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POLICY POINT

# Was the 1895 *Pollock* Case Decided Consistently with Existing Tax Principles?

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The foundation of the modern tax system in the United States is based on the 16th Amendment passed in 1909. The amendment was Congress's response to the 1895 Supreme Court decision in *Pollock*,[1] which held that an income tax levied on the U.S. population on "dividends, royalties, and rents" was unconstitutional. *Pollock* is a seminal case in the history of taxation and tax law in the United States. Theoretically, the key question is whether a tax on property is the same as a tax on "dividends, royalties, and rents" *arising from* that property. Understanding the reasoning of this case illuminates the history of taxation and key concepts underlying our tax system. It also has implications for constitutional interpretation. *Pollock* and the definition of a direct and indirect tax on differing kinds of property have recently been debated in the *ABA Tax Times* by Professors Calvin H. Johnson[2] and Erik M. Jenson in the context of considering the constitutionality of a wealth tax.[3]

## I. What Was the Court's Justification for the *Pollock* Decision?

Chief Justice Fuller, writing for the Court, provided a succinct explanation.

> First. We adhere to the opinion already announced—that, taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes.
>
> Second. We are of opinion that taxes on personal property, or on the income of personal property, are likewise direct taxes.

[1] *Pollock v. Farmers' Loan & Trust Company*, 157 U.S. 429 (1895), *affirmed on rehearing*, 158 U.S. 601 (1895).

[2] Calvin H. Johnson, *A Sur-Rebuttal to Professor Jensen on the Constitutionality of an Unapportioned Wealth Tax*, 39 ABA Tax Times (Nov. 5, 2019) (contending that "Professor Jensen's counterpoint in this issue, *An Unapportioned Wealth Tax Has Constitutional Problems*, misses the key point that under the Founders' meaning of the Constitution, apportionment was never intended to protect wealth from tax nor be a restraint on any federal tax. Under the Founders' meaning, expressed both by ordinary language and by *Hylton*, if apportionment is not a reasonable administrative measure, apportionment is not required"). Johnson adds that "[a]pportionment of direct tax by population arose in 1783 (not 1787) in a proposal to determine state quotas under requisitions—that is, direct taxes on the states. Under the Articles of Confederation, all national tax was a direct tax because Congress had power to raise tax revenue only by requisitions. The Articles determined states' quotas under a requisition by value of real estate and improvements, but Pennsylvania submitted appraisals that cut their tax to half of Virginia's, which the rest of the states thought was cheating. The 1783 proposal would have determined state wealth by population (counting slaves' contribution to wealth at three-fifths)."

[3] Erik M. Jensen, *An Unapportioned Wealth Tax Has Constitutional Problems*, 39 ABA Tax Times (Nov. 5, 2019) (arguing that "[t]he Court in the 1895 income tax cases, *Pollock v. Farmers' Loan & Trust Co.*, had extended the *Hylton* understanding to include a tax on any property, not just real estate, in the category of direct taxes").

> Third. The tax imposed by sections 27 to 37, inclusive, of the act of 1894, so far as it falls on the income of real estate, and of personal property, being a direct tax, within the meaning of the constitution, and therefore unconstitutional and void, because not apportioned according to representation, all those sections, constituting one entire scheme of taxation, are necessarily invalid.
>
> The decrees hereinbefore entered in this court will be vacated. The decrees below will be reversed, and the cases remanded, with instructions to grant the relief prayed.[4]

To understand the opinion, of course, it must be clear what a direct tax and indirect tax was in the context of the 1895 decision since those concepts have evolved over time and are different today. Today, direct taxes are those on income paid from the taxpayer directly to the government—e.g., the individual and corporate income taxes. Indirect taxes are those paid indirectly by consumers in a transaction for goods or services—e.g., sales, excise, value-added, and goods and services (GST) taxes where the retailer collects the tax amount and pays it over to the government. At the time of the *Pollock* decision, however, a direct tax was a tax levied directly on property that applied by the rule of apportionment, whereas indirect taxes, such as excise taxes, applied under the rule of uniformity in the same way across all areas of the country.

Commentary on the *Pollock* case the same year the case was decided summarizes that then-existing distinction.

