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Brief of Amicus Curiae Tax Professors in Support of Respondent in Moore v. United States

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No. 22-800

In The
Supreme Court of the United States

CHARLES G. MOORE and KATHLEEN F. MOORE,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICUS CURIAE* TAX PROFESSORS DONALD B. TOBIN AND ELLEN P. APRILL IN SUPPORT OF RESPONDENT

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INTERESTS OF *AMICI CURIAE*

Donald B. Tobin is Professor of Law and immediate past dean at University of Maryland Francis King Carey School of Law. Ellen P. Aprill is John E. Anderson Professor of Tax Law Emerita at LMU Loyola Law School. Together, *amici* have taught law school courses on federal income tax for more than five decades. Both also clerked on the Court of Appeals for the Fourth Circuit and have additional government experience. Professor Tobin worked on Capitol Hill as a professional staff member for U.S. Senator Paul Sarbanes, the Senate Committee on the Budget, and the Joint Economic Committee of Congress. He also worked as an appellate attorney in the Tax Division of the U.S. Justice Department. Professor Aprill served as an attorney-advisor in the Office of Tax Policy of the U.S. Department of Treasury. She also served as a clerk to the Honorable Byron White, Associate Justice of the United States Supreme Court. In their scholarly writing, both *amici* have emphasized issues of tax policy and addressed constitutional issues bearing on tax. Such is their purpose here, in particular to distinguish policy issues related to income tax statutes as enacted by Congress from issues regarding power granted to Congress by the Sixteenth Amendment.[1]

[1] Pursuant to Sup. Ct. R. 37 *amici curiae* represent that no counsel for any party authored the brief in whole or in part. Counsel of record funded the preparation and submission of this brief out of the budget provided to him by the University of Maryland Carey School of Law as part of his employment. *Amici*'s institutional affiliations are listed for identification purposes only. The opinions expressed are those of individual *amici* and do not represent the views of their affiliated institutions.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

"Incomes" in the Sixteenth Amendment is a broad term, encompassing both realized and unrealized income. When the Amendment was adopted, economists, accountants, legal scholars, and legislators all viewed the concept of income broadly.

During the late 1800s and early 1900s, leading economists espoused an inclusive and extensive definition of income. For example, both Irving Fisher and Robert Haig, two preeminent American economists, state unequivocally that the concept of income includes more than money income. They make clear in their writing that income includes unrealized appreciation as well as realized income. Properly interpreted, Edwin Seligman, a leading proponent of an income tax, likewise viewed income broadly.

Accountants working in the early twentieth century also conceived of income as an expansive concept. In a leading accounting treatise during that period, *Accounting Practice and Procedure* (1914), for example, Arthur Lowes Dickinson clarifies that, as an asset increases in value over time, partial realizations continue to take place such that "profit or loss is the estimated increase or decrease between any two . . . periods." *Id.* at 67. This Court also has long accepted accrual accounting to clearly reflect an entity's income even though that income had not yet been realized. See *United States* v. *Anderson*, 269 U.S. 422 (1926); *Spring City Foundry* v. *Commissioner*, 292 U.S. 182 (1934).

Legal scholars as well recognize the broad meaning of income. Thomas Cooley's important treatise, *Law of Taxation* (1876), characterizes the Civil War income tax as "unequal because those holding lands for the rise in value escape it altogether," thereby suggesting that future income tax laws could reach increases in wealth. *Id.* at 20. In the very first page of Henry Campbell Black's influential *Treatise on the Law of Income Taxation Under Federal and State Laws* (1913), he characterizes income as "not a tax upon accumulated wealth, but upon its periodical accretions." *Id.* at 1.

Similarly, legislators involved in drafting both income tax statutes and the Sixteenth Amendment recognize that income could include more than realized income. For both Republicans and Democrats, the Sixteenth Amendment offered a means of reducing the country's reliance on a regressive system of tariffs, which taxed consumption but not capital. Supporters of a progressive income tax argued that the wealthy needed to pay their fair share of the revenue to support the needs of government. A Congress seeking to have the wealthy pay its fair share and interested in a progressive income tax would not have promoted a limited definition of income that would run counter to those goals.

The legislative history of the phrase "from whatever source derived" underscores the breadth of the Amendment. The original version of the Amendment did not include this phrase. This version was referred to the Senate Finance Committee, which reported a

proposed Amendment with the language ultimately adopted and ratified. The addition of this phrase made clear that the Amendment would overrule the holding in *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895), that the source of income could determine whether a tax on income was a direct tax. Moreover, letters written in 1920 by Senator Knute Nelson regarding his insistence on including the phrase show that the changes to the original language of the Amendment were made in order to make the power to tax incomes as broad as possible.

Economists, accountants, lawyers and legislators in the early twentieth century all defined income in broad terms, embracing the definition of income as more than money income and including unrealized gain, and the Sixteenth Amendment was crafted against this backdrop. The powers granted by Article I and the Sixteenth Amendment provide Congress with broad taxing authority. Congress must exercise judgment in enacting particular tax provisions, including the extent to which unrealized gains should be taxed. Our tax laws are extremely complex, and Congress has the expertise, knowledge and discretion to balance competing interests with regard to tax legislation. In this case, where the Constitution specifically grants authority to the Congress, the Court should not substitute its judgment regarding tax policy for that of the Congress.

