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TAXATION: THE SEVENTH CIRCUIT'S SEARCH FOR ECONOMIC REALITY

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During the period from September 15, 1977 through June 1, 1978, the United States Court of Appeals for the Seventh Circuit decided eleven cases under the Internal Revenue Code of 1954, as amended. Seven of these decisions involved income tax questions, one involved an estate tax question, and three involved questions of tax procedure.

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1. The period hereinafter referred to as the last term runs from September 15, 1977 through June 1, 1978.

2. See Joint School Dist. No. 1 v. United States, 577 F.2d 1089 (7th Cir. 1978), rev'd 422 F. Supp. 576 (E.D. Wis. 1976); Wagner v. United States, 573 F.2d 447 (7th Cir. 1978), aff'd No. 74 C 565 (S.D. Ind. Jan. 3, 1977); Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (7th Cir. 1978), aff'd 66 T.C. 1068 (1976); Asher v. United States, 570 F.2d 682 (7th Cir. 1978), aff'd 436 F. Supp. 22 (N.D. Ill. 1976); Armantrout v. Commissioner, 570 F.2d 210 (7th Cir. 1978), aff'd per curiam 67 T.C. 996 (1977); Lewin v. Commissioner, 569 F.2d 444 (7th Cir. 1978), aff'd per curiam 43 T.C.M. (P-H) 76,355 (1976), cert. denied, 98 S. Ct. 3090 (1978); Consolidated Foods Corp. v. United States, 569 F.2d 436 (7th Cir. 1978), aff'd No. 75 C 1447 (N.D. Ill. Nov. 9, 1976); Canal-Randolph Corp. v. United States, 568 F.2d 28 (7th Cir. 1977), aff'd per curiam No. 73 C 702 (N.D. Ill. Dec. 23, 1976); Belt Ry. v. United States, 567 F.2d 717 (7th Cir. 1977), aff'd in part and rev'd in part No. 74 C 1336 (N.D. Ill. Dec. 26, 1975); Estate of Smith v. Commissioner, 565 F.2d 455 (7th Cir. 1977), aff'd per curiam 66 T.C. 415 (1976); Thor Power Tool Co. v. Commissioner, 563 F.2d 861 (7th Cir. 1977), aff'd 64 T.C. 154 (1975), cert. granted, 435 U.S. 914 (1978). Two other cases which dealt tangentially with tax issues were decided by the Seventh Circuit during the last term, but will not be discussed herein. Those cases are Sacks Bros. Loan Co. v. Cunningham, 578 F.2d 172 (7th Cir. 1977), aff'd per curiam in part and rev'd in part No. 77 C 140 (N.D. Ind. May 13, 1977) (state of Indiana personal property tax question) and Ryan v. Commissioner, 568 F.2d 531 (7th Cir. 1977), aff'd 67 T.C. 212 (1976) (tax evidence and contempt of court questions).

3. The Internal Revenue Code will hereinafter be referred to in the text as the Code.

4. See Joint School Dist. No. 1 v. United States, 577 F.2d 1089 (7th Cir. 1978); Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (7th Cir. 1978); Armantrout v. Commissioner, 570 F.2d 210 (7th Cir. 1978); Consolidated Foods Corp. v. United States, 569 F.2d 436 (7th Cir. 1978); Canal-Randolph Corp. v. United States, 568 F.2d 28 (7th Cir. 1977); Belt Ry. v. United States, 567 F.2d 717 (7th Cir. 1977). Belt Ry. will not be discussed since the case dealt with a technical issue under Code section 281, concerning the taxation of terminal railroads, and has limited application to taxpayers generally.

5. See Estate of Smith v. Commissioner, 565 F.2d 455 (7th Cir. 1977).

6. See Wagner v. United States, 573 F.2d 447 (7th Cir. 1978); Asher v. United States, 570 F.2d 682 (7th Cir. 1978); Lewin v. Commissioner, 569 F.2d 444 (7th Cir. 1978). Wagner dealt with the propriety of a seizure of a trust fund by the Commissioner in satisfaction of a federal tax lien, and Asher dealt with the priority of a federal tax lien. These cases primarily involved questions of state law and will not be discussed or included in the analysis.

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Six of the cases arose from appeals of decisions by federal district courts7 and five of the cases arose from appeals of decisions by the Tax Court.8 Eight of the eleven appeals were made by the taxpayer from adverse lower court decisions.9 With one exception,10 all lower court tax decisions were affirmed by the Seventh Circuit. Seven of the eleven Seventh Circuit tax cases were decided in favor of the Commissioner.11 During the same period a Seventh Circuit tax decision was reversed by the United States Supreme Court.12

The number of affirmations of lower court tax decisions by the Seventh Circuit may well indicate the keen perception of tax issues and the sound judgment reflected by the federal district courts and the Tax Court.13 The Seventh Circuit decisions during the last term also may reflect an emerging tax philosophy of the court. Although this philosophy may not yet be cohesively developed or fully articulated, most of the Seventh Circuit cases during the last term stress an analysis of the

7. See Joint School Dist. No. 1 v. United States, 577 F.2d 1089 (7th Cir. 1978); Wagner v. United States, 573 F.2d 447 (7th Cir. 1978); Asher v. United States, 570 F.2d 682 (7th Cir. 1978); Consolidated Foods Corp. v. United States, 569 F.2d 436 (7th Cir. 1978); Canal-Randolph Corp. v. United States, 568 F.2d 28 (7th Cir. 1977); Belt Ry. v. United States, 567 F.2d 717 (7th Cir. 1977).

8. See Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (7th Cir. 1978); Armantrout v. Commissioner, 570 F.2d 210 (7th Cir. 1978); Lewin v. Commissioner, 569 F.2d 444 (7th Cir. 1978); Estate of Smith v. Commissioner, 565 F.2d 455 (7th Cir. 1977); Thor Power Tool Co. v. Commissioner, 563 F.2d 861 (7th Cir. 1977).

9. See Joint School Dist. No. 1 v. United States, 577 F.2d 1089 (7th Cir. 1978); Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (7th Cir. 1978); Armantrout v. Commissioner, 570 F.2d 210 (7th Cir. 1978); Lewin v. Commissioner, 569 F.2d 444 (7th Cir. 1978); Consolidated Foods Corp. v. United States, 569 F.2d 436 (7th Cir. 1978); Canal-Randolph Corp. v. United States, 568 F.2d 28 (7th Cir. 1977); Belt Ry. v. United States, 567 F.2d 717 (7th Cir. 1977) (both the taxpayer and the Commissioner appealed the district court's decision); Thor Power Tool Co. v. Commissioner, 563 F.2d 861 (7th Cir. 1977).

10. See Joint School Dist. No. 1 v. United States, 577 F.2d 1089 (7th Cir. 1978). In addition, in Belt Ry. v. United States, 567 F.2d 717 (7th Cir. 1977) the Seventh Circuit reversed the district court on a procedural issue.

11. See Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (7th Cir. 1978); Armantrout v. Commissioner, 570 F.2d 210 (7th Cir. 1978); Lewin v. Commissioner, 569 F.2d 444 (7th Cir. 1978); Consolidated Foods Corp. v. United States, 569 F.2d 436 (7th Cir. 1978); Canal-Randolph Corp. v. United States, 568 F.2d 28 (7th Cir. 1977); Belt Ry. v. United States, 567 F.2d 717 (7th Cir. 1977); Thor Power Tool Co. v. Commissioner, 563 F.2d 861 (7th Cir. 1977). In addition, two of the remaining four tax decisions involved issues of tax procedure for which the Seventh Circuit's determination depended on the appropriate interpretation of state law. See Wagner v. United States, 573 F.2d 447 (7th Cir. 1978); Asher v. United States, 570 F.2d 682 (7th Cir. 1978).

[The Commissioner of Internal Revenue hereinafter will be referred to as the Commissioner.]


13. The authors do not intend to imply that they have developed empirical conclusions from any statistical analysis of the Tax Court, district court and Seventh Circuit decisions. Although the authors believe that the methodologies of the social sciences, including statistical analysis, can well be applied more frequently and exactly to the study of law, the authors do not believe that a sufficient statistical sampling exists, or that appropriate scientific techniques have been applied, to reach any scientific conclusions in this article.
economic substance of the underlying transactions, rather than the form of the transactions or the specific technical rules under the Code. Unless confronted with clearly applicable statutory standards or controlling precedent to the contrary, the Seventh Circuit applied this developing philosophy not only in the decisions rendered in favor of the Commissioner, but also in those decided in favor of the taxpayer.

WITHHOLDING OF TAX ON MEAL ALLOWANCES

On February 28, 1978 the United States Supreme Court reversed a prior decision of the United States Court of Appeals for the Seventh Circuit in *Central Illinois Public Service Co. v. United States.* The issue presented was whether employers are required to withhold taxes on employee meal allowances.

In 1963, the tax year in question, the Central Illinois Public Service Co. maintained a policy of providing its employees with a meal allowance when the employee was required to travel on company business. An employee was entitled to the allowance regardless whether he actually expended the money. The criteria for receiving the allowance were that the employee was traveling on company business (even if not overnight) and was unable to go home for lunch. An employee meeting these criteria need not have rendered any service to the company during his lunch period to qualify for the allowance. The company considered the payment mutually beneficial, since it created improved working conditions and bolstered company morale.

