynor and Surrey recommended the unification of the deficiency procedure and the refund procedure or at least requiring a bond to secure the collectibility of the tax. An additional method of lowering the volume of tax litigation as a preventive tax policy, suggested Traynor and Surrey, was adopting the exhaustion-of-remedies doctrine in tax matters, which would require certain administrative procedures be initiated and followed before taxpayers could seek relief from the courts.

As for appellate review, multiple appellate reviews of the Board of Tax Appeals' decisions created conflicting decisions and uncertainties in the interwar period. In order to eliminate such uncertainties and to achieve uniformity in tax adjudication, Traynor and Surrey suggested passing the exclusive authority to decide cases of income, estate and gift tax to the Board of Tax Appeals. This proposal aimed to transfer the review of tax disputes to professional tax experts who were better qualified than the average court judge.

The two also recommended establishing a single Court of Tax Appeals, which would have the sole appellate jurisdiction over the board's decisions. Appeals from the Court of Tax Appeals would have required a certiorari from the Supreme Court. If certiorari was denied, both parties had to settle for the Court of Tax Appeals decision, constituting a binding resolution, and not an invitation to litigation, as was the case in 1939.

Traynor and Surrey's proposals to improve the interwar tax system were not fully accepted. While trying to put their innovative philosophy into practice, they encountered political limitations. Their philosophy of preventive tax policy, specifically its normative aspect,

aroused a storm of criticism.[28] Nevertheless, parts of their proposal were adopted later, contributing greatly to the development of the U.S. tax system. The next section will present the practice of preventive tax policy in Traynor's decisions, along with historical review of the implementation of Traynor and Surrey's proposal, then and today.

III. PREVENTIVE TAX POLICY: DEFEATED?

A. Traynor's System of Tax Adjudication

Traynor's nomination to the Supreme Court of California did not mark the end of his legacy of preventive tax policy, but rather the beginning of its practice. In 1940, Traynor was appointed to the Supreme Court after a public debate over an earlier appointee.[29] Appointed at 40 years of age, Traynor was the youngest member of the Supreme Court of California, and, between 1964 and 1970, he served as its Chief Justice.

In the beginning of the 1930s, jurisprudential ideas of Legal Realism emerged as an anti-formalist reaction and later attracted many New Deal jurists. To some, Roger Traynor seemed typical of many liberal New Dealers in his belief in administrative expertise and judicial passivity. However, a closer look at his jurisprudence reveals a more complex outlook on law, reform, and the role of the judge as policy-

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[28] Angell B. Montgomery, *Procedural Reform in the Judicial Review of Controversies under the Internal Revenue Statutes; An Answer to a Proposal*, 34 Ill. L. Rev. 151(1939); G. Aaron Youngquist, *Proposed Radical Changes in the Federal Tax Machinery,* 25 A.B.A. J. 291(1939); Seidman, *Proposed Procedural Changes in Federal Tax Practice,* 67 J. of Accountancy 221 (1939); Barrett E. Prettyman, *A Comment on the Traynor Plan for Revision of Federal Tax Procedure,* 27 Geo. L. J. 1038 (1939); William A. Sutherland, New Roads to the Settlement of Tax Controversies: A Critical Comment, 7 Law & Contemp Probs. 359 (1940).

[29] Governor Culbert Olson had nominated Max Radin, Traynor's old Berkeley colleague, to the state Supreme Court, but the State Qualifications Committee rejected this appointment fearing Radin's radical tendencies. Olson called Radin to ask his advice on a substitute nominee, and Radin recommended Traynor. Ben Field, Activism in Pursuit of Public Interest: The Jurisprudence of Chief Justice Roger J. Traynor (2003) note 25 at 5.

maker.[30] Exposed to the ideas of Realism by his Berkeley professor, Thomas Reed Powell, Traynor believed judges should look beyond the mere facts of the case and consider "legislative facts" and "environmental data."[31] He resented the phrase, "judicial activism," and joined the Realists' protest against judges who abused their power to overrule precedents too quickly.

Nevertheless, unlike Legal Realists, Traynor's decisions involved a process of inquiry similar to the Pragmatists' concept of scientific method.[32] Furthermore, Traynor, far from holding a belief in judicial passivity, objected to it and promoted creative legal reasoning. Judicial creativity occurs, he theorized, when the judge succeeds in persuading the involved parties and the legal community of the necessity of modifying standing law. Legal changes, he believed, develop through those judicial innovations that bridge the law with reality and social changes, and venture "new answers to old questions."[33]

During Traynor's tenure on the California Supreme Court, he promoted these ideas and practiced his philosophy of preventive tax policy. For instance, he maintained the consistency of the law by following the legislative intent. In order to determine the Legislature's state of mind, Traynor tracked the legislative history of the bill and applied cautious reasoning using textual interpretation of the statute. The case

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[30] Neil Duxbury contended that realist jurisprudence was never a "revolt against formalism" and that the movement away from formalist legal thinking was very slow and hesitant. In his opinion there was no realist movement, but rather an inteletual mood and "a complex array of messages, some of which seemed rather feeble once placed in an institutional context." Neil Duxbury, Paterns of American Jurisprudence 4 (1995). For an intellectual history of New Deal legal thinking *see* Laura Kalman, Legal Realism at Yale 1927-1960 (2001); and Peter H. Irons, The New Deal Lawyers (1982). For a comprehensive analysis of American Legal Realism *see* Morton Horwitz, The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy (1992); William Nelson, The Legalist Reformation, Law, Politics, and Ideology in New York 1920-1980 (2001); and Lawrence Friedman, American Law in the Twentieth Century (2002).

