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Taxation - Union Strike Benefits Held Not To Constitute Income under Internal Revenue Code - Kaiser v. United States, 267 F.2d 367 (C.A. 7th, 1958)

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The joint debt which Aaron and Ada Keil incurred was $8,000. Assuming the property to be worth $20,000 each had an equity of $12,000, since as tenants by the entirety they were both seised of the whole. To allow contribution of $4,000 to Ada Keil would give her an equiy of $16,000. If she were to pay the whole debt her equity would remain $12,000. Thus when her husband died Ada Keil suffered no detriment. In addition the $8,000 was used for improvements to the land of which she is now sole owner. It therefore seems inequitable for the estate of a deceased tenant by the entireties.[9]

[9] Tenancy by the entirety is not a recognized type of property holding in Illinois. See Douds v. Fresen, 392 Ill. 478, 64 N.E.2d 729 (1946); Lawler v. Byrne, 252 Ill. 194, 96 N.E. 892 (1911). Non-recognition of tenancy in the Married Woman's Act of 1861, Laws 1861, p. 143.

TAXATION–UNION STRIKE BENEFITS HELD NOT TO CONSTITUTE INCOME UNDER INTERNAL REVENUE CODE

Plaintiff brought suit to recover taxes imposed by the Commissioner upon strike benefits received from the United Automobile Workers during the early stages of the now famous Kohler strike. At the trial,[1] the presiding judge reserved ruling on the Commissioner's motion for a directed verdict and submitted the case to the jury for a determination of whether the payments in question constituted a gift. The jury returned a verdict in favor of the taxpayer on this issue, whereupon the judge set aside the verdict and granted the Commissioner's motion for a directed verdict. On appeal, the court of appeals for the Seventh Circuit reversed, holding that strike benefits do not constitute income within the meaning of the Internal Revenue Code.[2] In addition, the court held that the particular receipts involved in this case were gifts and, therefore, expressly exempted from taxation by Section 102 of the Code.[3] *Kaiser v. United States,* 267 F.2d 367 (C.A. 7th, 1958).

One of the most perplexing problems in the interpretation of the Internal Revenue Code, taxability of strike benefits, is presented by the instant case. This decision raises serious questions of law and policy which doubtless will not be put to final rest unless and until the Supreme Court takes the case.

[1] The proceedings in the district court are reported in Kaiser v. United States, 158 F. Supp. 865 (E.D. Wis., 1958).

[2] The definition of gross income set forth in Section 61(a) is pivotal to all the income tax provisions in the Code. Only those receipts which are encompassed within this definition are subject to taxation.

[3] Section 102(a) provides: "Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance."

At the outset, it seems necessary to point out that the *Kaiser* case does not present the issue of taxability of strike benefits in its clearest form. The taxpayer in this case was not a member of the UAW at the time the strike commenced. A part of the strike benefits in issue were received under a plan whereby the UAW made these benefits available to non-members. Subsequently, Kaiser joined the union and a part of the benefits were received thereafter. At no time during the period in question, however, did the taxpayer pay dues to the union.[4]

In concluding that strike benefits do not constitute income within the meaning of §61(a) of the Internal Revenue Code, the court relied heavily upon a series of rulings by the Commissioner whereby analogous receipts had been held non-taxable. Reference was made to the non-taxable status of damages for alienation of affections;[5] damages for breach of promise to marry;[6] awards under wrongful death statutes;[7] payments to war prisoners for mistreatment by their captors;[8] retirement benefits paid under the Federal Old Age and Survivors Insurance System;[9] unemployment compensation benefits paid by a state;[10] public assistance relief payments;[11] subsistence given a disaster victim by the American Red Cross;[12] and, rehabilitation payments made to victims of a tornado disaster from a special fund set up by a large employer in the area for the benefit of his employees and their families.[13] Without any express explanation of the theory upon which these rulings were being related to the problem at hand, the court proceeded to the conclusion that strike benefits were similarly non-taxable because they were distributed on the basis of need.

An analysis of these rulings would seem to permit a fairly accurate reconstruction of the court's underlying theory. First, it seems clear that the first four rulings were cited merely to indicate the susceptibility of Section 61(a) to a limiting interpretation. These rulings seem to have little relation factually to the treatment to be accorded strike benefits. The remainder of the rulings may be treated collectively as authority for the proposition that payments received on the basis of need are non-taxable.

Although the tax-exempt status of unemployment compensation has long been established,[14] the Commissioner has not seen fit to extend this

[4] The strike was called on April 5, 1954. Taxpayer began to receive strike benefits on May 4, 1954. On August 19, 1954, he became a member of the UAW.

[5] I.T. 1804, II-2 Cum. Bull. 61 (1923).

[6] G.C.M. 4363, VII-2 Cum. Bull. 185 (1928).

[7] See I.T. 2420, VII-2 Cum. Bull. 123 (1928).

[8] Rev. Rul. 55-132, 1955-1 Cum. Bull. 213.

[9] I.T. 3447, 1941-1 Cum. Bull. 191.

[10] I.T. 3230, 1938-2 Cum. Bull. 136.