The only issue before the district court, the appellate court and the Supreme Court was whether the company should have been withholding taxes on the meal allowances. The Commissioner urged the courts to find that the payments constituted "wages" within the meaning of Code section 3401(a), which in relevant part defines "wages" as "all remuneration. . . . for services performed by an employee for his employer . . . ."

The district court held that the meal allowances did not constitute "wages" for purposes of the withholding statute. The court primarily relied on the decision of the Court of Appeals for the Fourth Circuit in *Royster Co. v. United States,* which held in part that salesmen’s meal allowances were not remuneration for services performed. The district

15. The issue before all three courts was not whether the lunch allowances constituted income, but rather whether they constituted wages requiring withholding. The concept of “income” is broader than the concept of “wages.” See 435 U.S. at 24.
court in *Central Illinois* held that since the employees were not rendering services to the company during the lunch hour, a necessary precondition to consider meal allowances as "wages" under Code section 3401(a) was not present. The district court believed that to consider such payments as "wages" would require "a departure from the realities of business life." 17

In reversing the district court, the Seventh Circuit began its opinion with the premise that such allowances constituted taxable income to the employees. 18 The Seventh Circuit considered the broad definition of remuneration for employee services which had been set forth by the Supreme Court, 19 concluding that such remuneration must be viewed in the context of "not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer."

Armed with the premise that the payments constituted taxable income and the broad definition of remuneration arrangements, the Seventh Circuit found that remuneration for employee services should not be viewed restrictively. 20 Accordingly, the Seventh Circuit concluded that the meal allowances in *Central Illinois* constituted remuneration for services and thus were "wages" for which the employer should have withheld taxes.

This decision of the Seventh Circuit reflects a probing and broad analysis of the relevant Code section, but reaches a conclusion that to some extent may have disregarded narrow technicalities. As a matter of substance, if not form, the meal allowances were part of the "total package of remuneration" paid by the employer to the employee. The economic substance of the meal allowances coupled with an otherwise

17. 405 F. Supp. at 749.
18. 540 F.2d at 301. While this premise is now a correct interpretation of the law, the law had not been settled at the time the Seventh Circuit rendered its decision in *Central Illinois*. See 435 U.S. at 24 (citing Commissioner v. Kowalski, 434 U.S. 77 (1977)). See also Kovey, *Impact of Supreme Court Decision Limiting Withholding on Employees' Meal Allowances*, 48 J. Tax. 276, 277-278 (1978).
19. *See* Commissioner v. LoBue, 351 U.S. 243 (1956); Social Security Bd. v. Nierotko, 327 U.S. 358 (1946); Educational Fund of the Elec. Indus. v. United States, 426 F.2d 1053 (2d Cir. 1970). These three cases concluded, *inter alia* and with respect to various fact situations, that the term "wages" generally must be defined to include all remuneration for employment, including the cash value of remuneration paid in a medium other than cash.
21. 540 F.2d at 302. *See* H.R. REP. No. 615, 74th Cong., 1st Sess. 32 (1939) and S. REP. No. 628, 74th Cong., 1st Sess. 49 (1939). The Seventh Circuit also reviewed the legislative history behind Code section 3121 which defines "wages" for purposes of the social security tax system. This definition of "wages" was held by the Fourth Circuit to have essentially the same meaning as the term "wages" for purposes of the withholding of income tax provisions of the Code. Royster Co. v. United States, 479 F.2d 387, 390 (4th Cir. 1973). Although the Seventh Circuit considered Royster as precedent for certain of its premises in *Central Illinois*, the court did not adopt Royster's conclusion.
apparently illogical distinction between "income received from an employer" and "wages," led the Seventh Circuit to the logical, albeit non-technical, conclusion that the meal reimbursements did constitute "wages" subject to withholding.

Nevertheless, the Supreme Court rejected the reasoning of the Seventh Circuit and determined that the payments were not "wages" subject to the withholding of income tax. Mr. Justice Blackmun, writing the majority opinion for the Supreme Court in Central Illinois, primarily analyzed the Commissioner's argument which attempted to impose a withholding obligation on the employer by virtue of the income tax result to the employee. The Court rejected this reasoning and stated:

The case of course would flow in the Government's favor if the mere fact that the reimbursements made in the context of the employer-employee relationship were to govern the withholding tax result. That they were so paid is obvious. But it is one thing to say that the reimbursements constitute income to the employees for income tax purposes, and it is quite another thing to say that it follows therefrom that the reimbursements in 1963 were subject to withholding. There is a gap between the premise and the conclusion and it is a wide one. Considerations that support subjectability to the income tax are not necessarily the same as the considerations that support withholding. To require the employee to carry the risk of his own tax liability is not the same as to require the employer to carry the risk of the tax liability of its employee. Requiring withholding, therefore, is rightly much narrower than subjectability to income taxation.

While the Seventh Circuit may have felt that there was no economic reality to a distinction between "income" paid to employees and "wages" paid to employees, the Supreme Court found distinct differences between the two concepts. The Supreme Court viewed the withholding tax procedure as one established for simplicity and ease of administration, thus susceptible to objective standards. Even conceding such a distinction from the income tax, the Supreme Court decision

23. No Justice specifically joined the majority opinion. However, Mr. Justice Brennan wrote a concurring opinion with whom Mr. Chief Justice Burger and Mr. Justice Powell joined. Mr. Justice Powell, with whom Mr. Chief Justice Burger joined, wrote another concurring opinion. Mr. Justice Stewart concurred only in the judgment.
24. The Commissioner argued that the definition of "wages" in Code section 3401(a) corresponded to the first category of "gross income" set forth in Code section 61(a)(1), and that the two statutes had "equivalent scope." 435 U.S. at 28. The Commissioner further argued that the meal allowance in question was compensatory because there was a direct causal relationship between the receipt of the allowance and the performance of services by the employee, such that there was no difference between the meal allowance and traditional wage or salary payments. In rejecting the Commissioner's contentions, Mr. Justice Blackmun termed the Commissioner's conclusion as "facile." Id. at 29.
25. Id.
may be vulnerable with regard to why meal allowances themselves cannot be considered "wages." At least theoretically, meal allowances could be subject to objective standards giving rise to ease of administration.26

Undoubtedly, the Supreme Court decision in Central Illinois presented a more narrow and technical reading of the underlying statute than the reading adopted by the Seventh Circuit in its opinion. While both courts examined the policy rationales behind the statute, the broader economic considerations may have provided, at least implicitly, the underpinnings for the tax decision of the Seventh Circuit which was reversed during the last term.

WITHHOLDING OF TAX ON RETIREMENT CONTRIBUTIONS

The United States Court of Appeals for the Seventh Circuit was guided by the reversal of Central Illinois in its decision on May 19, 1978 in Joint School District No. 1 v. United States.27 The specific issue in Joint School District No. 1 has limited applicability to individual taxpayers, since it involved mandatory contributions to the Wisconsin State Teachers Retirement System. The decision illustrates that the Seventh Circuit has restricted its analysis of economic reality and has narrowed its definition of "wages" in light of the Supreme Court's holding in Central Illinois. In Joint School District No. 1, the Seventh Circuit determined that contributions to a retirement fund made by an employer in lieu of the employees' statutorily mandated contributions did not constitute indirect wages of the employees and thus were not subject to withholding of tax by the employer under the withholding tax statute.28

The case arose from the policies of Joint School District No. 1 and facts peculiar to Wisconsin law. The Wisconsin statutes relating to

26. In conclusion, Mr. Justice Blackmun stated: "This is not to say, of course, that the Congress may not subject lunch reimbursements to withholding if in its wisdom it chooses to do so by expanding the definition of wages for withholding. It has not done so as yet. And we cannot justify the Government's attempt to do so by judicial determination." Id. at 33. That the foregoing may be the real rationale for the Supreme Court's holding in Central Illinois is supported by the concurring opinions of Mr. Justice Brennan (with whom Mr. Chief Justice Burger and Mr. Justice Powell joined) and Mr. Justice Powell (with whom Mr. Chief Justice Burger joined). Both concurrences expanded upon Mr. Justice Blackmun's statement, finding that the Commissioner abused his discretion in attempting to impose a withholding tax liability retroactively on Central Illinois Public Service Co. and that fundamental fairness required either notice to taxpayers of the liability or clear Congressional authorization prior to the retroactive assessment of a tax. Id. at 33-38.

27. 577 F.2d 1089 (7th Cir. 1978), rev'g 422 F. Supp. 576 (E.D. Wis. 1976).

teacher retirement benefits required that teachers contribute six per cent of their pay to the retirement system, by way of deduction from their paychecks, and that the school district contribute four per cent. The Wisconsin Attorney General had issued an opinion stating that contributions to the retirement system by an employer in excess of its mandatory contributions, which were made pursuant to a collective bargaining agreement, could be considered as payments from the employee-teacher’s compensation. The Attorney General’s opinion also stated that the statute requiring mandatory contributions merely established that such contributions be made, regardless of whether they were made by the teacher-employee or by the school district-employer. As a result of the collective bargaining process between the school district and the employee-teachers, Joint School District No. 1 withheld 3.5 per cent of each teacher’s compensation from each paycheck and paid the remaining 2.5 per cent of each teacher’s contribution from its own funds.