[31] Roger J. Traynor, *Better Days in Court for a New Day's Problem*, 17 Vand. L. Rev. 109 (1963).

[32] Ben Field, Activism in Pursuit of Public Interest: The Jurisprudence of Chief Justice Roger j. Traynor (2003) 9-14.

[33] Robert B. McKay, *Constitutional Law; Ideas in the Public Forum*, 53 Cal. L. Rev. 67 (1965).

of *Roehm v. Orange County*[34] is an example of this form of interpretation. In this case, Traynor had to decide whether a liquor license is taxable intangible property. In reversing the lower court decision, Traynor examined the history of Article XIII §14 of the California Constitution and the legislative intent of its amendments. He concluded that this history showed liquor licenses were not intended to be taxed as personal property subject to ad valorem taxation. Traynor demonstrated how the framers of the amendments of Article XIII and generations of Supreme Court decisions sustained the view that only intangibles listed in the Constitution were taxable property.[35] Foreseeing the administrative problems of future taxation of intangible property, Traynor noted that among the absurdities of such taxation would be taxation of life insurance policies, which would result in increasing tax avoidance by exchanging taxable intangible assets for tax-free intangible assets.[36] To be cautious, Traynor added that in case the Legislature was not satisfied with his ruling in this matter, it had the vested power to amend the law. True to his administrative roots, Traynor concluded that it is up to the Legislature and not the local subdivisions of the administration to make such a change.[37]

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[34] Roehm v. Orange, 32 Cal. 2d 280; 196 P.2d 550; 1948 Cal. LEXIS 223 (Cal. 1948).

[35] *Id.* at 285.

[36] "Intangible assets are often interchangeable so that exemption of some and taxation of others at high rates would induce taxpayers to convert highly taxable intangibles into tax-free intangibles or to conceal them. Thus, subjection of patents or copyrights to such taxes would lead to the transfer of such rights to foreign corporations in exchange for corporate stock specifically exempted from property taxation by section 212 of the Revenue and Taxation Code*." Id.,* at 290.

[37] *Id.* at 291. Another example of Traynor's purposive interpretation seeking legislative intent was the case of Golden State Theatre & Realty Corp. V. Johnson (21 Cal. 2d 493; 133 P.2d 395; 1943 Cal. LEXIS 274. (Cal. 1943)). The taxpayer challenged the taxation of dividends received from its subsidiaries under the Bank and Corporation Franchise Tax Act. The taxpayer claimed that the dividends are deductible from its gross income since they were declared from income arising out of business done in the state. Traynor ruled in favor of the taxpayer by interpreting the legislative text and holding that the corporation was not a holding company because it was actively doing business in the state and not only receiving dividends from its subsidiaries. Traynor interpreted the language of the Bank and Corporation Franchise Tax Act in light of its legislative intent and the purpose of the 1933 modifications. He interpreted the term "doing business" by looking at the legislative history of the act

Influenced by the Realist mood and, while trying to prevent unnecessary adjudication of an already complex tax code, Traynor used his stage to call for judicial restraint and warn fellow judges against erroneous interpretation of the law in conflict with its original intent.[38] He stressed the necessity of judicial restraint to preserve American democracy and legal ordering.[39] Activist judges, he thought, undermine the law by making too many changes that impair its stability. He claimed that the Legislature's silence is not a rejection of a rule nor a green light for activist judges to alter it, but a sign of its acceptance.[40] His judicial

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and held that following the decision in the lower court the Legislature amended the definition of doing business and added the provision that holding companies should not be regarded as doing business. Traynor's definition of "doing business" was affirmed by later cases.

[38] Being one of the architects of the Bank and Corporations Franchise Tax Act, Traynor rejected the taxpayer contention that it was necessary to amend it to specify that a trustee in bankruptcy conducting the business of a corporation should be subject to tax as if he were a corporation. District Bond Co. v. Florence Pollack, 19 Cal. 2d 304; 121 P.2d 7; 1942 Cal. LEXIS 364 (Cal. 1942).

[39] Judicial restraint and employing purposive interpretation of the law were at the core of Traynor's decisions. For example, Traynor was faced with a political attack over the use of municipal funds. In this case, he had set the limits on judicial criticism of municipal discretion by requiring the exhausting of remedies before the court could interfere in the administrative and legislative branches' actions. He stated: "In the absence of constitutional or statutory limitations the amount of revenue necessary for the needs of a municipality is within the sole discretion of the legislative authorities and this discretion is not subject to judicial interference. The power of courts to interfere in matters of taxation, except as permitted by statute, is limited. The courts cannot pass upon the question of the policy of a tax law or the expediency of the exercise of the taxing body or the wisdom or fairness of the method of distributing the burden of taxation where no provision of the constitution is violated." The importance of this decision is in its prevention of future litigation of political issues under the pretense of misuse of tax money. Rancho Santa Anita v. Arcadia, 20 Cal. 2d 319; 125 P.2d 475; 1942 Cal. LEXIS 279 (Cal. 1942).