> The clause in the Constitution regarding direct taxes was the result of a compromise between conflicting views, "resting on the doctrine that the right of representation ought to be conceded to every community on which a tax is to be imposed, but crystallizing it in such form as to allay jealousies in respect of the future balance of power; to reconcile conflicting views in respect of the enumeration of slaves; and to remove the objection that, in adjusting a system of representation between the States, regard should be had to their relative wealth, since those who were to be most heavily taxed ought to have a proportionate influence in the government. The compromise, in embracing the power of direct taxation, consisted not simply in including part of the slaves in the enumeration of population, but in providing that as between State and State such taxation should be proportioned to representation."[5]

The key to the *Pollock* case was determining whether the tax was an indirect tax or a direct tax. If the tax were a direct tax, it would have to be apportioned to the states under the constitutional Apportionment Clause. The Supreme Court decided that the tax levied was a direct tax.

## II. Was *Pollock* Decided to Protect Monied Interests?

The Supreme Court reached its holding in *Pollock* by equating taxes on the property itself with taxes on income earned from property—i.e., with taxes on "dividends, royalties, and rents." Under that view, owning and living in a property would be equivalent to owning and renting out the property for tax purposes. In the modern U.S. tax system, rents derived from property are a form of taxable income, whereas the benefit from an owner's personal use of that property (i.e., the "imputed income") is not treated as a form of economic gain subject to taxation.

[4] *Id.* at 637.

[5] Francis R. Jones, *Pollock v. Farmers' Loan and Trust Company*, 9 Harv. L. Rev. 198, 200–01 (1895) (quoting from the majority opinion in Pollock).

Since in the *Pollock* case's historical context, those who owned land and other property such as stocks and bonds yielding incomes represented the monied interest, not mere plebian wages earned, the Court's conclusion suggests that the idea of taxing landowners on their income from landholdings was politically untenable. There is no clear statement to that effect, of course, but the notion of settled law regarding the idea that a tax on real estate would have to be apportioned suggests particular concern at the time for the propertied class. In fact, Justice Henry Billings Brown in the dissent wrote that "as it implies that every income tax must be laid according to the rule of apportionment, the decision involves nothing less than the surrender of the taxing power to the moneyed class."[6]

## III. Was the Federal Government's Role in Taxation and the Function of the Apportionment Clause Clear to the Early Courts?

Hamilton, of course, argued for a strong federal government. He wanted to create a federal Treasury Department in order to raise federal revenues.[7] With a Treasury Department, the United States government would be able to incur a national debt. Hamilton suggested to President Washington that Congress "adopt" the debts of every individual state through a new national bank. That national debt would create a "credit rating" for the early Republic. This "credit rating" (referred to at the time as simply "credit") would allow the United States to engage in riskier levels and volumes of international trade which, Hamilton believed, would ensure the future prosperity of the United States.

The proposer of the Apportionment Clause suggested it to resolve a distinctly different issue—a "special and temporary purpose", as Justice Brown described it in his dissent in *Pollock*.[8] As Madison stated in Federalist No. 54 (and *Pollock* reiterates), "The establishment of the same rule for the apportionment of taxes as for regulating the proportion of representatives … was by no means founded on the same principle, for, as to the former, it had reference to the proportion of wealth … while the opposite interests of the states, balancing each other, would produce impartiality in enumeration."[9] The Supreme Court stated in the 1881 *Springer*[10] case (a case decided when chattel slavery no longer existed) that Gouverneur Morris suggested the Clause to resolve a debate about slavery. That debate, of course, brought the primary "property" of the slave-holding states into contention. The *Springer* Court itself was unclear regarding the exact nature of that debate, but it undoubtedly referenced the question of how the slave population would be taken into account for congressional representation. Gouverneur Morris suggested the Apportionment Clause as a "bridge" to solve that debate; but once the debate on slavery had been settled, Gouverneur Morris did not see a purpose for retaining apportionment.[11] Nonetheless, the Constitutional Convention kept the clause. The constitutional drafting thus described does not provide a firm answer as to why the Apportionment Clause was retained and what was encompassed in the "direct taxes" it sought to govern.

[6] *Pollock v. Farmers' Loan & Trust Company*, 158 U.S. 601 (Justice Brown in dissent). Brown adds a statement that should be of import to today's audience, in light of increasing inequality due to the ability of the wealthy to avoid taxation: he hopes that the Court's decision "may not prove the first step toward the submergence of the liberties of the people in a sordid despotism of wealth." *Id.*

[7] The concepts in this paragraph are well summarized in the John Adams HBO series available at the following link: https://www.youtube.com/watch?v=notJuFGXQ9w.

[8] *Pollock v. Farmers' Loan & Trust Company*, 158 U.S. 601 (Justice Brown in dissent).

[9] *Pollock v. Farmers' Loan & Trust Company*, 157 U.S. 429 (1895) (at paragraph 32 in the Legal Information Institute source).

[10] *Springer v. United States*, 102 U.S. 586, 596 (1880).