In addition, Joint School District No. 1 did not report this 2.5 per cent as wages subject to withholding of tax on its employer’s quarterly federal tax return. The Commissioner disagreed with this procedure, claiming that the taxes withheld should have been increased since the direct payment into the retirement system by the school district constituted “wages” subject to withholding. The district court upheld the Commissioner’s finding and concluded that the payments were “wages” since they were made “on behalf of the employees and in satisfaction of the obligation imposed on the employees” by the Wisconsin statute.

The Seventh Circuit reversed the district court’s decision, initially noting that the Supreme Court’s decision in Central Illinois established the premise that there are differences between taxable income and wages subject to withholding. Although the Seventh Circuit did not expressly apply the reasoning of Central Illinois to this case, it perhaps tacitly used Central Illinois for the proposition that the concept of

33. See I.R.C. § 6071.
34. 422 F. Supp. at 578.
36. 577 F.2d at 1091, 1092.
“wages” must be construed narrowly within the language of the withholding statute.\(^37\) In reaching its decision in *Joint School District No. 1*, the court did not rely on or discuss any of the provisions of the Code, but found that the question was one of construction of Wisconsin law. The court found it significant that, subsequent to the tax year in issue, both the state of Wisconsin and the federal government enacted legislation\(^38\) expressly providing that the “pick-up” payments on behalf of the employees were to be treated as employer contributions\(^39\) and that the legislative history behind the federal law indicated that the changes were to “clarify present law.”\(^40\) Accordingly, the Seventh Circuit held that the “pick-up” payments were in fact employer contributions and therefore were not subject to withholding.\(^41\)

One may wish to speculate whether the result here would have been different if the Seventh Circuit had not been reversed in *Central Illinois*. In *Joint School District No. 1* the court expressly refused to examine the nature of employer contributions in terms of income to the employees\(^42\) as it had in *Central Illinois*. Furthermore, the court did not apply the broad economic analysis it utilized in *Central Illinois*. If it had, the court might have determined that the amounts paid by Joint School District No. 1 to the retirement system arose out of the employment relationship, and that the payments inured to the benefit of the school district’s employees as a consequence of their services. Although it is difficult to speculate as to what would have occurred had the Seventh Circuit not been reversed in *Central Illinois*, it seems clear that in *Joint School District No. 1* the Seventh Circuit shied away from any economic analysis and narrowly construed the definition of “wages” in determining whether the payments were subject to withholding.

**Compensation from Educational Benefit Trusts**

In *Central Illinois*, the Seventh Circuit decided in favor of economic reality notwithstanding a restrictive tax statute. In *Joint School District No. 1*, the Seventh Circuit abandoned economic reality when confronted with a restrictive tax statute and Supreme Court precedent.

\(^{37}\) I.R.C. § 3401(a).


\(^{39}\) Generally, such employer contributions are not subject to withholding of income tax. See I.R.C. § 3401(a)(12).


\(^{41}\) Id.

\(^{42}\) Id. at 1092. See text accompanying notes 12, 14-26, supra.
In *Armantrout v. Commissioner*, however, economic reality appeared more consistent with the broad precedent interpreting the tax statute involved. In this case, the Seventh Circuit on February 10, 1978 affirmed *per curiam* a Tax Court decision and determined that distributions from an "educational benefit trust plan" constituted taxable income to employees whose children received the benefit of payments under the employer's plan. The holding in this case also reflects the Seventh Circuit's search to discern the economic realities of the substance, and not merely the form, of the transactions in income tax controversies.

Hamlin, Inc., a corporation in the electronic components business, had established an educational benefit plan with Educo, Inc., a corporation which designed, implemented and administered college education benefit plans for children of corporate employees. The terms of the plan required that Hamlin make contributions to a bank as trustee. The children of Hamlin's key employees were entitled to receive sums from the trustee to defray their college education expenses, subject to various limitations and procedures. An employee without children would receive nothing directly or indirectly under the plan, including no adjustment in compensation. Three of the children of Richard T. Armantrout, a corporate executive employed by Hamlin, received educational expenses from the trustee in accordance with the plan. The Armantrouts did not report these amounts as income on their 1971, 1972, and 1973 federal income tax returns.

The Commissioner determined that the amounts distributed by the Educo Trust to Armantrout's children were scholarships which were directly related to Armantrout's employment. As such, the scholarships were a part of Armantrout's compensation and includable in his gross income. In support of this argument, the Commissioner cited Code section 61, which in relevant part defines gross income as "all income from whatever sources derived," including "compensation for services." The Commissioner further buttressed his argument by reference to Code section 83, which generally states that where property is transferred to any person other than the person for whom the services are performed, the performer of the services must pay income tax on

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43. 570 F.2d 210 (7th Cir. 1978), *aff'g per curiam* 67 T.C. 996 (1977).
45. I.R.C. § 61(a)(1).
these amounts.46

The taxpayer argued that, while amounts distributed by the Educo Trust were perhaps "generated" by his efforts as an employee of Hamlin, such amounts did not constitute gross income to him.47 According to the taxpayer, the Educo plan distributions were not beneficially received by him, he did not have the right to receive such distributions and he did not possess any "ownership" or "control" interest in the amounts.48 Without such constructive receipt or interest in the funds, the taxpayer-employee argued that according to the various "assignment of income" precedents the distributions could not constitute income to him.49

In a per curiam decision, the Seventh Circuit upheld the Commissioner's position. The opinion cited United States v. Basye50 for the principle that one who earns income may not avoid taxation through anticipatory arrangements. Then, with the force of logic but perhaps less precedent, the court concluded that the amounts paid for the education of an employee's children were compensatory in nature because the "'plan was adopted by Hamlin to relieve its most important employees from concern about the high cost of providing a college education for their children.'"51 The opinion further stated that the corporate employees had some degree of control over the manner in which they were compensated52 and that it was immaterial that the

46. I.R.C. § 83(a) (these amounts are calculated pursuant to Code section 402(b)).
47. 67 T.C. at 1002. It appears questionable, as both a matter of law and fact, whether the taxpayer had to make this concession.
48. Id.
49. Id. at 1005. See Commissioner v. First Security Bank of Utah, 405 U.S. 394 (1972) and Teschner v. Commissioner, 38 T.C. 1003 (1962). In these cases the courts held that the taxpayers who did not actually receive the income in question, and were prevented from obtaining actual receipt without action on their part, did not possess sufficient dominion and control over the income to be taxed thereon.
50. 410 U.S. 441 (1973). In Basye, the Supreme Court considered the question of whether partners could escape income taxes by having their partnership enter into an agreement which placed the partnership income out of their reach. However, query whether the holding in Basye applies to a corporate employee who is not a shareholder and who does not enter into any agreement to place either the corporate income or his own income from the corporation out of his reach.
51. 570 F.2d at 212 (quoting 67 T.C. 996, 1004 (1977)). The authors question whether "relief from concern" is too subjective to constitute an economic benefit giving rise to taxation; or, if "relief from concern" does constitute an economic benefit, whether it has an ascertainable value. However, if the Seventh Circuit actually meant to refer to a relief from the taxpayer's legal obligation of support, which would constitute an economic benefit of presumably ascertainable value, the court should not have considered this argument in reaching its decision. The Commissioner, prior to the taxpayer's appeal in Armantrout, withdrew his alternative argument that the amounts distributed by Éduco discharged the taxpayer's legal obligations to support his children. Apparently, Armantrout was not so obligated or at least the Commissioner was reluctant to raise the issue in this case.
52. 570 F.2d at 213. It appears dubious whether any of Hamlin's employees could have
payments were never received by the employees since "the first principle of income taxation [is] that income must be taxed to him who earns it."\(^{53}\)

As a matter of economic analysis, relieving employees from the burden of paying educational expenses of dependents does provide a financial benefit that only arises by virtue of the employment relationship. When considering Code section 61, which contains an extremely broad definition of income,\(^{54}\) the economic realities of \textit{Armantrout} fall squarely in line with the position asserted by the Commissioner.

It is surprising, however, that the opinion of the Seventh Circuit did not probe more deeply into the technical issues involved. The court did not extensively discuss the argument raised by the taxpayer that the assignment of income doctrine is not applicable in a situation where no amounts are received by the taxpayer nor is the right to receive or control the payment of such amounts vested in the taxpayer.\(^{55}\)

While the decision of the Seventh Circuit in this case may be technically correct, it is perhaps incomplete.

It also is interesting that the opinion of the Seventh Circuit states near its conclusion that: "To hold otherwise would foster easy tax evasion . . . ."\(^{56}\) While this standard is not a \textit{per se} criterion for deciding tax cases, it appears that the court did place some reliance on the practical effects of its holding. However, tax evasion, as distinguished from tax avoidance, generally refers to criminal, and not civil, tax issues.\(^{57}\)

individually negotiated the terms of his employment arrangement, other than by not accepting an initial offer of employment or by terminating his employment. Whether terminating one's employment by itself constitutes sufficient control over his employment arrangement, at least in other areas of federal taxation, is questionable. \textit{Cf.} Rev. Rul. 68-334, 1968-1 C.B. 403 (the right to cancel group insurance coverage by terminating employment is not an "incident of ownership" with respect to that insurance under Code section 2042). \textit{But cf.} Commissioner v. Treganowan, 183 F.2d 288 (2nd Cir.), \textit{cert. denied sub. nom.}, Estate of Strauss v. Commissioner, 340 U.S. 853 (1950) (owning a seat on the New York Stock Exchange constitutes an "incident of ownership" over the exchange's "gratuity fund" death benefit, since the owner could sell his exchange seat).

