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Constitutional Law -- Taxation -- Federal Excise and Occupational Tax on Wagering

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Where a partner is *adjudged* bankrupt there is specific statutory authority enabling him to get a discharge from both his individual and partnership debts.⁷⁶ Adjudication is therefore a condition precedent to discharge. An important objective of the Act is achieved under this rule, *viz.*, to enable the debtor to start anew unhampered by old obligations.

ROGER B. HENDRIX

Constitutional Law—Taxation—Federal Excise and Occupational Tax on Wagering

The occupational tax provisions of the Revenue Act of 1951¹ which levy a tax on persons engaged in the business of accepting wagers and require such persons to register with the collector of internal revenue were recently upheld by the United States Supreme Court as a valid

⁷⁶ 11 U. S. C. § 23(j) (1947).

¹ INT. REV. CODE § 3285:

"(a) Wagers. There shall be imposed on wagers, as defined in subsection (b), an excise tax equal to 10 per centum of the amount thereof.

"(d) Persons liable for tax. Each person who is engaged in the business of accepting wagers shall be liable for and shall pay the tax under this subchapter on all wagers placed with him. Each person who conducts any wagering pool or lottery shall be liable for and shall pay the tax under this subchapter on all wagers placed in such pool or lottery.

"(e) Exclusions for tax. No tax shall be imposed by this subchapter (1) on any wager placed with, or on any wager placed in a wagering pool conducted by, a parimutuel wagering enterprise licensed under State law, and (2) on any wager placed in a coin-operated device with respect to which an occupational tax is imposed by section 3267."

INT. REV. CODE § 3290:

"A special tax of \$50 per year shall be paid by each person who is liable for tax under subchapter A or who is engaged in receiving wagers for or on behalf of any person so liable."

INT. REV. CODE § 3291:

"(a) Each person required to pay a special tax under this subchapter shall register with the collector of the district—

(1) his name and place of residence;

(2) if he is liable for tax under subchapter A, each place of business where the activity which makes him so liable is carried on, and the name and place of residence of each person who is engaged in receiving wagers for him or on his behalf; and

(3) if he is engaged in receiving wagers for or on behalf of any person liable under subchapter A, the name and place of residence of each such person."

INT. REV. CODE § 3294:

"(a) Failure to pay tax. Any person who does any act which makes him liable for special tax under this subchapter, without having paid such tax, shall, besides being liable to the payment of the tax, be fined not less than \$1,000 and not more than \$5,000.

"(c) Willful violations. The penalties prescribed by section 2707 with respect to the tax imposed by section 2700 shall apply with respect to the tax imposed by this subchapter."

INT. REV. CODE § 2707 provides that willful violations such as failure to give the information required by law, shall subject such person to a fine of \$10,000 or imprisonment of from one to five years or both.

exercise of federal taxing power.² The decision arose on appeal from a district court's ruling³ that the provisions contravened the Tenth Amendment⁴ in that Congress was attempting to regulate the purely state matter of gambling under the guise of a taxing statute. In reversing this decision the Supreme Court held that the occupational tax was a valid revenue measure;⁵ that its ancillary registration requirements were reasonable provisions to facilitate the collection of the tax; and that the information required in registering was not a denial of the privilege against self-incrimination as guaranteed by the Fifth Amendment.⁶

The difficulty in determining when the power to tax should be curtailed because its use results in regulatory effects beyond the direct legislative power of Congress is brought about by the inherent nature of a tax itself as well as Constitutional requirements.⁷ It is obvious

² *United States v. Kahriger*, 73 Sup. Ct. 510 (1953).