[40] Garvey v. Byram, 18 Cal. 2d 279; 115 P.2d 501; 1941 Cal. LEXIS 363; 136 A.L.R. 1137. (Cal. 1941) In another case Traynor commented: "The foregoing statement is particularly applicable here, where it is contended that the silence of the Legislature in 1945 establishes the intention of the Legislature that enacted the provision some eight years previously, even though administrative construction antedating the Green case and in contradiction with it was followed by reenactment of the section without change. It would be as logical to contend that the Legislature thereby adopted the administrative construction. Although legislative silence may

philosophy was that, when a rule is long engrained in public policy, it must be presumed that the Legislature took it for granted rather than sought to alter it. Traynor emphasized that it is for the Legislature and not the courts to formulate such policy. In his opinion, the role of the judge was significant in preserving the consistency, predictability, and unity of the code. Inconsistent decisions puzzled both taxpayers and the administration, and created incentives to litigate in order to receive different results.

Nevertheless, Traynor also sought to forewarn the judiciary not to ignore cases that misinterpreted the law. Therefore, when confronted with a case of erroneous interpretation of the law that created bad precedent, he maintained it is the obligation of the judge to overrule it.[41] The power of precedents is not complete and immutable, he asserted, for erroneous interpretation of the law by the court defeats the purpose of legislation not only for the past, but also for the indefinite future.[42]

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sometimes give a clue to legislative intention, it is by no means conclusive….In short, although recognizing that by silence Congress at times may be taken to acquiesce and thus approve, we should be very sure that, under all the circumstances of a given situation, it has done so before we so rule… Just as dubious legislative history is at times much overridden, so also is silence or inaction often mistaken for legislation." Rosemary Properties v. McColgan, 29 Cal. 2d 677; 177 P.2d 757 (Cal. 1947).

[41] An illustration of such preventive tax policy is found in Traynor and Surrey's second project concerning section 820 of the Revenue Code of 1938. Section 820 sought to reduce litigation by mitigating the hardships of erroneous tax returns produced by applying the statute of limitation on tax returns. Their mutual project with Professor John Maguire commended this new provision in order to reduce litigation related to tax readjustments between taxable years, but also offered criticism of the remaining loopholes. John M. Maguire, Stanley S. Surrey & Roger J. Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 509 (1939); Maguire, Stanley S. Surrey & Roger J. Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 719 (1939). At that time, several court decisions disallowed refunds for erroneous overpayments made in previous years by applying the statute of limitation. The newly enacted section 820 in the Revenue act of 1938 (Pub. L. No 75-544 §820) was designed to offer relief where the tax results of an earlier year and a later year combined to present an inequitable burden or avoidance. The writers protested against not carrying out the exact recommendations of the House Committee on Ways and Means Subcommittee on Internal Revenue Taxation and the Senate Finance Committee, which aimed to repair inconsistent and erroneous tax treatment while preserving the essential function of the statue of limitation.

[42] Texas Co. v. L.A. County ,52 Cal. 2d 55, 64; 338 P.2d 440; 1959 Cal. LEXIS

Accordingly, in *Texas Company v. Los Angeles County*[43] Traynor advised taxpayers against thinking the law is fixed and inflexible. There are cases where innovation in the law requires reconsideration of the current legal convention. The judge has to identify this critical juncture of the law and reject outdated precedents. Taxpayers have no constitutional right to prevent future changes in the law, as it is the constitutional obligation of the legislature to change the law when needed. Legislation, he thought, has to be flexible in order to withstand the changes of time and reality.[44] He viewed the role of the judge as bridging the gap between law and the realities of everyday society.

In the case of *Sutter-Yuba Inv. Co.*[45] Traynor employed "judicial creativity" to avoid an undesirable reality. Although this seemed to be a straightforward redemption of property case, it had significant consequences for the overall process of calculating the tax liability on delinquent property. In this matter, the taxpayer contended he should not have to pay taxes imposed on delinquent property for the years

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180. (Cal. 1959). Roger J. Traynor, *La Rude Vita, La Dolce Giustizia; or Hard Cases Can Make Good Law*, 29 U. Chi. L. Rev. 223, 229-230 (1962).

[43] Texas Co. v. L.A. County, 52 Cal. 2d 55, 64; 338 P.2d 440; 1959 Cal. LEXIS 180. (Cal. 1959).