\(^{53}\) 570 F.2d at 213 (quoting \textit{Commissioner v. Culbertson}, 337 U.S. 733, 739-40 (1949)).

\(^{54}\) \textit{See text accompanying note 45, supra.}

\(^{55}\) \textit{See Commissioner v. First Security Bank of Utah}, 405 U.S. 394 (1972); \textit{Teschner v. Commissioner}, 38 T.C. 1003 (1962). The Seventh Circuit did not discuss these cases relied on by the taxpayer and thereby left their precedential value, at least in the Seventh Circuit, in some doubt; however, the Seventh Circuit in its \textit{per curiam} opinion at least tacitly accepted the Tax Court's decision. While not discussing in any detail the taxpayer's most compelling argument, the Seventh Circuit did note that it had considered numerous authorities not contained in the taxpayer's brief and found them "inapposite" to the facts at hand. 570 F.2d at 213. \textit{See also} \textit{Teschner, The First Educational Benefit Trust Case}, 56 \textit{TAXES} 255, 263 (1978), where Mr. Teschner, the taxpayer's counsel in \textit{Armantrout}, criticized the courts' decisions, claiming in part that the decisions relied on what the record did not show rather than what it did show.

\(^{56}\) 570 F.2d at 213.

The use of such broad reasoning in a technical area and within the context of civil litigation may underscore the Seventh Circuit's non-technical approach to tax cases when the court attempts to discern economic reality.

INCORPORATION EXPENSES AND SETTLEMENT PAYMENTS

In Canal-Randolph Corp. v. United States,\(^{58}\) the Seventh Circuit on December 16, 1977 issued a \textit{per curiam} opinion affirming the decision of the district court. The case dealt with two separate situations, the first involving the deductibility of incorporation expenses and the second involving the nature of income received in settlement of litigation. While neither issue was novel nor universal, the opinions of the Seventh Circuit on both issues reflect an analysis of the substantive realities involved.

The first issue stemmed from a dispute concerning the tax consequences of a merger between the taxpayer, Canal-Randolph Corp., and United Stockyards Corp. In 1964, United entered into a merger agreement with Canal-Randolph Corp. Pursuant to the terms of the merger agreement, United organized UST Corp. and transferred all of its assets and liabilities to UST in exchange for all of UST's stock. On the effective date of the merger, Canal-Randolph acquired all of the stock of UST, as successor to United, and thus effectively (if not technically) merged with United and became the surviving corporation to the merger.

The second issue stemmed from the business activities of United prior to the merger. In 1904, Fort Worth Stockyards Corp., Armour & Co. and Swift & Co. entered into an agreement which provided in part that all animals slaughtered on Armour's and Swift's premises were to pass through Fort Worth's stockyards. In addition, Armour and Swift were to pay Fort Worth the customary yardage and other stockyard charges. In 1936, United acquired two-thirds of the assets of Fort Worth and in 1944 it acquired the remainder. In 1958, Armour and Swift allegedly discontinued the use of Fort Worth's stockyards and discontinued the payments.\(^{59}\) United, as transferee of Fort Worth's assets, instituted a lawsuit against Armour and Swift for breach of the agreement. The lawsuit was dismissed after the parties entered into settlement agreements. These agreements provided in relevant part that Armour and Swift would make reduced yardage payments to

\(^{58}\) \textit{Id.} at 30.\(^{59}\) \textit{Id.} at 30.
United whenever Armour or Swift brought animals into their packing plants without passing them through United's stockyards.

The first issue before the Seventh Circuit was whether the expenses incurred by United in connection with its 1936 incorporation were fully deductible under Code section 165 as a "loss sustained during the taxable year and not compensated for by insurance or otherwise . . . ." at the time of the 1964 merger between Canal-Randolph and United. The Seventh Circuit initially noted the rule that, upon dissolution or liquidation of a corporation, capital expenditures incurred before 1954 would be deductible because they no longer were of any value to the business being liquidated. Nevertheless, the Seventh Circuit affirmed the district court decision holding that the organizational expenditures were not deductible by Canal-Randolph. To reach this holding, the Seventh Circuit relied on Vulcan Materials Co. v. United States which stated: "These assets were not lost but were continued beyond the corporate existence of the constituent corporations and persisted as capital assets of the surviving corporation. So construed, the expenses were not deductible." The court concluded that since United had become a subsidiary of Canal-Randolph by merger, there was no uncompensated loss to Canal-Randolph by virtue of expenditures incurred in organizing United.

The Seventh Circuit then distinguished this case from Dragon Cement Co. v. United States. In Dragon Cement, the surviving corporation to the merger was permitted a current deduction for a fee paid to Pennsylvania which the merged corporation also had made. The Seventh Circuit distinguished Dragon Cement on the ground that the initial payment to the state in fact had been "lost" by virtue of the required second payment and accordingly constituted an uncompensated loss which was deductible for federal income tax purposes. Furthermore, the Seventh Circuit refused to recharacterize the merger of United and Canal-Randolph as a dissolution for which the payment presumably would have been "lost." The court noted that Canal-Ran-

60. I.R.C. § 165(a).
61. Code section 248 specifically provides that post-1954 organizational expenditures may be deducted from taxable income ratably over a period of more than five years upon election by the taxpayer. However, this section was inapplicable to the taxpayer since United had incorporated in 1936. Accordingly, any loss available to Canal-Randolph Corp. by virtue of its merger with United would be available as a deduction only if Code section 165(a) were applicable. See I.R.C. § 248.
62. 568 F.2d at 31.
63. 446 F.2d 690 (5th Cir.), cert. denied, 404 U.S. 942 (1971).
64. 446 F.2d at 694-95, quoted in 568 F.2d at 31.
65. 144 F. Supp. 188 (D. Me. 1956), vacated and remanded on other grounds, 244 F.2d 513 (1st Cir.), cert. denied, 355 U.S. 833 (1957).
dolph had structured the merger in the manner it had in order to consummate the transaction as a tax-free reorganization. That the assets of United had been transferred to UST prior to the merger was considered irrelevant, since the “taxpayer acquired the stock of that subsidiary in the merger just as it would have acquired United’s generating assets had they remained in United.”

The second issue in *Canal-Randolph Corp.* involved a determination of whether the settlement payments received by the taxpayer from Swift and Armour constituted ordinary income or capital gain income. In affirming the district court’s determination that the settlement payments were ordinary income, the Seventh Circuit relied on several cases in holding that “the . . . tax classification of settled amounts is determined by reference to the nature of the claim settled.” Since the suit instituted by United against Swift and Armour concerned an alleged breach of contract for the payment of yardage and other stockyard fees to Fort Worth and its successors in payment for allegedly required stockyard services, the fees themselves would have been ordinary income to Fort Worth and its successors when received. Accordingly, the settlement payments also were characterized as ordinary income.

66. *See generally* I.R.C. § 368. However, even if the merger were planned as a “tax-free reorganization,” it should not follow that the taxpayer not be allowed the deduction because of the “tax-free” character of the acquisition.
67. 568 F.2d at 32.
68. “Capital gains” occur for federal tax purposes upon the disposition of a “capital asset” at a profit, which is defined in Code section 1221. “Capital assets” generally include property held by a taxpayer exclusive of stock in trade, inventory, depreciable property, real property used in a trade or business, business accounts receivable and notes receivable, and obligations of the United States. *See* I.R.C. § 1221. Under Code section 1201, the disposition of a “capital asset” after 1978 by a corporate taxpayer will generally result in the imposition of a tax of twenty-eight per cent of the net “capital gain.” *See* I.R.C. § 1221 (as amended). On the other hand, Code section 11 provides that with respect to “ordinary” (i.e., non-capital) income, for taxable years beginning after December 31, 1978 a corporation is subject to federal income tax at graduated rates ranging from seventeen per cent to forty-six per cent on amounts of taxable income in excess of $100,000. Thus, capital gains generally are taxed at reduced rates for corporate taxpayers.
69. Clark Oil and Refining Corp. v. United States, 473 F.2d 1217 (7th Cir. 1973); and Anchor Coupling Co. v. United States, 427 F.2d 429 (7th Cir. 1970), *cert. denied*, 401 U.S. 908 (1971).
70. 568 F.2d at 33.
71. It is interesting to note that the Seventh Circuit reached its conclusion for a different reason than that utilized by the district court. The district court held that the settlement payments were ordinary income because Ft. Worth had retained an interest in the land purchased by Armour and Swift, which was in return for the agreement that all animals slaughtered on the transferred land would pass through Ft. Worth’s stockyards with all customary charges paid. As a consequence, the district court concluded that Ft. Worth and its successors had retained “a continuing economic interest in the transferred property,” which meant that the settlement payments were part of the “continuing economic interest” and constituted ordinary income. *See* Canal-Randolph v. United States, No. 73 C 702 (N.D. Ill. Dec. 23, 1976) (77-1 U.S.T.C. ¶ 9158 at 86,228). The Seventh Circuit dismissed this reasoning as a basis for its decision and considered the real economic effect of the arrangement to be that Ft. Worth would receive payment for the
ROYALTY PAYMENTS: ORDINARY OR CAPITAL GAIN INCOME

On January 11, 1978 the Seventh Circuit in Consolidated Foods Corp. v. United States affirmed the district court's grant of summary judgment in favor of the government. Consistent with the other tax cases before the Seventh Circuit during the last term, the Consolidated Foods decision reflects the court's probing of the realities of the business relationships rather than the technical form of the transaction.