³ *United States v. Kahriger*, 105 F. Supp. 322 (E. D. Pa. 1952). Six other district courts sustained the validity of Subchapter B (occupational tax) of the Act. *United States v. Smith*, 106 F. Supp. 9 (S. D. Cal. 1952); *United States v. Nadler*, 105 F. Supp. 918 (N. D. Cal. 1952); *United States v. Robinson*, 107 F. Supp. 38 (E. D. Mich. 1952); *United States v. Arnold, Jordan, and Wingate*, No. 478, E. D. Va., Sept. 18, 1952; *United States v. Penn*, No. 2021, M. D. N. C., May 1952; *Combs v. Snyder*, 101 F. Supp. 531 (D. C. D. C. 1952); *United States v. Forrester*, 105 F. Supp. 136 (N. D. Ga. 1952). *Combs v. Snyder*, *supra*, was affirmed in 342 U. S. 939 (1952) on the doctrine of unclean hands; the constitutional question was not raised.

⁴ "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U. S. CONST. AMEND. X.

⁵ The district court did not contend that the occupational tax as such was invalid. "A careful consideration . . . convinces this Court that the subject matter of this legislation so far as revenue purposes is concerned is within the scope of Federal authorities." *United States v. Kahriger*, 105 F. Supp. 322 (E. D. Penn. 1952). It has long been settled that a federal tax is not invalid because it may be levied on an occupation or transaction unlawful under state laws. *United States v. Sanchez*, 340 U. S. 42 (1950) (marihuana); *Sonzinsky v. United States*, 300 U. S. 506 (1932) (certain classes of firearms); *Nigro v. United States*, 276 U. S. 332 (1928) (narcotics); *United States v. Doremus*, 249 U. S. 86 (1919) (same); *License Tax Cases*, 5 Wall. 462 (U. S. 1866) (dealers in liquor and lottery tickets).

⁶ "No person shall . . . be compelled in any criminal case to be a witness against himself." U. S. CONST. AMEND. V. The Court pointed out that the privilege has relation only to past acts, not to future acts that may or may not be committed. If the defendant wished to take wagers subject to excise taxes he must pay the tax and register and in doing so he is not compelled to confess to acts already committed, but is merely informed by statute that in order to engage in the business of wagering in the future he must fulfill certain conditions. A detailed discussion of self-incrimination is beyond the scope of this note, but it must be emphasized that regardless of their constitutionality the registration provisions do afford harmful evidence to state law enforcement officers. See note 24, *infra*.

⁷ The federal taxing power is granted in U. S. CONST. ART. I, § 8: "The Congress shall have Power . . . to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States. . . ." In addition to the uniformity requirement for excise taxes the only other express limitations are that direct taxes must be imposed by rules of apportionment and that there can be no tax on imports from

that it would be impossible to levy taxes which do not have social and economic consequences of a non-fiscal character. Therefore, in its selection of persons, objects, or transactions which are to bear the incidence of taxation Congress must necessarily consider policies of a nature other than revenue.⁸ The Court has recognized that these collateral results will inevitably follow taxation and has not interfered with revenue legislation merely because Congress has been motivated in part by non-fiscal policies in deciding just what segment of the nation's economy or society should be effected by such results.⁹

This refusal to inquire into the ultimate effects of the taxing laws, or into the ulterior motives or purposes of Congress in enacting them arises also from the Court's fear of allowing its judicial power to encroach upon legislative domain.¹⁰

On the other hand, the ostensible taxing power to create results and control in matters not within the direct control of Congress has not been allowed to go unchecked. The Tenth Amendment has been invoked to invalidate revenue measures when the Court felt that it was necessary

any state. U. S. CONST. ART. I § 9. Further limitations have been implied from the due process clause of U. S. CONST. AMEND. V. Thus defective methods of valuation, assessment, collection or remission may amount to lack of procedural due process. *Anniston Mfg. Co. v. Davis*, 301 U. S. 337 (1937). Substantial due process may be violated where there is an attempt to make a tax law unreasonably retroactive. *Nichols v. Coolidge*, 274 U. S. 531 (1927); *Blodgett v. Holden*, 275 U. S. 142 (1927). The most difficult limitation to define, however, is the one implied by the Tenth Amendment which is the topic of this note.