[44] In the case of Von Hamm-Yong Co. v. San Francisco, 29 Cal. 2d 798; 178 P.2d 745; 1947 Cal. LEXIS 267; 171 A.L.R. 274. (Cal. 1947) Traynor realized that the answer to the case in front of him was not stated in the law, but in practice. Justice and tax policy prevailed in this case over strict application of case law. In this matter, the city of San Francisco challenged a refund of personal property taxes levied on the corporation's property. Traynor denied the city's appeal holding that movement of goods from the place of purchase to the warehouses was due to the fact that they could not have been delivered directly to the carriers under the wartime emergency regulations, and thus had to be considered a movement in interstate commerce just as it would have been had the goods been delivered directly to the common carriers and held under their control until shipped. In this case, it was clear to Traynor that the shipper had done everything possible to deliver the goods. He had never sold the goods locally and did not have the authority to divert the goods into local trade. So although under the "dry law" the corporate merchandise was subjected to property taxes, Traynor recognized that reality dictated different results and the shipper "should not be penalized because wartime emergency regulations have prevented him from following the normal practice of the business in delivering the goods directly to the common carriers that will carry them to their ultimate destination."

[45] Sutter-Yuba Inv. Co. v. Waste , 21 Cal. 2d 781; 136 P.2d 11; 1943 Cal. LEXIS 310 (Cal. 1943).

it was held by the local government. Traynor had to bridge between the "dry law" and the new reality by which local governments held delinquent property for a long period until this property was finally sold. A tax policy issue was at stake that could seriously affect the redemption process of tax delinquent property. Traynor decided to reject the taxpayer's contention, and stated that taxes for that period must be included in calculating the redemption cost. He considered the inevitable repercussions of a decision to accept the taxpayer's interpretation of the law. If the county did not require that redemption prices take into account the taxes that would have been imposed if the property not had been deeded to the state, owners would find it advantageous to allow their property to be deeded to the state with the intention of delaying redemption as long as possible to escape taxes that attended ownership. Although the right of redemption until disposal of the property serves the taxpayer's convenience, he stated, it does not enable him to escape taxes for that period while others pay their taxes conscientiously year by year.

Twenty years later another tax redemption case came to Traynor's desk.[46] This time Traynor believed that a wrong judgment might give taxpayers an incentive to loot their tax-deeded property before its seizure by the government. The defendants in this case sold timber cut from tax-deeded land. After being required to pay their taxes, they claimed the amount they paid to redeem the property included taxes on the value added to the land by the timber before it was removed. They asserted that by paying a redemption price based on the value of the land including the timber, they would in effect have paid the state for the timber. In rejecting their contention, Traynor was concerned that owners of tax-deeded property would extract its natural resources and then argue that the harvest should be excluded from the tax deed on the property. It was a substantial matter of tax policy, he claimed, to prevent tax delinquency and speculation as to whether the proceeds from the harvest made it worthwhile to redeem the land or sell it under the tax deed.[47]

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[46] People v. Lucas, 55 Cal. 2d 564; 360 P.2d 321; 11 Cal. Rptr. 745; 1961 Cal. LEXIS 237 (Cal. 1961).

[47] **"**To permit defendants to retain the proceeds from the sale of the timber would be to condone a brazen trespass to property that section 3441 makes a crime

Acting as the ultimate professor, Traynor's opinions employed a lean, analytical style of policy analysis.[48] Like other pragmatist judges, he framed his opinions with a scientific approach, which portrayed his decisions as objective analysis of the facts and the inevitable result of public interest. Moreover, he wrote explanatory judgments providing details and examples, in the hope that his judgments would guide taxpayers, Bureau agents and fellow judges in future cases, thus preventing further litigation.

Law's Estate[49] is one example of a Traynor opinion containing details and examples of how to compute marital deductions in estate tax. In this case, the decedent's will provided that his estate tax should be paid out of the residuary estate. The controller subtracted all the allowable deductions including federal estate tax from the fair market value of the estate. Then the controller declared half of the remainder of the estate as marital deduction. The executor of the will objected to this calculation, arguing that the marital deduction should have been subtracted from the fair market value of the estate *prior* to the deduction of the federal estate tax. Traynor affirmed the controller's computation, holding that the marital deduction was properly determined. He detailed the way to compute the marital deduction by first subtracting federal estate taxes to ascertain the clear market value of the estate. Only then and from that clear market value, Traynor stated, should the marital deduction be determined. This decision appeared to be more a "class exercise" than a traditional judicial opinion and involved a deep understanding of accounting. It was important to Traynor to explain and demonstrate his calculations so it would be

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and would encourage the stripping of timber and the removal of minerals from tax-deeded lands. It would also encourage tax delinquency, for it would permit the former owner to speculate as to whether the proceeds from the property would be sufficient to justify his redeeming it and would permit him to collect such proceeds until the state took steps to compel an accounting and payment and then defeat the rights of the state by redeeming the property before judgment could be obtained. As the Maxfield case makes clear, the statutes are plainly drawn to preclude such maneuvers." *Id.* at 571.

[48] Ben Field, Activism in Pursuit of Public Interest: The Jurisprudence of Chief Justice Roger j. Traynor, 126 (2003).