Consolidated Foods Corp., the taxpayer, was the successor to Kitchens of Sara Lee, Inc. In 1963, Sara Lee U.S. entered into an agreement with Kitchens of Sara Lee (Canada) Ltd., a wholly owned subsidiary of Consolidated Foods. Pursuant to the agreement, which was termed a "license agreement," Sara Lee U.S. transferred to Sara Lee Canada the exclusive and perpetual use in Canada of its Canadian licensed trademark "Sara Lee." Sara Lee U.S. retained certain rights, including the right to maintain product quality standards, the right to prohibit sub-licensing without prior consent and the right to legal title to the trademark. In exchange for the grant of the trademark to Sara Lee Canada, Sara Lee U.S. was to receive royalties based on the net sales of products sold by Sara Lee Canada under the trademark. The "license agreement" was of perpetual duration, but it could be terminated by Sara Lee U.S. upon Sara Lee Canada's insolvency or default.

Sara Lee U.S. reported the payments that it received from Sara Lee Canada under the agreement as long-term capital gain on its United States corporate income tax returns for the years 1965 through 1971. The Commissioner determined that the payments constituted ordinary income and accordingly assessed income tax deficiencies. Sara Lee U.S. paid the additional tax assessments and then filed a refund suit in the United States District Court for the Northern District of Illinois.

The district court found that the trademark in question was itself a capital asset. Nevertheless, the district court concluded that the alleged "sale" was a "royalty" paid pursuant to a license agreement. A "royalty" paid for the use of a capital asset, unlike the income from the stockyard services it actually rendered. The Seventh Circuit also disregarded the district court's alternative reasoning that the payments must be ordinary income because the taxpayer failed to carry its burden of designating what portions of the payments were capital gains. See generally 568 F.2d 28 (7th Cir. 1977).

72. 569 F.2d 436 (7th Cir. 1978), aff'd No. 75 C 1447 (N.D. Ill. Nov. 9, 1976).
73. Hereinafter referred to as Sarah Lee U.S.
74. Hereinafter referred to as Sarah Lee Canada.
75. See I.R.C. § 1222(3).
sale of the asset, creates ordinary income rather than capital gain income to the recipient. The district court found that Sara Lee U.S. had not met the burden of showing that the transaction constituted the sale of a capital asset, since the "license agreement" failed to provide for the sale of the trademark at a price payable in money or its equivalent and did not reflect a transfer of all Sara Lee U.S.'s interest in the asset.

In affirming the decision of the district court, the Seventh Circuit noted that the issue was a "thorny one" which the courts had not consistently resolved. The opinion noted that, as part of the Tax Reform Act of 1969, Congress enacted Code section 1253 in order to set forth clear standards on how restrictive an agreement can be with respect to the retention of proprietary rights by the transferor but constitute a "sale" rather than a "license." However, Code section 1253 did not

77. See I.R.C. § 1253(c).
79. See Moberg v. Commissioner, 365 F.2d 337 (5th Cir. 1966); Estate of Gowdey v. Commissioner, 307 F.2d 816 (4th Cir. 1962) (sale of asset is evidenced by the transfer of all of seller's interest in the asset).
80. 569 F.2d at 437.
82. I.R.C. § 1253(a), (b) and (c), as enacted in 1969, reads as follows:
(a) General rule
A transfer of a franchise, trademark, or trade name shall not be treated as a sale or exchange of a capital asset if the transferor retains any significant power, right, or continuing interest with respect to the subject matter of the franchise, trademark, or trade name.
(b) Definitions
For purposes of this section—
(1) Franchise
The term "franchise" includes an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area.
(2) Significant power, right, or continuing interest
The term "significant power, right, or continuing interest" includes, but is not limited to, the following rights with respect to the interest transferred:
(A) A right to disapprove any assignment of such interest, or any part thereof.
(B) A right to terminate at will.
(C) A right to prescribe the standards of quality of products used or sold, or of services furnished, and of the equipment and facilities used to promote such products or services.
(D) A right to require that the transferee sell or advertise only products or services of the transferor.
(E) A right to require that the transferee purchase substantially all of his supplies and equipment from the transferor.
(F) A right to payments contingent on the productivity, use, or disposition of the subject matter of the interest transferred, if such payments constitute a substantial element under the transfer agreement.
(3) Transfer
The term "transfer" includes the renewal of a franchise, trademark, or trade name.
(c) Treatment of contingent payments by transferor
Amounts received or accrued on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name which are contingent on the productivity, use, or disposition of the franchise, trademark, or trade name transferred shall be treated as
TAXATION 241
codify existing case law and applied only to transfers made after December 31, 1969.83 Since the initial transfer in question took place in 1963, the Seventh Circuit was required to analyze the unsettled case law.

After an extensive analysis of a series of cases in several other circuits involving the tax treatment of various Dairy Queen franchise agreements,84 the Seventh Circuit noted that the Sara Lee agreement was similar to the agreements in the Dairy Queen cases. All of the cases involved the transfer of an exclusive right to use a patent, the retention of quality control powers, payments computed by reference to the amount of products sold by the transferee, the use of the terms “license” and “royalties,” and possession by the transferor of the right to terminate the agreement upon default by the transferee.

However, the Seventh Circuit concluded that a salient difference existed between the Sara Lee agreement and the Dairy Queen agreements; in the Sara Lee agreement the royalty payments were the only form of consideration. In examining the various factors distinguishing a “license” from a “sale,” the Seventh Circuit noted that since the only form of monetary consideration passing from Sara Lee Canada to Sara Lee U.S. was the royalty payments, treatment of the royalty payments as something other than consideration for the transfer of a right to use a trademark was precluded. Coupled with the fact that the agreement was entitled “license agreement” and that Sara Lee Canada deducted the payments as business expenses on its Canadian income tax return,85 the payments received by Sara Lee U.S. were held to constitute ordinary income as royalties and not capital gains stemming from the sale of a trademark.

The Seventh Circuit thus established its own position, declining to adopt the position of any of the conflicting circuit courts of appeals decisions, “because we do not believe that the royalty arrangement should be analyzed separately from the other provisions of the agree-

83. 569 F.2d at 438.
84. See Moberg v. Commissioner, 365 F.2d 337 (5th Cir. 1966); United States v. Wernentin, 354 F.2d 757 (8th Cir. 1965); Moberg v. Commissioner, 310 F.2d 782 (9th Cir. 1962); Estate of Gowdey v. Commissioner, 307 F.2d 816 (4th Cir. 1962); Moberg v. Commissioner, 305 F.2d 800 (5th Cir. 1962) and Dairy Queen of Okla., Inc. v. Commissioner, 250 F.2d 503 (10th Cir. 1957).
85. It appears that the taxpayer was attempting to have the best of all possible worlds: the payments by Sara Lee Canada were considered by the taxpayer as royalties deductible against its Canadian income, but the payments received by Sara Lee U.S. were reported as long term capital gain for United States tax purposes. Although the Seventh Circuit noted this difference, it said: “[W]e do not suggest that the tax treatment of a transaction by a foreign country should primarily control our characterization of the agreement for United States tax purposes, but we do take notice of this conduct as reflecting some light upon the intent of the parties.” 569 F.2d at 442.
ment, especially if, as here, the royalties are the only form of monetary consideration." Rather than establish a hard technical rule, the Seventh Circuit determined that each case in this area must be decided on its particular facts.

**TAX ACCOUNTING AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

On September 28, 1977 the Seventh Circuit affirmed an important Tax Court decision in *Thor Power Tool Co. v. Commissioner.* The United States Supreme Court has granted certiorari to the plaintiff. The issue in this case was whether the Commissioner has the authority to determine that an accounting practice fails to clearly reflect the taxpayer's income, even though the particular accounting practice utilized is "generally accepted" as a "best accounting practice." The issue in *Thor,* at least in a general sense, related to the fundamental question whether commonly utilized accounting procedures are sufficient to reflect economic reality for tax reporting purposes. As the Seventh Circuit decision indicates, however, the issue was narrowed to whether the Commissioner had reasonably exercised his discretion in determining that the accounting methods chosen by the taxpayer did not clearly reflect its income.

The case arose from the accounting practices of Thor Power Tool Co., a manufacturer of tools and tool parts. When Thor discontinued the manufacture of tools of a particular model, it continued to maintain an inventory of stock replacement parts and accessories. In 1964, Thor established a procedure for "writing down" the value of this inventory after determining that the number of parts on hand exceeded future demand.