⁸ That the framers of the Constitution clearly realized this aspect of the taxing power, and assumed that Congress should and would consider such effects, is evident from Alexander Hamilton's statement in *The Federalist*, No. 12. After pointing out the revenues which could be derived from a national tax on liquor, he added: "That article would well bear this rate of duty; and if it should tend to diminish the consumption of it, such an effect would be equally favorable to the agriculture, to the economy, to the morals, and to the health of society." See Cushman, *Social and Economic Control Through Federal Taxation*, 18 MINN. L. REV. 759 (1934).

⁹ "From the beginning of our government, the courts have sustained taxes although imposed with the collateral intent of effecting ulterior ends which, considered apart, were beyond the constitutional power of the lawmakers to realize by legislation directly addressed to their accomplishment." *Magnano v. Hamilton*, 292 U. S. 40 (1934). *United States v. Sanchez*, 340 U. S. 42 (1950); *Sonzinsky v. United States*, 300 U. S. 506 (1937); *Nigro v. United States*, 276 U. S. 332 (1928); *Hampton v. United States*, 276 U. S. 394 (1928); *United States v. Doremus*, 249 U. S. 86 (1919); *McCray v. United States*, 195 U. S. 27 (1903); *Veazie Bank v. Fenno*, 8 Wall. 533 (U. S. 1869); *License Tax Cases*, 5 Wall. 462 (U. S. 1866).

¹⁰ In answer to the contention that it is the duty of the judiciary to invalidate the exercise of the taxing power whenever it seems to the Court that the power has been abused the Court in *McCray v. United States*, 195 U. S. 27 (1903) replied: "But this reduces itself to the contention that, under our constitutional system, the abuse by one department of the government of its lawful powers is to be corrected by the abuse of its powers by another department." Much earlier the Court in *Veazie Bank v. Fenno*, 8 Wall. 533 (U. S. 1869) had said: "The power to tax may be exercised oppressively upon persons, but the responsibility of the legislature is not to the courts, but the people by whom its members are elected." See also *McCulloch v. Maryland*, 4 Wheat. 316 (U. S. 1869) and cases cited note 9 *supra*.

to exercise its quasi-political duty of preserving the traditional separation of state and federal powers.¹¹

The test to determine whether a particular exercise of power purporting to be a revenue measure¹² falls within federal or state boundaries seemingly involves an objective examination of the statute to decide whether or not it is actually a tax.¹³ Thus, if the act can be fairly said to be for the purpose of collecting revenue¹⁴ and its penal or regulatory features are reasonably incidental to fiscal purposes the enactment is deemed a tax and upheld.¹⁵ The fact that Congress had ulterior mo-

¹¹ *Carter v. Carter Coal Co.*, 298 U. S. 238 (1936); *United States v. Butler*, 267 U. S. 1 (1936); *United States v. Constantine*, 297 U. S. 287 (1935); *Trusler v. Crooks*, 269 U. S. 475 (1926); *Linder v. United States*, 268 U. S. 5 (1925); *Bailey v. Drexel Furniture Co.* (Child Labor Tax Case), 259 U. S. 20 (1922); *Hill v. Wallace*, 259 U. S. 44 (1922).

¹² Congress has in several instances used its taxing power as an alternative method of regulation in fields where it has the plenary power to regulate directly. The authority of such cases to sustain the general use of federal taxing power to effect results in matters beyond the delegated power of Congress is, therefore substantially weakened. However, because of their sweeping and emphatic language as to the scope of revenue power two of such cases are often relied on without distinction. *Veazie Bank v. Fenno*, 8 Wall. 533 (U. S. 1869) (tax on state bank notes—power to regulate currency); *Hampton v. United States*, 276 U. S. 394 (1928) (protective tariff—power to regulate foreign commerce).