[49] Estate of Law v. Kirkwood, 50 Cal. 2d 345; 325 P.2d 449; 1958 Cal. LEXIS 161 (Cal. 1958).

clear for future estate executors how to administer the convoluted law. Similar to a textbook solution, Traynor constructed a table comparing the controller's computation to the executor's computation, followed by a detailed explanation of their differences, supported by relevant sections of the Revenue Code.

Another example of Traynor's academic opinions came a few years later, in the dissent opinion of *Rosemary Properties v. McColgan*.[50] At issue was the matter of deductibility of dividends received by a corporation under section 8(h) of the Bank and Corporation Franchise Tax Act. The majority opinion in this case agreed with the plaintiff, holding that any dividend paid from earnings and profits would be a dividend paid out of income included in the measure of the tax and, as such, the dividend was exempt from franchise tax in the hands of the recipient corporation.

In a long and detailed dissenting opinion, Traynor traced the legislative purpose of the dividend allowance as designed solely to prevent double taxation of corporate income by the state, and limited only to dividends declared out of taxable income. In this opinion, Traynor incorporated an illustration of the differences between "income" and "earning and profits"; the latter included a deduction of federal taxes. Next, Traynor provided a mathematical example to demonstrate the differences between net income and earning and profits. His opinion detailed the majority's mistake of allowing the plaintiff to declare a dividend out of "earning and profits" in excess of the "net income" although no tax was paid on this excess.

Having advised on and crafted the Bank and Corporation Franchise Tax Act, Traynor had a thorough and detailed understanding of this legislation. During his academic career, he wrote several articles on the constitutional basis of this act.[51] While referring to its legislative intent, Traynor held that the plaintiff's interpretation of section 8(h) was not only "administratively unworkable, but is inconsistent with

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[50] Rosemary Properties v. McColgan, 29 Cal. 2d 677; 177 P.2d 757 (Cal. 1947).

[51] Roger J. Traynor, *National Bank Taxation in California,* 17 Calif. L. Rev. 83-119, 232-57, 456-528 (1929); Roger J. Traynor & Frank M. Keesling, *Recent Changes in The Bank and Corporation Franchise Tax Act,* 21 Calif. L. Rev. 543; 22 Calif. L. Rev. 499 (1933).

the basic structure of the act."[52] He protested against the majority's acceptance of the taxpayer's contention, citing error after error, which in fact, changed the provisions of the act so as to be radically different from what the Legislature had sought to adopt.[53] Finally, Traynor criticized the complexity and lack of unity of the Bank and Corporation Franchise Tax Act as mystifying taxpayers, judges, and tax officials, resulting in wrongful judicial interpretation and administrative application.[54] Traynor's opinion was later affirmed by the Supreme Court of California.[55]

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[52] "Rules of statutory construction are at best only aids in ascertaining the legislative purpose. One of those aids has here been seized upon, in disregard of the plain signposts within the statute and the basic concepts underlying it, to establish administratively unworkable conditions, accord unequal treatment to dividends, and open the way to a more extensive deduction than necessary to achieve the legislative purpose of avoiding double taxation." Rosemary Properties v. McColgan, 29 Cal. 2d 677, 706; 177 P.2d 757 (Cal. 1947).

[53] "How can the Legislature state in plainer terms that "net income" is the measure of the tax? ... In light of this language how can it be seriously contended that the measure of the tax is "gross income subject to taxation by the state?" "The opinion in the Green case, however, contains so many errors fundamentally at variance with many provisions of the act that the Legislature cannot reasonably be presumed to have adopted the construction of the act in that case." *Id*. at 772. This opinion was affirmed by Robertson v. Health Net of California, Inc., 132 Cal. App. 4th 1419, 1427, 34 Cal. Rptr. 3d 547 (Cal. App. 2005) and County of Orange v. Flournoy, 42 Cal. App. 3d 908, 912, 117 Cal. Rptr. 224 (Cal. App. 1974).

[54] "A comprehensive tax statute such as the Bank and Corporation Franchise Tax Act exemplifies intricate draftsmanship; it evolves out of the painstaking deliberations and studies not only of public officials but of others interested in tax legislation. Such a statute, wrought from a consideration of many conflicting interests, cannot long retain unity and coherence if one section or another is refabricated by the courts without regard for the structural whole. The technical concepts of the statute, its express provisions, should not lightly be vitiated by facile phrases such as "gone through the tax mill" or "flailed by the taxmaster" that denote a lack of insight into the legislative purpose that binds together the provisions of the statute. If the express words of the statute are overridden by such phrases neither taxpayers nor tax officials can look to the written word of the statute for its authentic meaning, and the already difficult task of understanding the revenue acts becomes hopeless." Rosemary Properties v. McColgan, 29 Cal. 2d 677, 700; 177 P.2d 757 (Cal. 1947).

[55] Safeway Stores, Inc. v. Franchise Tax Board, 3 Cal. 3d 745, 91 Cal. Rptr. 616, 478 P.2d 48 (Cal. 1970); Security-First Nat'l Bank v. Franchise Tax Board, 55 Cal. 2d 407, 11 Cal. Rptr. 289, 359 P.2d 625 (Cal. 1961).