[11] Rev. Rul. 57-102, 1957-1 Cum. Bull. 26.

[12] Spec. Rul. of I.R.S., 5 Stan. Fed. Tax. Rep. § 6196.

[13] Rev. Rul. 131, 1953-2 Cum. Bull. 112.

[14] The ruling referred to in note 11 was made in 1938.

exemption to strike benefits. This, despite the fact that the very reason unions maintain such programs is that unemployment compensation is not generally available to strikers.[15] Several arguments have been urged to justify this disparate treatment.[16]

First, it has been suggested that the distinction rests upon the fact that one system (unemployment compensation) is administered by the government whereas the other is private. It is difficult to perceive the relevance of this distinction in relation to the provisions of the Code. When viewed in the light of the Commissioner's recognition of the tax-exempt status of the employer-administered rehabilitation payments, it becomes incomprehensible.

Another ground for the distinction which has been suggested is the fact that unemployment compensation is provided only for workers whose unemployment is involuntary, whereas, strike benefits go to those who choose not to work. Here, again, there is difficulty in relating this difference to the Code provisions. And the tax-exempt status of public assistance relief payments would seem to indicate that such a distinction is unwarranted. Moreover, the fact that unemployment compensation is available in a few states to strikers indicates that the voluntariness issue is not critical.[17]

The final argument upon which the distinction between unemployment compensation and strike benefits is supposed to rest is that the union member has already been allowed a deduction for the payment of his dues from which payments the union strike fund is generated. To allow recipients of strike benefits to exclude them from gross income is thus said to create a "double-deduction" problem. On its face this argument seems to have considerable validity. An examination of the facts, however, reveals its fatal weakness. Deductions for payment of union dues are taken "below the line," i.e., they cannot be taken if the taxpayer avails himself of the standard deduction.[18] In view of the fact that the vast majority of workers use the standard deduction, the "double-deduction" problem would seem to

[15] "In only two states and only after an extensive waiting period are striking workers eligible to receive unemployment compensation benefits, although other workers forced out of work as a result of the strike, may be eligible under certain circumstances." AFL-CIO Collective Bargaining Report, Vol. III, No. 11, November, 1958.

[16] For a summary of these arguments, see 19 U. of Pitt. L. Rev. 824 (1958).

[17] The fact that unemployment compensation is sometimes available to strikers creates the possibility of disparate treatment occasioned by a variance in state law. For example, if state A allows such compensation, a worker therein receives subsistence free from taxation. At the same time, a worker in state B, where unemployment compensation is unavailable and reliance upon union support therefore necessary, would be taxed on his subsistence under the Commissioner's view. Such a result must be regarded as questionable at best.

[18] See Section 62 of the Internal Revenue Code.

be more apparent than real. Moreover, the tax-exempt status of disaster benefits administered by the Red Cross may provide an example where the Commissioner has allowed a double deduction. If, for example, the recipient of such benefits claimed a charitable deduction for a contribution previously made to the Red Cross, his position would be identical to that of the dues-paying union member who subsequently receives strike benefits. Despite this obvious analogy, the Commissioner has insisted that disparate treatment is warranted.

The foregoing would seem to indicate that the court of appeals was correct in holding strike benefits not to constitute income within the meaning of Section 61(a). Though the rulings upon which it rested its decision have never received judicial sanction,[19] a sound policy of tax administration would seem to demand consistency in the application of the law. The decision here guarantees such consistency.

The court of appeals found, in the *Kaiser* case, that the strike benefits to Kaiser were intended as a gift. The court had to deal with facts that would both buttress and weaken the presence of donative intent. On the one hand, (*a*) the verdict of the jury that there was a gift, (*b*) the status of the taxpayer vis-a-vis the union, and (*c*) the past practice of the union to use its strike fund for charitable purposes[20] constitute facts which tend to warrant the inference of a donative intent on the part of the union. On the other hand, (*a*) the commercial context in which the payments were made, (*b*) the fact that the Union Constitution forbade the use of the strike fund for purposes other than the aiding of local unions during strikes and lockouts,[21] and (*c*) the fact that recipients of strike benefits generally regarded themselves as bound to perform certain duties in return therefor[22] would seem to lead to an opposite result. An evaluation of each of these factors would appear to be a necessary prerequisite to the construction of a framework within which the problem can be solved.

The weight to be accorded to the jury's determination that the benefits conferred upon Kaiser by the Union constituted a gift presents a difficult problem. If findings by a jury in suits in the district courts are accorded the same status as findings by the Tax Court, an altogether quite reasonable assumption, the Supreme Court decision in *Bogardus v. Commissioner*[23] would seem to be in point. There, the Court reversed a judgment predicated upon a finding by the Tax Court that the transfer involved was made

[19] This is, of course, due to the fact that there is no one to complain of leniency on the part of the Commissioner.

[20] See Kaiser v. United States, 158 F. Supp. 865, 868 (E.D. Wis., 1958).

[21] Ibid., at 867 where the court discusses Article 16, Section 11 of the International Union Constitution.

[22] Authority cited note 20, supra.