¹³ The test of "objective constitutionality" is clearly set out in *McCray v. United States*, 195 U. S. 27 (1906): "Undoubtedly, in determining whether a particular act is within a granted power, its scope and effect are to be considered. Applying this rule to the acts assailed, it is self-evident that on their face they convey a tax. That being their necessary scope and operation, it follows that the acts are within the grant of power." And in *Sonzinsky v. United States*, 300 U. S. 506 (1937) the Court said: "On its face it is only a taxing measure . . . it has long been established that an Act of Congress which on its face purports to be an exercise of the taxing powers is not the less invalid because the tax is burdensome or tends to restrict or suppress the thing taxed." *But cf.* *United States v. Constantine*, 296 U. S. 287 (1935); *Bailey v. Drexel Furniture Co.* (Child Labor Tax Case), 259 U. S. 20 (1922).

¹⁴ It is obvious that from a practical standpoint a tax which is designed to end the activity with respect to which it is imposed cannot be said to be for the purpose of collecting revenue. This contention was raised in connection with the validity of a ten cent per pound tax on yellow oleomargarine which would in effect end its production. However, *McCray v. United States*, 195 U. S. 27 (1906) upheld the tax saying that *on its face* it was clearly a revenue measure. *Cf.* *Veazie Bank v. Fenno*, 8 Wall. 533 (U. S. 1869). A similar problem arises when the tax is not prohibitive, but purely nominal. In *United States v. Doremus*, 249 U. S. 86 (1919) the Court upheld a one dollar per year tax upon narcotic dealers though there were elaborate ancillary provisions as to registration requirements and records. After the same act was amended so as to increase rates the Court in *Nigro v. United States*, 276 U. S. 332 (1928) stated that any doubt as to the invalidity of the tax as it originally stood had been removed by the change from a nominal to a substantial tax. See *Brown, When Is a Tax Not a Tax*, 11 *IND. L. J.* 399 (1936).

¹⁵ Examples of regulatory provisions held reasonable: *United States v. Sanchez*, 340 U. S. 42 (1950) (tax on transfer of marihuana—regulations imposed much heavier tax on transfers to persons not registered in compliance with the act); *Sonzinsky v. United States*, 300 U. S. 506 (1934) (tax on firearms with ancillary registration requirements); *Doremus v. United States*, 249 U. S. 86 (1919) (tax on narcotics—all dealers in drugs required to register; sales to be made on prescribed forms issued by the Treasury Department); *Alston v. United States*, 274 U. S. 209 (1927) (same); *Felsenberg v. United States*, 186 U. S. 126

tives other than revenue and that the tax actually results in regulation or discouragement of the activities taxed does not impair its validity.¹⁶

But if the Court from an on-the-face examination of a particular statute determines that the tax or its ancillary regulations constitute primarily an effort to regulate or destroy matters beyond Congressional control it will classify the enactment an imposition of a penalty rather than an exercise of the power to tax.¹⁷ In such case legislative motives are considered but only as they are evident in the express language of the statute itself.¹⁸

The net result seems to be that if the act is actually a tax the power of Congress cannot be denied except for the limitations placed upon the

(1901) (tax on tobacco—coupons, premiums or gift certificates could not be attached to packages); *In re Kollock*, 165 U. S. 536 (1899) (tax on sales on boards of trade—regulation required written memorandum of sale with names of parties, etc.).

¹⁶Cases cited notes 9 and 15, *supra*.