In an effort to prevent tax litigation ex post and advance administrative settlement of tax controversies, Traynor established a judicial rule by which taxpayers should avail themselves of full information and properly communicate with the tax administration; otherwise they cannot receive remedies from the court. While sitting in the case of *West Pub. Co. v. McColgan,*[56] he established a requirement that taxpayers provide the Bureau with the necessary information prior to filing a lawsuit with the court.

In this case, the taxpayer was a Minnesota corporation engaged in the business of selling law books and other publications. The corporation shipped its books to California from orders taken in California by its employees. However, it refused to file returns under the California Income Tax Act or to furnish any information requested by the commissioner, claiming that the tax levied under the Bank and Corporation Income Tax Act was unconstitutional since California could not impose a tax on a foreign corporation engaged in interstate commerce. Without the information, the commissioner had no choice but to acquire data from the State Board of Equalization and to estimate the company's income. Traynor rejected the corporation's claims and held that it cannot call upon the court's help to determine whether agencies acted properly when it refuses to submit issues of fact to such agencies. He concluded that a tax on the net income from interstate commerce did not violate the commerce clause of the Constitution, but more importantly, that taxpayers could not complain of errors in the computation of their tax liability if they refuse to avail themselves of administrative remedies to prevent or correct such errors.

In the case of *Star-Kist Foods v. Quinn,*[57] Traynor continued to implement this idea establishing a rule by which taxpayers could not receive remedies from the court unless they had exhausted their remedies with the tax administration. The issue in this case was erroneous assessments. Although the taxpayer had the option of applying to the Board of Equalization for the correction of his return, he instead filed a claim in court seeking a writ of mandate against the tax assessor to

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[56] West Pub. Co. v. McColgan, 27 Cal. 2d 705; 166 P.2d 861; 1946 Cal. LEXIS 348 (Cal. 1946).

[57] Star-Kist Foods v. Quinn, 54 Cal. 2d 507; 354 P.2d 1; 6Cal. Rptr. 545 (Cal. 1960).

cancel the assessments. Traynor was familiar with this issue as he had written extensively on the problem of taxpayer's choice according to the affordability of the dispute resolution mechanism. He claimed that taxpayers often chose the less-expensive option of filing a court claim before exhausting other appellate mechanisms and thus overloading the court system with unnecessary litigation. Reversing the trial court judgment, Traynor held that as a matter of law the taxpayer was not required to file with the Board of Equalization before it sought a judicial determination. However, as a matter of tax policy, the taxpayer had a plain, speedy, and adequate remedy in the ordinary course of law by paying the tax under protest and seeking recovery thereof.[58]

B. Today's Implementation of Preventive Tax Measures

Although the idea of creating a single tax tribunal was suggested earlier, only by the late 1930s had the idea gained momentum, primarily due to Traynor and Surrey's proposal.[59] Their proposal differed in the administrative and judicial authority this court would hold. However, Traynor and Surrey's proposal for a single Court of Tax Appeals was not executed because of objections by members of Congress who did not want to grant life tenure and judicial power to the Board members. Many articles have been written on the need for final judicial authority in tax matters,[60] but the idea has continuously been rejected

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[58] "Star-Kist, however, could have obtained relief by paying its taxes under protest and suing for recovery thereof …Mandate is ordinarily denied when the petitioner has a plain, speedy, and adequate remedy in the ordinary course of law…. In more recent cases, however, the adequacy of such remedies has been considered and mandate has been denied.… The fact that Star-Kist filed its petition for mandate before the assessment was complete, however, does not affect the adequacy of its remedy by payment of taxes under protest and suit for recovery thereof." *Id*. at 511.

[59] Justice Robert H. Jackson also recommended the establishment of a centralized tax tribunal as a final appellate tax review, stressing its retrospective character as interpreting tax cases in light of tax changes over the years. He suggested that the members of the congressional committee would sit on this court, with a notion of harmonious interpretation on the tax court. Kirk Stark, *The Unfulfilled Tax Legacy of Justice Robert H. Jackson,* 54 Tax L. Rev. 171, 188 (2001).

[60] Stanley S. Surrey, *Some Suggested Topics in the Field of Tax Administration*, 25 WASH. U.L.Q. 399, (1940); Erwin N. Griswold, *The Need for a Court of Tax Appeals*, 57 Harv. L. Rev. 1153 (1944); Caplin & Brown, *A New U.S. Court of*

by the legislative branch.[61]

A few years later, the Revenue Act of 1942 changed the name of the Board to the Tax Court of the United States. Although it seems this was only a cosmetic change, in fact, the act elevated the status of the Board to a judicial body and its members to judges. Two decades later, the Tax Reform Act of 1969 removed the court's description as an agency within the executive branch and elevated its status to a court under Article I of the Constitution, as suggested by Traynor and Surrey. This act also created a category of small tax cases, which were decided by special trial judges, and removed the burden of small tax matters from the Tax Court.

