

# TAX PLANNING AND LEGAL AUTHORITY

Prepared by:  
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[Criminal Tax Evasion - Part 1](#)

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[Criminal Tax Evasion – Part 3](#)

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# Tax Planning and Legal Authority

By Gary S. Wolfe, Esq.

The US Supreme Court has a long history of supporting legal tax planning while disavowing illegal tax evasion (which has both civil and criminal consequences). Please see the authorities cited below.

In 1864, in the case of *US v. Isham* 84 US 496 (1864) the US Supreme Court considered the Stamp Duty (Tax) and stated their seminal proposition which is the foundation for tax planning: “(the court declared) if a device to avoid the payment of a stamp duty...is carried out by the means of legal forms, it is subject to no legal censure”.

In the *Isham* case, the Court gave their ruling citing the case of an individual whose tax planning circumvented the Stamp Act of 1862 (which imposed a “duty” (i.e. tax) upon bank-checks for an amount of \$20 or more); the Court noted: “A careful individual... who pays no stamp duty (by paying a creditor \$20 by two \$10 checks not one \$20 check) (their) practice and this system he pursues habitually and persistently... while his operations deprive the government of the duties it might reasonably expect to receive, it is not perceived that the practice is open to the charge of fraud (upon the revenue).”

In the landmark 1916 Supreme Court Case of *Bullen v. Wisconsin* 240 US 625, 630 (1916), the issue was whether the State of Wisconsin could impose an inheritance tax on funds belonging to a resident of Wisconsin, which were held in a revocable trust in Chicago. Justice Holmes, in his opinion, declared that the fund was subject to the tax but he used a clear-cut explanation to explain the difference between legal tax planning and illegal tax evasion:

“We do not speak of evasion, because when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits” (at p. 630).

In the 1923 case of *US v. Merriam* 263 US 179,187 (1923) upheld the Taxpayer’s rights to minimize taxes thru tax planning rejecting the US



Government argument that "taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with the legal forms or expressions". This "tax planning legal right" was upheld by both lower federal courts and the Board of Tax Appeals (now US Tax Court) in the following cases:

Weeks v. Sibley, 269 F. 155, 158 (1920) (D. N.D. Tex.) where the court held that planning to "avoid tax" is legitimate and is altogether different from tax dodging, the hiding of taxable property, or the doing of some unlawful or illegal thing in order to avoid taxation".

Appeal of Peterson and Pegau Banking Co. 2 B.T.A. 637, 639 (1925) which affirmed the "right of any taxpayer to minimize its taxes by legitimate devices".

Since the US Constitution, nor any express Congressional statutory provision, recognizes any legal right for "tax planning" these rights are based on common law i.e. court rulings. The court rulings on "substance over form" and the US taxpayer right to minimize their taxes by "legal tax planning" is best expressed in two cases:

Appeal of W.C. Bradley, 1 B.T.A. 111, 117 (1924) which stated that "the law... deals not alone with the form but with the substance of transactions, looks if necessary through the form to the substance, and predicates its findings upon realities rather than upon fictions"...

U.S. v. Barwin Realty Co. 25 F.2d 1003 (1928) (D. E.D. N.Y.), aff'd 29 f. (2d) 1019 (where the corporate form is used for the purpose of evading the law, the court will not permit the legal entity to be interposed so as to defeat justice").

In the realm of legal tax planning (as contrasted to illegal tax evasion) the US Supreme Court has issued numerous pro-taxpayer opinions, including:

So. Pacific Co. v. Lowe 247 US 330 (1918), which applied substance over form to prevent taxation of dividends issued prior to the enactment of the 1913 Income Tax Act (so the dividends could not be taxed by the 1913 income tax act);

Gulf Oil Corp. v. Llewellyn 248 U.S. 71 (1918) in which Justice Holmes declared substance over form should be the rule declaring “that one should ignore forms when analyzing the taxable nature of earnings transferred for bookkeeping purposes from subsidiaries to a holding company”;

Weiss v. Stearn 265 U.S. 242 (1924) held that a reorganization exempted the stock distributed as taxable income subject to tax;

Prairie Oil & Gas v. Motter 66 F.2d 309 (C.C.A. 10th, 1933) “taxation is an intensely practical matter and that the substance of the thing done, and not the form it took, must govern). See: Arctic Ice Machine Co. v. Commr 23 B.T.A. 1223 (1931) in which the court rejected the taxpayer’s attempt to designate a sale as a tax-free reorganization, basing the decision on “the substance of the transaction rather than its mere form”.

Due to the US Supreme Court rulings, lower courts have enforced a taxpayer’s right to minimize taxes by “legal tax planning”:

Iowa Bridge Co. v. Commr, 39 F.2d 777 (1930) where the court held “unless fraud exists, the fact that a corporation attempts to avoid its taxes is not a reason to recharacterize the transaction”;

Jones v. Helvering 63 App. D.C. 204 (1934) stating that “it has been the invariable holding that a taxpayer may resort to any legal method available to him to diminish the amount of his tax liability”;

Satwell v. Commr 82 F.2d 221 (1st Cir. 1936) stating that “nothing is better settled than that persons are free to arrange their affairs to the best advantage for themselves under the law as it stands. A purpose to avoid taxation is not an illicit motive”.

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