¹⁷*Carter v. Carter Coal Co.*, 298 U. S. 238 (1936) held invalid a 15% excise tax on bituminous coal which provided for an exemption for operators who accepted codes of fair competition prescribed by the act. The Court said this was clearly a penalty for non-compliance with regulations rather than a revenue measure. *United States v. Butler*, 267 U. S. 1 (1936) involved a tax levied on processors of cotton with a provision that the proceeds could be employed for the purpose of removing surplus agricultural products from the market. Held: invalid because the expenditure clause showed the immediate purpose of the act to be regulation of agriculture. *United States v. Constantine*, 296 U. S. 287 (1935) dealt with a federal tax of \$25 on the business of a retail dealer in malt liquor which stipulated that there was to be a tax of \$1000 if the business was conducted in violation of state law. The Court held that the larger tax was clearly a penalty to enforce state laws. *Linder v. United States*, 268 U. S. 5 (1925) held that a doctor could not be convicted under the narcotics tax law for having prescribed in the ordinary course of professional service doses of drugs to an addict without written application as required. The specific requirement was held to have no reasonable relation to the collection of revenue. *Bailey v. Drexel Furniture Co. (Child Labor Tax Case)*, 259 U. S. 20 (1922) held invalid a 10% tax upon the net income of those who knowingly employed children below certain ages. Pointing out the element of scienter and the fact that the tax did not vary with the amount of the thing taxed the court held that the purpose of the enactment was clearly to impose a burden on those who did not comply with an elaborate code of regulations set forth in the act. *Hill v. Wallace*, 259 U. S. 44 (1922) invalidated a tax of 20 cents a bushel placed on grain sold on future contracts except when sold on boards of trade operating under regulations provided for in the act. See also *Trusler v. Crooks*, 269 U. S. 475 (1926). Where Congress has used its taxing power to regulate matters in which it has expressly delegated powers to deal directly, the "taxes" have often been deemed penalties, thus greatly changing the type of procedure permissible in enforcement. See, e.g. *United States v. La France*, 282 U. S. 568 (1930); *Lepke v. Lederer*, 259 U. S. 557 (1922).

¹⁸*United States v. Kahriger*, 105 F. Supp. 322 (E. D. Pa. 1952) relied solely on *United States v. Constantine*, 296 U. S. 287 (1935), in holding that the occupational tax on wagerers was an attempt to punish violation of state law. The obvious distinction as pointed out by the Supreme Court in *United States v. Kahriger*, 73 S. Ct. 510 (1953) is that the penalty provisions of the wagering tax applies to those who do not comply with the tax, irrespective of whether his state laws permit wagering or not. The penalty exaction in the *Constantine* case, *supra*, was on its face imposed only on persons who were dealing in liquor contrary to state law. *But cf. United States v. Smith*, 106 F. Supp. 9 (S. D. Cal. 1952). See Note, 14 U. OF PRR. L. REV. 71 (1952).

taxing power by the Constitution in express terms.¹⁹ Although this doctrine of "objective constitutionality" does not afford a completely satisfactory explanation of the Court's decisions on the extent of federal taxing power it appears to be a rational classification for the most part.²⁰

From a strictly objective viewpoint of the occupational tax on wagers it is not surprising that the Supreme Court had no difficulty in deciding that it is a valid exercise of the taxing power. On its face the act appears to be designed primarily for the production of revenue.²¹ The registration provisions of the statute can certainly be declared as essential aids in the collection of the tax on wagering as well as for necessary identification of the taxpayer.²² The penalty provisions can be classified as permissible measures adopted for the enforcement of the tax and its provisions.²³

On the other hand, one would have to ignore reality in order to fail to recognize that Congress has devised a means to regulate and prohibit wagering in all the states where it is illegal. The gamblers are faced with the choice of subjecting themselves to prosecution under the state criminal laws by complying with the act or going to federal prison for willfully violating it.²⁴ That such an inevitable result was a primary

¹⁹ See note 7 *supra*.

²⁰ Some authorities have found the distinctions drawn by the Court between a tax and a penalty untenable. Corwin, *Constitutional Law in 1921 and 1922*, 16 AM. POL. SCI. REV. 613 (1922); Cushman, *Social and Economic Control Through Taxation*, 18 MINN. L. REV. 757 (1934). See, however, Brown, *The Excise Tax As a Regulatory Device*, 23 CORNELL L. Q. 45 (1937); Powell, *Child Labor, Congress and the Constitution*, 1 N. C. L. REV. 61 (1922).

²¹ See note 1 *supra*. It had been estimated that the annual revenue to be derived from the wagering and occupational taxes would be \$400,000,000. H. R. REP. NO. 586, 82nd Cong., 1st Sess. 112 (1951).