[11] Justice Noah Haynes Swayne mentioned the "bridge" discussion at the 1787 Constitutional Convention in the Springer case. "Mr. Morris said that 'he hoped the committee would strike out the whole clause. … He had only meant it as a bridge to assist us over a gulf; having passed the gulf, the bridge may be removed. He thought the principle laid down with so much strictness liable to strong objections.' The gulf was the share of representation claimed by the Southern States on account of their slave population. But the bridge remained. The builder could not remove it, much as he desired to do so. All parties seem thereafter to have avoided the subject." *Id.* at 1197.

*Hylton*,[12] decided in 1796, is the earliest case dealing with the Apportionment Clause. Notably, Alexander Hamilton argued before the U.S. Supreme Court for approximately three hours. The *Hylton* case considered whether Congress had the authority to levy a tax on carriages, a form of personal property. The question was whether such a tax would be a direct tax that must be apportioned under the Apportionment Clause. The Supreme Court ultimately decided that the tax on carriages, which is a tax on the possession of goods, was *not* a direct tax and did not have to be apportioned even though it was an annual tax paid directly by the person holding and using the carriages. In arriving at its conclusion, however, the Court also restated the old landholdings position that a tax on land would nonetheless be considered a direct tax.

It seems clear from this one case that the Supreme Court did not have a clear conception of what taxation should mean in the new republic or even what role the Supreme Court had to play in developing the tax system. Justice Samuel Chase wrote that the U.S. Supreme Court should consider taxes as they were understood in Great Britain.[13] Because the *Hylton* case was decided a few years before the 1803 Supreme Court development of the concept of judicial review in *Marbury v. Madison* (which determined that the judiciary had the constitutional power to declare a congressional statute unconstitutional), the *Hylton* determination that the tax on carriages was *not* a direct tax requiring apportionment allowed the Court to avoid stating that the tax on carriages was unconstitutional for failing the Apportionment Clause. The case was a steppingstone, however, to the later *Marbury v. Madison* decision since stating that the carriage tax act was valid under the constitution suggests an unequivocal power to be able to say that another act is unconstitutional.

## IV. *Pollock* Simply Doesn't Fit with the *Hylton* (and Prior) Precedent

Nonetheless, it seems clear that the 1796 *Hylton* decision that a tax imposed directly on certain property (in this case, carriages) was not a "direct tax" subject to apportionment differs markedly from the decision reached almost a decade later in *Pollock*. The 1895 *Pollock* decision, by treating any tax on income generated by land held by the person ostensibly subject to the tax as equivalent to a direct real estate property tax and therefore a direct tax that would be subject to apportionment does not appear to follow the *Hylton* precedent. Justice White, in dissent in *Pollock*, said as much, noting that the result of the majority "opinion just announced is to overthrow a long and consistent line of decisions, and to deny to the legislative department of the government the possession of a power conceded to it by universal consensus for 100 years."[14] He added later that the decision "affects fundamental principles of the government by denying an essential power of taxation long conceded to exist, and often exerted by congress."[15] The *Pollock* case created a considerable lack of clarity, rather than bringing the definitions of "direct" and "indirect" taxation into greater clarity, since

- The terms themselves seem inconsistently defined and applied;
- The constitutional history is unclear at best while either contradictory itself or irrelevant to taxation since it was meant to deal with other issues; and

[12] *Hylton v. United States*, 3 U.S. (3 Dall.) 171 (1796).
[13] Justice Chase defined a direct tax and indirect tax within the context of how Great Britain understood the terms from which the United States adopted its legal terms for taxation. Justice Chase wrote that "an annual tax on carriages for the conveyance of persons, may be considered as within the power granted to Congress to lay duties. The term duty, is the most comprehensive next to the generical term tax; and practically in Great Britain (whence we take our general ideas of taxes, duties, imposts, excises, customs, etc.) embraces taxes on stamps, tolls for passage, etc. and is not confined to taxes on importation only." *Hylton v. United States*, 3 U.S. 171, 175 (1796).
[14] *Pollock v. Farmers' Loan & Trust Company*, 157 U.S. 429 (1895) (at paragraph 162 in the Legal Information Institute source).
[15] *Id.* (at paragraph 273 in the Legal Information Institute source).

- The case law draws opposite conclusions from similar situations.

*Pollock* can be viewed as accurately decided only if one accepts the Court's poorly reasoned premise that a tax on *income from any property* for which a tax on the property itself is a direct tax is also a direct tax. Accepting this premise does not seem reasonable considering the contextual definitions at the time, the development of the Apportionment Clause at the convention, and the early *Hylton* case that explicitly considered what was encompassed in those key terms. ■