Yet, today's Tax Court appellate review has not changed, and it is still in the hands of the various Circuit Courts. Throughout the years, the principle by which appeals from the District Courts are confined to "clearly erroneous" cases was also applied to appeals from the Tax Court, thus limiting appellate review to unusual matters.[62] However, there is still no requirement for prepayment of tax liability of any bond in order to file with the Tax Court. For those reasons and more, Traynor and Surrey's proposals still have merit today. Their goals of lowering the incentive to litigate tax matters, standardizing tax decisions and minimizing the current tax uncertainties remain relevant.

One of Traynor and Surrey's successes was enacting a binding taxpayer-government agreement. For years, the Bureau of Internal Revenue refused to apply the idea of a "closing agreement" to future transactions. Its caution originated in the notion that the determination of a commissioner in one case cannot bind his successor or other taxpayers outside the agreement. Traynor and Surrey used their influence in the Treasury and incorporated this mechanism of taxpayer-government agreement in the Revenue Act of 1938.[63] They also added

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Tax Appeals: S. 678, 57 TAXES 360 (1979); Martin D. Ginsberg, *Making Tax Law Through Judicial Process*, 70 A.B.A. J. 74 (1984). For historical overview of this idea *see* Todd H. Miller, *A Court of Tax Appeals Revisited*, 85 YALE L.J. 228 (1975).

[61] The proposal for federal judicial reform in 1997 rejected the idea of a separate court of tax appeals and suggested it be centralized in the federal circuit system. Commission on Structural Alternatives for the Federal Courts of Appeals, Final Report 73 (Dec. 18, 1998). PL 105-119, 1997 HR 2267.

[62] Id. at 4 (1998).

[63] Revenue Act of 1938, Pub. L. No. 75-544, § 801, 52 Stat. 447, 573 (amending

a requirement that taxpayers show a bona fide motive in seeking the ruling. This measure was necessary to prevent the Bureau from becoming a huge information authority abused by tax avoiders. The idea of a private letter ruling as we know it today originated in Traynor and Surrey's concept of a "closing agreement" designed to apply to future transactions. Its extensive use today as a preventive mechanism for tax disputes is no doubt by virtue of Traynor and Surrey's project.

Today's most challenging problem in international taxation is addressing the implications of Cross-Border Tax Arbitrage, such as transfer pricing transactions. The use of these types of transactions as a form of tax avoidance and income allocation among different taxing jurisdictions became widespread with the development of multinational organizations. "Transfer pricing transactions" refers to the pricing of goods and services between a parent company and its foreign subsidiary, or between various divisions of a multinational corporation. Given that the parties in this transaction are clearly related, this mechanism is used to affect the profits of different divisions in the company, along with the company's overall tax liability.

In conjunction with traditional mechanisms for confronting this phenomenon, such as enacting laws and regulations, the U.S. government, followed by other governments around the world, developed Advance Pricing Agreements (APA's) to prevent future tax litigation over international transactions.[64] An APA is an agreement between the taxpayer and the government relating to a future transaction, by which the parties agree upon the price and time period of a specific transaction. This mechanism prevents future litigation and guarantees that the taxpayer is acting in good faith. Today we witness bilateral and multilateral APAs that involve taxing authorities in other countries relevant to the transaction, and protect the taxpayer from double taxation and assessment procedures.

Revenue Act of 1928, Pub. L. No. 70-562, § 606, 45 Stat. 791, 874). The reform added that a closing agreement may be related not only to a past tax year already closed, but also to a present tax year not yet terminated, or to a future tax year not yet commenced.

[64] For more on the emergence of APAs, see Diane M. Ring, *On the Frontier of Procedural Innovation: Advance Pricing Agreements and the Struggle to Allocate Income for Cross Border Taxation, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=235275*

This procedural innovation is preventive tax policy *per se,* which had originated in the 1940s with Traynor's and Surrey's clever idea of using a closing agreement for future transactions. It demonstrates that preventive tax policy can serve as a model for reducing litigation and preventing controversies in other areas of the law and, most especially, how 1940s public policy continues to shed light on future developments in the legal system.

Traynor and Surrey's innovative idea of preventive tax policy is especially timely today as the government is struggling to improve the effectiveness, integrity and fairness of our tax laws. Various proposals have been drafted suggesting the transformation to a tax system based on a consumption tax. Some of those proposals have suggested enacting a value-added tax, a national sales tax, or a broad individual and business postpaid consumption tax.[65] Those proposals may revive the need to reconsider changing the Tax Court's status to a National Court of Tax Appeals, simplifying the tax code and unifying deficiency and refund litigation, as Traynor and Surrey proposed nearly 70 years ago.

IV. CONCLUSION

> There is something basically wrong in a procedure which enables so many cases to travel the long, expensive and futile route up to the threshold of a judicial settlement only to retrace their steps at that point to an administrative settlement or to be abandoned altogether by the taxpayer or the government.
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> —Roger J. Traynor and Stanley S. Surrey[66]

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[65] For consumption tax proposals see Robert E. Hall & Alvin Rabushka, The Flat Tax (1995); David Bradford, Untangling the Income Tax (1986); The Armey-Shelby Flat Tax, H.R. 2060 and S.1050; Laurence S. Seidman, USA Tax, A Progressive Consumption Tax (1997); S. 722 The Nunn-Domenici USA Tax; Simple, Fair & Pro-Growth: Proposals to Fix America's Tax System, President's Advisory Panel on Federal Tax Reform, 21-22 (Nov. 2005).