²² See note 1 *supra*. The registration provisions of the tax were explained by the Committee Reports as follows: "The committee conceives of the occupational tax as an integral part of any plan for the taxation of wagers and as essential to the collection and enforcement of such a tax. Enforcement of a tax on wagers frequently will necessitate the tracing of transactions through complex business relationships, thus requiring the identification of the various steps involved. For this reason, the bill provides that a person who pays the occupational tax must, as part of his registration, identify those persons who are engaged in receiving wagers for or on his behalf, and, in addition, identify the persons on whose behalf he is engaged in receiving wagers." H. R. REP. NO. 586, 82nd Cong., 1st Sess. 60 (1951); SEN. REP. NO. 781, 82nd Cong., 1st Sess. 118 (1951).

²³ See note 1 *supra*.

²⁴ "Each collector shall . . . place and keep conspicuously in his office, for public inspection, an alphabetical list of the names of all persons who shall have paid special taxes within his district, and shall state thereon the time, place, and business for which such special taxes have been paid, and upon application of any prosecuting officer of any State, county, or municipality, he shall furnish a certified copy there of . . ." INT. REV. CODE, § 3275; made applicable to occupational tax on wagers by INT. REV. CODE, § 3292. Justice Frankfurter in his dissent in *United States v. Kahriger*, 73 Sup. Ct. 510 (1953) says: "In addition to the fact that Congress was concerned with activity beyond the authority of the Federal Government, the enforcing provision of this enactment is designed for the systematic confession of crimes with a view to prosecution for such crimes

purpose and motive of Congress in passing the enactment is too obvious to be denied.²⁵

Conceding that the suppression of professional gambling would be of great moral benefit to our society it is still difficult to regard an attempt at such accomplishment under the guise of a revenue measure to be in the best interests of public policy.²⁶ An enactment which in return for the payment of an occupational tax purports to grant to the taxpayer the privilege of performing certain acts but which actually and designedly subjects him to punishment for their performance cannot be viewed as a rational or good-faith use of the federal taxing power. And yet in view of the fact that all taxation inevitably results in economic and social regulation to some extent and that extreme deference is due Congressional use of its delegated power to tax it is submitted that the United States Supreme Court has adopted the better policy in upholding the Wagering Tax Act. The real solution lies in the hope that in the future Congress will make a more reasonable use of its delegated powers and that the states will make a more effective use of their police powers.

THOMAS W. STEED, JR.

Damages—Fraud and Deceit—Recovery of Punitive Damages for Fraud and Deceit

One segment of the law of damages not frequently discussed is the question of assessing punitive damages in an action of fraud and deceit. North Carolina has recently considered this question in a case of first impression.¹

There the plaintiffs, aged Negroes without education, were induced to buy a tract of land from the defendant as a result of false and

under State law." Justice Black, also dissenting, calls the act "a squeezing device contrived to put a man in federal prison if he refuses to confess himself into a state prison as a violator of state gambling laws." *United States v. Kahriger, supra*.²⁶ There are many instances in the Congressional debates prior to the passage of the tax where the suppression of gambling was discussed. For instance see 97 CONG. REC. 6892 (1951):

"Mr. Hoffman of Michigan. Then I will renew my observation that it might if properly construed be considered an additional penalty on the illegal activities."

"Mr. Cooper. Certainly, and we might indulge the hope that the imposition of this type of tax would eliminate that kind of activity."

²⁶ Although concurring in the majority opinion upholding the wagering taxes Justice Jackson said: "But here is a purported tax law which requires no reports and lays no tax except from specified gamblers whose calling in most states is illegal. It requires this group to step forward and identify themselves, not because they like others have income, but because of its source. . . . It will be a sad day for the revenues if the good will of the people toward their taxing system is frittered away in efforts to accomplish by taxation moral reform that cannot be accomplished by direct legislation." *United States v. Kahriger, 73 Sup. Ct. 510 (1953)*.

¹ *Swinton v. Savoy Realty Co., 236 N. C. 723, 73 S. E. 2d 785 (1953)*.