In 1960, Thor established an inventory contra account in order to

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86. 569 F.2d at 441.
87. *Id.* The Seventh Circuit's refusal to apply mechanical rules without detailed examination of the transactions at issue further illustrates the emphasis that the court places on such realities and its refusal to apply automatically "black letter" law.
90. 563 F.2d at 866.
91. The American Institute of Certified Public Accountants, in 1973, established the Financial Accounting Standards Board (FASB), as successor to the Accounting Principles Board, to promulgate "financial accounting standards." The purpose of FASB is to standardize the financial accounting field with rules that result in the most accurate picture of the financial position of a company. *See 3 Professional Standards (CCH) §§ 510.08, 520.01.*
92. "A contra account is an account that reduces either an asset or liability on a balance sheet." D. E. KIESO & J. J. WEYGANDT, INTERMEDIATE ACCOUNTING 178 (1974). The use of an inventory contra account allows the balance sheet user to see the original cost of the inventory and the reductions therein to date. *See id.*
reduce the book value of replacement parts and accessories for discontinued tools. These parts and accessories were amortized over a ten year period as was reflected in the credit entries to the contra account. The credit balance in this account at the end of each year was shown on Thor's federal income tax return as a reduction of closing inventory. Thus, the net addition to this account during a taxable year increased Thor's cost of goods sold and reduced its taxable income for that year.

Furthermore, in connection with the preparation of Thor's 1964 financial statements, a complete physical inventory was taken. Thor's management concluded that existing inventory quantities were in excess of anticipated market demand. Accordingly, Thor's management adjusted its inventory valuations "in order to show inventory at its 'net realizable value,' as required by the standards of the accounting profession, and to value the inventory at 'the lower of cost or market' as had been Thor's practice for income tax purposes." Much of the inventory for replacement parts and accessories with respect to discontinued products was "written down" to reflect obsolescence. The remaining inventory also was evaluated for the purpose of ascertaining the extent to which it was in excess of estimated demand. The Commissioner did not oppose the write down for obsolescence, but did object to the devaluation of excess inventory.

In addition, Thor utilized the so-called "reserve-method" for claiming losses from bad debts. In computing the addition to its reserve for the taxable year 1965, the collectibility of all accounts receivable was estimated by Thor personnel. All inter-company accounts were treated as fully collectible. A 100 per cent reserve was established for certain accounts estimated to be wholly uncollectible. Lesser percentage reserve accounts were created for other receivables, again based on estimates of collectibility.

The Commissioner, upon audit of Thor's corporate income tax returns, disagreed with these accounting practices, claiming in part that the "write-downs" of Thor's inventory (other than inventory "written down" with respect to obsolete parts and accessories) did not clearly reflect Thor's income for federal income tax purposes. The Commissioner also found that Thor's method of estimating bad debts was not reasonable. The Tax Court upheld the Commissioner, even though it agreed that Thor's "write-downs" of excess inventory constituted a "best accounting practice" within the meaning of Code section 471. The Tax Court determined that Thor had failed to establish that its

93. 563 F.2d at 864.
94. Id. at 865.
inventory accounting clearly reflected its income in 1964 for federal income tax purposes. The Tax Court held that the Commissioner did not abuse the discretion vested in him under Code section 471 in making his determination that the inventory "write-downs" did not clearly reflect Thor's income, thus raising the "clearly reflecting income" concept above that of "best accounting practice."

In affirming the decision of the Tax Court, the Seventh Circuit initially analyzed Code sections 446 and 471 in order to determine whether the Commissioner had abused the discretion vested in him when he determined that Thor had to utilize another method of accounting in order to clearly reflect its income. Code section 446 provides that taxes shall be computed in accordance with the taxpayer's usual method of accounting unless that method does not clearly reflect income. Although the Seventh Circuit noted that the taxpayer's method of accounting normally is given preference, it also found that the Commissioner may require another method of accounting if the method used by the taxpayer does not clearly reflect income. The court further noted that Code section 471 gives even greater discretion to the Commissioner with respect to inventory accounting, by establishing a bipartite standard on which the Commissioner may act: the taxpayer's inventory method must both conform closely to the relevant "best accounting practices" and also must clearly reflect income.

Citing Arinell Co. v. Commissioner and Brown v. Helvering, the Seventh Circuit held that, in order to overturn the Commissioner's disallowance, Thor was required to show that the Commissioner's act was "plainly arbitrary." This was because the issue "whether a given method of accounting clearly reflects income" is one of fact to be decided by the Tax Court. Accordingly, the issue could be reviewed by a circuit court of appeals only if the Commissioner's exercise of discretion was clearly erroneous. Consistent with this role, the Seventh Circuit then found that Thor had not shown that the Commissioner's act was "plainly arbitrary." The court dismissed Thor's argument that

95. I.R.C. §§ 446(a), 446(b).
96. Treas. Reg. § 1.446-1(a)(2) (1957) provides in relevant part that: "Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income."
97. 400 F.2d 981 (7th Cir. 1968) (whether a given method of accounting clearly reflects income is a question of fact).
98. 291 U.S. 193 (1934) (when reviewing the Commissioner's exercise of discretion, it is not the role of the appellate courts to weigh and determine the relative merits of systems of accounting).
99. 563 F.2d at 866.
100. Id.
the Tax Court erred in not allowing Thor to take advantage of the "presumption" that best accounting practice will clearly reflect income. The court noted that the sentence in the Treasury Regulations utilized as authority by Thor later had been repealed and that in all events such a "presumption" was weakened by a preceding sentence in the regulations which required consistency in inventory practice to clearly reflect income.

The Seventh Circuit also found that the Commissioner had not been "plainly arbitrary" in disallowing a portion of Thor's addition to its bad debt reserve. The court found that Code section 166(c) clearly permits the Commissioner to exercise his discretion regarding the reasonableness of any particular addition to a bad debt reserve. As with the "write-down" of inventory issue, Thor was required to show that the Commissioner abused his discretion in order to overturn the Commissioner's disallowance in this context. Since the Commissioner utilized a formula for computing a reasonable bad debt reserve as set forth in Black Motor Co. v. Commissioner, the Commissioner's method of determining the reserve for bad debts, which gave preference to experience over estimates, was held to be reasonable.

The Seventh Circuit did not look at the economic realities of Thor's accounting methods. The factual issue had been decided in the Tax Court and the only question actually before the Seventh Circuit was whether the Commissioner's position was "reasonable." Despite certain equities in favor of the taxpayer, Thor apparently was not able to deny the reasonableness of the Commissioner's findings. Given the broad grant of administrative discretion from Congress to the Commissioner, the decision in Thor Power Tool Co. by the Seventh Circuit is not surprising.

103. I.R.C. § 166(c) provides:
   (c) Reserve for Bad Debts.
   In lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary [or his delegate]) a deduction for a reasonable addition to a reserve for bad debts.
104. 41 B.T.A. 300 (1940), aff'd on other grounds, 125 F.2d 977 (6th Cir. 1942) (supporting the Commissioner's method of computing reasonable annual additions to a taxpayer's bad debt reserve. The calculation is a percentage, generally computed by dividing average bad debts of the taxpayer for the preceding six year period by the aggregate receivables owed the taxpayer during the period).
105. See note 103, supra.
TAX PROCEDURE: TIMELY FILING

In *Lewin v. Commissioner*,\(^\text{106}\) the Seventh Circuit on January 12, 1978 issued a *per curiam* decision which adopted the memorandum opinion of the Tax Court. The issue in *Lewin* was whether the requirements of Code section 6212\(^\text{107}\) for mailing statutory notices of deficiency\(^\text{108}\) had been met by the Commissioner. Although the Seventh Circuit decided that the Commissioner had no duty to act beyond the narrow requirements of the governing statute, the court nevertheless examined the realities of the situation before making its determination.

The case arose from the certified mailing by the District Director of Internal Revenue on June 18, 1973 of a statutory notice of deficiency of income tax for the years 1966-68 to the taxpayers. The envelope was addressed to the taxpayers at their last known address, as required by Code section 6212. On June 19, 1973, the mail carrier attempted to hand deliver the notice to the taxpayers at their home. Receiving no answer, the mail carrier left a postal service form indicating the attempted delivery in the taxpayers' mailbox. On June 29, 1973, a second notice of attempted delivery also was placed in the taxpayers' mailbox. The envelope containing the statutory notice of deficiency was returned to the District Director on July 10, 1973, unopened and marked "unclaimed." On October 1, 1973, the taxpayers received a notification of a tax assessment and a demand for payment. The taxpayers' attorney eventually secured a copy of the notice, which the taxpayers saw for the first time on February 1, 1974. The taxpayers then attempted to contest the deficiency by filing a petition in the Tax Court.

The Commissioner filed a motion to dismiss the case for lack of jurisdiction, asserting that the statutory deadline for filing a petition in


107. I.R.C. § 6212 in relevant part reads:

(a) In general

If the Secretary determines that there is a deficiency in respect of any tax imposed by subtitle A or B or chapter 41, 42, 43, or 44, he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.

(b) Address for notice of deficiency

(1) Income and gift taxes and taxes imposed by chapter 42

In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, or chapter 44 if mailed to the taxpayer at his last known address, shall be sufficient for purposes of subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, chapter 44, and this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence. (Emphasis added.)