[66] Roger J. Traynor & Stanley S. Surrey, *New Roads Toward the Settlement of Federal Income, Estate, and Gift Tax Controversies,* 7 Law & Contemp. Probs. 336, 339 (1940).

Between World War I and World War II, the United States tax system underwent a dramatic change with the evolution of the individual income tax. In about 20 years, the income tax was transformed from a novel measure that generated very little revenue into a major source of income for the federal government. One of the consequences of that development was that the tax code became very complex. Public discontent with the system grew and tax litigation increased, along with tax evasion.

Some can predict the consequences of changes in present legal treatment by deriving the resolution of old problems from current studies. Very few can foresee entirely new problems and predict the effect alternative reform proposals will have on a different set of circumstances.[67] The transformation of the tax system from "class tax" to "mass tax" marked the end of the "innocent" era and the evolution of tax avoidance, followed by complicated tax legislation. It reflected the genesis of sophisticated tax avoidance schemes commonly endorsed today by accounting firms and tax lawyers.

In 1938 and 1939, two relatively unknown tax administrators came together to propose a major overhaul of the tax system. One was Roger Traynor, who would go on to be recognized as one of the most accomplished and brilliant state judges in U.S. history.[68] The other was Stanley Surrey, who later would be called the greatest tax scholar of his generation.[69] Traynor and Surrey were among those who not only identified the shift in public dislike of the convoluted tax system, but also predicted the proper way to halt the progression of this development.

Traynor and Surrey's preventive tax policy sought to prevent disputes from arising by decreasing the friction between taxpayers and

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[67] On the ability to predict legal changes see: Robert Charles Clark, *The Morphogenesis of Subchapter C: An Essay in Statutory Evolution and Reform*, 87 Yale L. J. 90 (1978).

[68] American legal historian Harry N. Scheiber wrote of him, "[i]n any list of the most admired and influential state judges in the nation's history, Traynor stands at the very top level." Ben Field, Activism in Pursuit of the Public Interest: The Jurisprudence of Chief Justice Roger j. Traynor, ix-xi (2003).

[69] Erwin N. Griswold, *In Memoriam: Stanley S. Surrey*, 98 Harv. L. Rev. 329, 331 (1984).

the government.[70] Creating a coherent and simple tax code enables taxpayers to comprehend the correct tax treatment. Obtaining full and accurate information from the taxpayer in a protest letter is the next step for the executive branch to dispose of cases that otherwise would block the system. Then the judiciary could focus on legal, rather than factual, questions, ensuring taxpayers fair and fast application of the law to their case. By implementing their proposals one might hope to "return to innocence" and reduce the uncertainties that surround tax matters, while restoring the trust between taxpayers and the government.

Throughout their careers, Traynor and Surrey continued to promote their philosophy of preventive tax policy. As professors, consultants, and state supreme court judges, they no doubt influenced the tax system.[71] Traynor's administrative experience established his reputation as a tax expert and an architect of California's tax system. His insights on tax policy and his experience from both the academic and the government side echoed through his tax opinions.[72] His reputation allowed him to continue and advance his philosophy of preventive tax policy from his prestigious stage.[73] In 1970, Traynor retired from the Supreme Court and returned to Berkeley, where he taught and wrote dozens of articles until his death in 1983. Although he is mostly known

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[70] Id. *supra* note 7 at 344..

[71] On Sept. 9, 1952, while continuing to suggest improvement of the tax administration, Surrey published a paper supporting the separation of the Bureau of Internal Revenue from the Treasury Department, placing it in the executive branch of the government. The paper was delivered in the 1952 meeting of the National Tax Association, in Toronto, Canada. Stanley S. Surrey, *A Comment on the Proposal to Separate The Bureau of Internal Revenue From the Treasury Department*, 8 Tax L. Rev. 155 (1953).

[72] Don Barrett, Traynor's clerk and friend, called the period from 1945 to 1956 the "Long Court" for its long and unchanged composition. During this period Traynor became a "leading state court judge in the nation" who set a high literary standard for judicial writing. Donald P. Barrett, *The Supreme Court of California, 1981-1982 In Memoriam- Roger John Traynor: Master of Judicial Wisdom*, 71 Calif. L. Rev. 1060 (1983).

[73] Traynor wrote 892 opinions and 75 law review articles. Ben Field, Activism in Pursuit of the Public Interest: The Jurisprudence of Chief Justice Roger j. Traynor, 121 (2003). In the field of taxation, Traynor wrote about 25 majority opinions and over 20 dissenting opinions. For a list of Traynor's tax decisions *see* Kragen, at 813. On the judicial philosophy of Traynor *see* John W. Poulos, *The Judicial Philosophy of Roger Traynor,* 46 Hastings L.J. 1643 (1995).

for his non-tax adjudication, his legacy of preventive tax policy continues to contribute to today's tax debate.