[23] 302 U.S. 34 (1937).

without a donative intent on the grounds that the circumstances surrounding the transfer "clearly indicated" that the Tax Court's finding was erroneous. In view of the vigorous dissent in the case,[24] the question cannot be regarded as entirely settled.

Assuming, however, that this aspect of the *Bogardus* case retains its vitality, it would seem to constitute a precedent clearly sufficient to justify a review of the jury's finding in the *Kaiser* case. For, in *Kaiser,* as in *Bogardus,* no conflict in testimony is involved. Rather, the finding is no more than an inference from stipulated facts and uncontroverted testimony. Its validity would seem, therefore, to depend solely upon a proper evaluation of the surrounding circumstances and not at all upon a determination as to the credibility of particular witnesses. Where such findings are involved, it seems quite proper that the appellate courts exercise their powers of review and not consider themselves bound by jury determinations at the trial.

Thus, under the *Bogardus* rule, the finding of the jury in the *Kaiser* case could stand only if it was not clearly erroneous when considered in the light of the attendant circumstances. For reasons to be developed below, it is submitted that the finding could not be set aside as clearly erroneous. Rather, it would appear that the circumstantial context in which Kaiser received strike benefits from the Union were so wholly ambiguous that the jury would have been warranted in finding either way.

The fact that the taxpayer in the *Kaiser* case was not a member of the union during a part of the period in question and, during no part of that period, paid dues to the union would appear to be of substantial significance. Whatever the legal or moral obligation of the union toward its dues-paying members, it seems clear that no obligation of any kind was owing to Kaiser. Thus, in this respect at least, there is no inconsistency with the finding of a donative intent.

The prior history of use of the Union strike fund for charitable purposes would seem to have a twofold significance. First, it indicates that the predominantly commercial purpose of the Union is not completely inconsistent with a charitable intent on its part. Secondly, it militates against an overly strong reliance upon the limitations in the Union Constitution on the use of the strike fund. Thus, two of the factors mentioned above as tending to negative the existence of a donative intent are not so weighty as they may on the surface appear.

Nevertheless, it would not seem justified to discount either of these factors completely. The recent Supreme Court decision in *Commissioner v. Jacobson,*[25] all but overruling an earlier decision in *Helvering v. American*

[24] The dissenters were Cardozo, Brandeis, Stone, and Black.

[25] 336 U.S. 28 (1949).

Dental Co.,[26] is indicative of an increasing reluctance on the part of the courts to infer the presence of a gift in a commercial situation. Similarly, a cautious attitude can be expected from the courts when they are asked to infer a motive which would be *ultra vires*. Given the currently prevailing climate of opinion, this would seem particularly true where the *ultra vires* act would constitute a misappropriation of union funds.

One factor remains to be discussed, i.e., the obligations which the recipient of strike benefits incurred. There was testimony at the trial that the recipient of strike benefits considered himself morally obligated to aid the union in the conduct of the strike by picketing, serving in a soup kitchen, or similar duties. It is clear that if the union conferred these benefits in order to induce such activities, they were not gifts but merely compensation for services within the rule of *Old Colony Trust Co. v. Commissioner*.[27] But the uncontroverted testimony seems to indicate that this was not the case. Rather, the Union seems to have conferred strike benefits upon only one criterion—the needs of the various strikers. It is possible then that the moral obligation felt by the recipients was no more than the normal feeling of gratitude which donees have toward donors. If this be the case, the fact that their gratitude found voluntary expression in activity beneficial to the Union is not inconsistent with the existence of a gift.

The foregoing discussion indicates the complexity of this question, a complexity which was well camouflaged by both the majority opinion and the dissent in the court of appeals. It seems fair to say that under the circumstances of the case, either inference (presence or lack of donative intent) would appear defensible. In such a situation, the normal solution is to uphold the decision reached by the body charged with the primary determination of the facts. For reasons to be developed below, this solution is not feasible in the *Kaiser* case.

The *Kaiser* case was set up as a test case from the very beginning. Literally thousands of taxpayers similarly situated were awaiting the outcome of the case in order to accurately determine their own tax liabilities. Under such circumstances, it would seem imperative that some decision which does not involve a case by case adjudication be made. The reliance upon a jury to determine the donative intent of the taxpayer inevitably involves this impractical method of adjudication. The trial judge's decision to set aside the jury determination and direct a verdict in favor of the Tax Commissioner was doubtless prompted by considerations of a practical judicial administration of the problem of strike benefits. It has already been shown that such a directed verdict as a matter of law is not justified by the facts.

[26] 318 U.S. 322 (1943). Both this and the Jacobson case involve the taxability of cancellation of indebtedness income.

[27] 279 U.S. 716 (1929).

The court of appeals' primary reliance upon the definition of gross income contained in Section 61(a) was doubtless premised upon these same considerations of judicial administration. For reasons set forth above, it is felt that the solution of the problem chosen by the court of appeals is superior to that of the district court.

Final decision of this case may well be yet to come. The case is of sufficient importance to merit consideration by the Supreme Court. The desirable conclusion would, of course, be the enactment of clarifying legislation by Congress. As usual, however, the possibility of such legislation in the foreseeable future is dim.