108. A "statutory notice of deficiency" is the notice referred to in Code section 6212 and represents the Commissioner's formal notification to a taxpayer of a determination by the Commissioner of a tax deficiency. [The statutory notice of deficiency hereinafter will be referred to as the notice.]
the Tax Court had not been met by the taxpayers, since their petition had been filed more than ninety days after the date the notice had been sent by certified mail.\textsuperscript{109} The taxpayers contended that since the Commissioner failed to attempt further delivery prior to the expiration of the filing deadline, the ninety day period should begin to run from the date they actually received the notice.\textsuperscript{110}

In holding that the taxpayers had missed the deadline for filing a petition, the Tax Court relied on \textit{Pfeffer v. Commissioner}.\textsuperscript{111} In \textit{Pfeffer} the court held that as a general rule the ninety day period begins with the mailing date of the notice, regardless of the date of actual receipt by the taxpayer. The Tax Court held that there were no circumstances in \textit{Lewin} to warrant relaxation of the specific statutory language.

The Seventh Circuit's three paragraph \textit{per curiam} opinion in \textit{Lewin} adopted in full the Tax Court's memorandum decision since there was no precedent on point in the Seventh Circuit and since the Tax Court had reached the correct result for the correct reasons. The Tax Court's decision, as adopted by the Seventh Circuit, is consistent with the Seventh Circuit's non-technical interpretation of the tax law during the past term when not confronted with controlling precedent. Although the statute in question appears to be dispositive of the issue at hand, it was not mentioned by the Seventh Circuit in its opinion. Only at the end of the Tax Court opinion did the court make reference to the technical wording of the statute;\textsuperscript{112} instead the opinion was based on the equities of the specific circumstances giving rise to the issue.\textsuperscript{113}

\section*{Marital Deduction Equalization Clauses}

During the last term, the Seventh Circuit was faced with one federal estate tax case, \textit{Estate of Smith v. Commissioner}.\textsuperscript{114} On November 3, 1977, the Seventh Circuit affirmed the decision of the Tax Court.\textsuperscript{115}

\begin{itemize}
  \item \textsuperscript{109} I.R.C. \textsection{} 6213.
  \item \textsuperscript{110} The taxpayer relied on \textit{Estate of McKaig v. Commissioner}, 51 T.C. 331 (1968), for the proposition that the narrow requirements of Code section 6212 could be waived under exceptional circumstances. Narrowly construed, that case held that a mailing of a notice was not completed when the postal service crossed out the correct address on the envelope, inserted a new incorrect address and then returned the letter to the Commissioner as "unclaimed."
  \item \textsuperscript{111} 272 F.2d 383 (2d Cir. 1959).
  \item \textsuperscript{112} I.R.C. \textsection{} 6212.
  \item \textsuperscript{113} The Seventh Circuit made the additional comment in its \textit{per curiam} opinion that the taxpayer still had an adequate avenue to contest the notice by paying the tax and then instituting a refund suit in federal district court. 569 F.2d at 445 (relying on \textit{Phillips v. Commissioner}, 283 U.S. 589 (1931); \textit{Brown v. Lethert}, 360 F.2d 560 (8th Cir. 1966); \textit{Cohen v. United States}, 297 F.2d 760 (9th Cir. 1962)).
  \item \textsuperscript{114} 565 F.2d 455 (7th Cir. 1977), \textit{aff'd per curiam} 66 T.C. 415 (1976).
  \item \textsuperscript{115} It is noteworthy that, after the Seventh Circuit decision, the Commissioner announced that he will not acquiesce to the Tax Court decision in \textit{Estate of Smith}. 1978-21 I.R.B. 6. Al-
This decision was one of the few tax decisions during the last term which the Seventh Circuit decided in favor of the taxpayer. A close examination of the underlying rationale indicates again that the Seventh Circuit emphasized the substance of the transaction rather than the form or literal rules of the applicable tax law.\(^{116}\)

The issue arose after the death of Charles W. Smith in 1970. His taxable estate was owned primarily by a revocable inter vivos trust which the decedent had established in 1967 with a corporate fiduciary as trustee. The trust agreement provided that upon Smith's death the trust assets were to be divided into two portions.

The first portion constituted the marital portion and was to be held as a separate trust designed to qualify for the federal estate tax marital deduction.\(^ {117}\) Pursuant to the terms of the trust, the decedent's surviving spouse would receive all of the net income during her lifetime and would possess a general power of appointment exercisable at her death.\(^ {118}\)

The portion of the original revocable trust which was not allocated to the marital portion constituted the residual portion. The residual portion was not intended to qualify for the federal estate tax marital deduction but, unlike the marital portion, would not be includable in the surviving spouse's estate on her later death. The division of a decedent's estate into two portions, one intended to qualify for the maximum federal estate tax marital deduction and the other intended to exclude the maximum amount of assets from the surviving spouse's subsequent taxable estate, is a commonly utilized estate planning technique.

The allocation language in the trust agreement with respect to determining the appropriate marital portion was contained in a so-called

\(^{116}\) I.R.C. § 2056(b)(1).

\(^{117}\) See I.R.C. § 2056. The marital deduction for federal estate tax purposes allows the value of qualified property passing to a decedent's surviving spouse to be deductible against the decedent's "adjusted gross estate," subject to a limitation of the greater of $250,000 or one-half the value of the decedent's adjusted gross estate. I.R.C. § 2056(c)(1)(A). At the date of the decedent's death in Estate of Smith, however, the marital deduction was limited to the value of one-half of the decedent's adjusted gross estate as determined for federal estate tax purposes. I.R.C. § 2056(c)(1)(A) (amended 1976).

\(^{118}\) Although the trust estate did not pass outright to the surviving spouse and might constitute a "terminable interest" (see I.R.C. § 2056(b)), such an interest expressly qualifies for the federal estate tax marital deduction pursuant to Code section 2056(b)(5).
“equalization clause.” Instead of simply qualifying the marital portion for the maximum marital deduction with respect to the decedent’s estate, the equalization clause in the Smith Trust required the trustee to allocate an amount to the marital portion which would result in the lowest federal estate taxes for both the decedent’s estate and the decedent’s wife’s estate, assuming that the decedent’s wife survived the decedent. In addition to computing the value of both estates in order to determine the appropriate allocation for the marital portion, the trustee had the power to select as the valuation date for the determination either the date of the decedent’s death or the alternate valuation date in order to produce the greatest overall tax savings. The clause stated that it was the decedent’s purpose “to equalize, insofar as possible, his estate and her estate for federal tax purposes, based upon said assumptions.”

The Commissioner took the position that the equalization clause caused the property interest passing from the decedent to his wife, through the trust, to be a “terminable interest” as defined under Code section 2056(b)(1) and that, accordingly, the marital portion did not qualify for the federal estate tax marital deduction. The “terminable interest” rule states that an interest in property passing to (or for the benefit of) the surviving spouse of a decedent will not qualify for the marital deduction if, on account of the lapse of time or occurrence or failure to occur of any contingency, the interest passing to the surviving spouse would terminate or fail, such that the property interest then


120. Pursuant to Code section 2032, there is an elective alternate valuation date for valuing a decedent’s gross estate for federal estate tax purposes, which now is six months after the date of the decedent’s death, but was one year after the date of the decedent’s death in Estate of Smith. I.R.C. § 2032(a)(1) (amended 1976).

121. 66 T.C. at 418.

122. I.R.C. § 2056(b) in relevant part reads as follows:

(b) Limitation in the case of life estate or other terminable interest.

(1) General rule

Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such an interest—

(A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money’s worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))—

(C) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.
would pass to another person.\textsuperscript{123} The Commissioner's position was that, theoretically at least, it was possible for no property to pass under the marital portion for the benefit of Smith's surviving spouse. If both estates were exactly equal in size at the date of the decedent's death, then appropriate equalization would mean that no additional property would be utilized to fund the marital portion, since transferring additional property would result in inequality between the two estates. Moreover, since the trustee could use the alternate valuation date in making the determination, the amount of the interest, if any, passing to the marital portion was uncertain on the date of the decedent's death.\textsuperscript{124}

The Tax Court, however, disagreed with the Commissioner's position and did not view the "equalization clause" as one which determined whether any property would pass to the decedent's surviving spouse. Instead, the Tax Court considered the clause as simply a mechanism for determining the value of the property interest passing to the surviving spouse. In holding that an interest is not terminable under the "terminable interest rule" simply because the value or quantity thereof cannot be determined as of the date of the decedent's death, the Tax Court concluded that the interest here, if any and as finally determined, would qualify for the marital deduction.\textsuperscript{125} For example, if the equalization formula required the trustee to allocate nothing to the marital portion, then the value of the decedent's surviving spouse's interest in the trust would be zero and the decedent's estate would not be allowed a marital deduction.

Judge Irwin of the Tax Court dissented,\textsuperscript{126} finding that technically the "equalization clause" made the spouse's interest terminable and therefore insufficient to qualify for the marital deduction. The dissent reached its conclusion reluctantly, since neither the purpose of the marital deduction statute nor the terminable interest rule itself would have been frustrated by allowing the deduction.\textsuperscript{127} Nevertheless, the dissent believed that such a decision was the natural consequence of the literal requirements of the statute.

\textsuperscript{123} 66 T.C. at 423-24.
\textsuperscript{124} The Commissioner's argument in this respect seems to be somewhat attenuated, since the decedent's personal representative could in all events elect the alternate valuation date for valuing the estate and calculating the value of the marital deduction. I.R.C. § 2032(a). Further, Code section 2056(b)(3) in general provides that an interest passing from a decedent to his surviving spouse may be conditioned on the surviving spouse's subsequent survival for a limited period of time, not to exceed six months, still qualifying for the marital deduction and without violating the terminable interest rule. I.R.C. § 2056(b)(3).
\textsuperscript{125} 66 T.C. at 428.
\textsuperscript{126} Id. at 433.
\textsuperscript{127} Id. at 436.
The Seventh Circuit, in agreeing with the majority of the Tax Court, also held that the remote possibility that Mrs. Smith would receive nothing from the equalization clause bequest was only a question of the value of the interest and not a question of whether the interest existed. Describing the Commissioner's position as "hidebound," the Seventh Circuit felt that it was impossible to distinguish between a so-called "fractional share bequest," which qualifies for the marital deduction even though the precise value of the fractional share cannot be known until subsequent events occur, and an equalization clause of the type in Smith. After distinguishing Jackson v. United States, the Seventh Circuit concluded that the equalization clause in Smith operated to determine a fixed property interest, although one that was subject to a valuation determination occurring after the date of the decedent's death.

The Seventh Circuit also stressed the equities involved in holding for the taxpayer, by concluding that there was no possibility that the property interest passing to Mrs. Smith would escape taxation altogether. Although it is true that a property interest qualifying for the marital deduction under most circumstances eventually would be included in the estate of the surviving spouse, it would have been possible for the marital portion funds to escape estate taxation if spent during Mrs. Smith's lifetime. In all events, property qualifying for the marital deduction provides a deferral of the estate tax (in this instance from the date of Mr. Smith's death to the later date of Mrs. Smith's death). To the extent that the tax liability is deferred there is a savings generated by the "use value" of money which indirectly would escape taxation in this instance.

It is interesting to note, however, that the Commissioner conceded many of the relevant issues. He admitted that the equalization clause is not a "tax avoidance measure," because estate taxes still would

128. 565 F.2d at 458.
129. See 66 T.C. at 431 n.23 (citing R.B. Covey, The Marital Deduction and the Use of Formula Provisions (1966)).
130. 376 U.S. 503 (1964) (an allowance provided by California law for the support of a widow during the settlement of her husband's estate constituted a terminable interest). The facts in Jackson were distinguished from those in Estate of Smith, because the widow's allowance in Jackson was a "creature of state law" which the state courts had held did not vest at the date of the husband's death, but rather "related back" to the husband's death. 565 F.2d at 459. Apparently in Estate of Smith the equalization clause was considered to have created a property interest that did "vest" at the date of the husband's death and only the calculation of that interest "related back."
131. 565 F.2d at 459.
132. Id. at 457. At least in Estate of Smith it appears likely that federal estate tax was collected with respect to the marital portion property upon Mrs. Smith's subsequent death. 66 T.C. at 429 n.21.
be collected from the estate of each spouse and none of the funds would escape taxation. The Commissioner's counsel admitted during oral argument that there were no policy grounds for vitiating the equalization clause. As a consequence, the Commissioner's position was simply that the literal language of Code section 2056(b) required disqualification of the interest for the marital deduction, a particularly harsh result by any standard. Although the line between an interest in property and the value of that interest may be a fine one to draw, the equities and realities of the case lend support for the Seventh Circuit's affirmation of the Tax Court decision.

DETERMINING WHAT CONSTITUTES AN INSURANCE COMPANY

Unlike Smith, where the Commissioner desired a literal reading of the relevant tax statute and lost before the Seventh Circuit, in Allied Fidelity Corp. v. Commissioner the Commissioner desired a broad reading of a different provision in the tax law and won. In Allied Fidelity, the Seventh Circuit on March 23, 1978, issued a technical decision which again illustrates the court's search for the underlying substance of the tax controversy. The issue presented was whether a wholly owned subsidiary of the taxpayer, Allied Fidelity Insurance Corp., was entitled to be classified for federal income tax purposes as an "insurance company" under Code sections 831 and 832. Despite the narrowness of the issue, the decision reflects the Seventh Circuit's probing of the economic substance, rather than only the form, of tax transactions. The court's positions in both Smith and Allied are entirely consistent, although one might question whether the Commissioner's tax philosophy in the two cases was equally consistent.

Allied Fidelity Insurance Corp. was engaged in the business of writing fidelity and surety bonds in addition to automobile insurance contracts. A major portion of Allied's business was writing surety bail contracts. Its articles of incorporation were amended during 1972 to permit Allied to insure a wide range of casualties and other risks. Since its incorporation, Allied filed annual statements with the insurance regulatory authorities in those states in which it was authorized to

133. Id. at 458.
134. 572 F.2d 1190 (7th Cir. 1978), affg 66 T.C. 1068 (1976).
135. In fairness to the Commissioner, his apparently inconsistent philosophies as reflected in Allied and Smith may be consistent or at least justifiable. In Allied, the relevant statute did not contain any definition of the term "insurance company" and the Commissioner desired a broad interpretation of the term; in Smith, the relevant statute contained a specific definition of a "terminable interest" and the Commissioner desired a literal construction. In addition to the possible inference of different Congressional intent, Allied was an income tax case and Smith was an estate tax case.
do business and was subject to regulation. Allied's tax accounting techniques were consistent with generally accepted accounting principles for insurance companies.

The Commissioner determined that Allied did not qualify as an "insurance company" during the taxable years in question. As a consequence, the Commissioner determined that Allied's accounting procedures for tax purposes were not appropriate and that Allied was not entitled to tax benefits available only to insurance companies. Therefore, the Commissioner assessed a tax deficiency against Allied for 1971 and 1972.

Treasury Regulation section 1.831-1(a) defines the term "insurance company" by reference to the definition in the Treasury Regulations issued under Code section 801, which in relevant part reads:

"Though its name, charter powers, and subjection to state insurance laws are significant in determining the business which a corporation is authorized and intends to carry on, the character of the business actually done in the taxable year determines whether it is taxable as an insurance company under the Code."

The Seventh Circuit, in affirming the Tax Court decision in *Allied Fidelity*, admitted that Allied's name included the word *insurance* and that the company's corporate charter and corporate authority were specifically founded upon and governed by the Indiana Insurance Law. Nevertheless, the court noted that the cumulative result of a series of cases decided by the United States Supreme Court in the 1920's and 1930's and the plain language of the regulation required that the "character of the business actually done" determine whether the taxpayer is an "insurance company" under the Code.

The court therefore analyzed the nature of the bail system and how it relates to the characteristics of an insurance contract in order to determine the "character of the business actually done" by Allied. The Seventh Circuit perceived Allied's role in issuing criminal bail contracts as not an economic one in the nature of issuing insurance. The court came to this conclusion because, unlike insurance, a forfeiture payment by Allied would not make the state whole and fully compen-

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136. While the normal federal corporate tax rates are applicable to insurance companies, the taxable income of certain insurance companies is computed under special rules contained in Code sections 831 and 832, including special deductions with respect to capital losses and loss carryovers. See I.R.C. §§ 831 and 832.


sated for its loss (since the state could only be made whole by the recapture of the accused). The court stated: "From Allied's position as surety, the transaction may appear to be essentially a pecuniary one but . . . the loss to the state by an accused fleeing, which is the 'risk' to the state, may be societal, legal, or moral but certainly is not merely a pecuniary one."141 Allied's surety contracts were determined to be more in the nature of contracts to perform services (that is, to produce the defendants) than in the nature of contracts of insurance.

The Seventh Circuit rejected the taxpayer's assertion that, under the doctrine of Helvering v. LeGierse,142 Allied was engaged in the insurance business because its surety bail contracts involved "risk shifting" and "risk distributing." The court concluded that the "risk" was not distributed among all of Allied's customers by virtue of its premiums and that the "risk" of an accused failing to appear for trial was not shifted fully from the state to Allied.143

While the Allied Fidelity decision appears to be of little significance to most taxpayers, it is a prime example of the search by the Seventh Circuit to discern the underlying economic substance of the actions of the parties. As such, the decision is consistent with a large number of the tax cases decided by the Seventh Circuit during the last term.

* * *

In conclusion, the last term was one in which the United States Court of Appeals for the Seventh Circuit decided several tax cases of significance, although most of the decisions involved technical provisions of the Code or issues of limited applicability to taxpayers in general. The number of affirmations may reflect the soundness of the decisions by the federal district courts and the Tax Court, undoubtedly making the task of the Seventh Circuit an easier one.

An examination of the tax decisions of the Seventh Circuit indicates the difficulties confronted by a non-specialized court when required to interpret a highly technical statute, often without guidance in the form of intelligible statutory language or controlling precedent. The Seventh Circuit has accomplished an admirable task in this regard. Such an undertaking cannot be simple and the task is complicated by the court's perceived need to base its tax decisions on the equities and

141. 572 F.2d at 1193.
142. 312 U.S. 531 (1941) (analyzing certain types of life insurance contracts and concluding that they involved "risk shifting" and "risk distributing").
143. 572 F.2d at 1194.
economic realities of the cases before it. A review of last term’s tax decisions indicates an emphasis by the Seventh Circuit on such realities, perhaps with less emphasis upon the technical requirements of the law but nevertheless with a skillful attempt at reconciling tax realities and tax technicalities. If the results are not entirely consistent, it may be that the fault is with the Code and not with the judicial craftsmanship of the Seventh Circuit.