ARGUMENT

I. Influential economists prior to and at the time of the passage of the Sixteenth Amendment recognized a broad definition of income.

During the late 1800s and early 1900s, economists took the lead in examining the theoretical underpinnings of the question "what is income." The definition of income historically had not been a legal one, but one developed by economists and accountants. See generally Herbert Hovenkamp, *The First Great Law & Economics Movement*, 42 Stanford Law Review 993 (1990). For example, Professor Alfred Marshall in *Principles of Economics* (3d ed. 1895) discusses the broad definition of income. Professor Marshall asserts, "For scientific purposes, it would be best if the word income when occurring alone should always mean total real income," which to Marshall meant far more than money income. *Id.* at 155.

Similarly, Professor Irving Fisher, in *The Nature of Capital and Income* 118 (1906), explains that income represents "services rendered by capital." He goes on to clarify the statement "by capital." The "by" in the phrase does not require realization, but instead differentiates the change in the value of the asset from the original capital. His definition of income, which includes "income realized plus appreciation of the capital (or minus its depreciation)," *id.* at 333, makes this distinction clear.

Fisher, who has been called "this country's greatest scientific economist," Joseph Schumpeter, *Ten Great Economists from Marx to Keynes* 222 (Routledge 1997) (1952), acknowledges that in business one often refers to "money-income" and that for commerce this definition works well enough. But, Fisher continues, money income "is far from exhausting the complete income concept." Fisher 103. To Fisher, the economic benefits, or what he refers to as service from capital, are income. He notes that the "service of a dwelling to its owner (shelter or money rental), the service of a piano (music), and the service of food (nourishment) . . . " constitute income, and the dwelling, the piano, and even the food are the capital. Fisher 106-107. Fisher thus recognizes that realization is not a core component in the definition of income.

The Haig-Simons definition of income, on which policymakers today rely, emerged in the United States during this period in the work of Robert Murray Haig (and was further developed in the work of economist Henry C. Simons). The Joint Committee on Taxation recognizes, "Economists generally agree that, in theory, a Haig-Simons measure of income is the best measure of economic well-being." Joint Committee on Taxation, *Overview of the Definition of Income Used by the Staff of the Joint Committee on Taxation in Distributional Analyses*, No. JCX-15-12, at 3 (Feb. 8, 2012). See also John R. King, *The Concept of Income*, in IMF Tax Policy Handbook 117 (Parthasarathi Shome ed., 1995) (Schanz-Haig-Simons definition of income is "probably the most

influential definition of the personal income of an individual . . . ").

> The Joint Committee writes,
>
> > Broadly speaking, Haig-Simons income is defined as consumption *plus changes in net worth*. Increases in net worth are generally derived from savings and become a source of a family's consumption in a future year. Decreases in net worth are generally the result of drawing down a family's past savings.

Joint Committee on Taxation at 3 (emphasis added).

While the Internal Revenue Code does not adopt the Haig-Simons definition of income, the Haig-Simons definition creates the baseline for understanding the concept of income and for measuring the possible tax base. See Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 Harv. L. Rev. 925, 933-934 (1967); Michael J. Graetz & Deborah H. Schenk, *Federal Income Taxation, Principles and Policies* 84 (7th ed. 2013). This definition treats a change in wealth, not the wealth itself, as income. The Haig-Simons definition does not rely on realization. Changes in wealth, even if not realized, are income because they add to the resources available to a person or entity. See Robert Murray Haig, *The Concept of Income—Economic and Legal Aspects*, in *The Federal Income Tax* 27 (1921). This definition is far broader than realized income, taxable income, net income, or adjusted gross income. It encompasses all the different types of income

that together create the aggregate whole that is income.

Robert Murray Haig built his definition of income on the theoretical framework of Fisher, Marshall, and others. The definition encapsulated Fisher's view of income being services from capital and Marshall's view that income consisted of far more than "money" income. Although Haig's groundbreaking work was first published in 1921, he makes clear that the definition he is endorsing was developed before the adoption of the Sixteenth Amendment. Haig 2. That is, he wrote his seminal piece in the midst of debates surrounding enactment of an income tax and the passage of the Sixteenth Amendment.

As a start to his analysis, Haig characterizes economic conceptions of income in broad terms. Haig 1-2. Haig explains that when an economist speaks of income, the economist is doing so in terms that are "approximately the same sense as it is used in ordinary intercourse" and there has been "no revolutionary contribution" to economic thought on this topic since the passage of the Sixteenth Amendment. Haig 2. "The economist and the man in the street both use the term now as they used it in 1913." *Ibid.* (citing F.W. Taussig, *Principles of Economics* 134 (1916) (income as the creation of utilities), and Irving Fisher, *Elementary Principles of Economics* 34 (1911) (flow of benefits over time)). Haig, relying on definitions from economists in the late 1800s and early 1900s, defines income as " . . . the money value of the net accretion to one's economic power between two points of time." *Id.* at 3, 27. This

formulation, according to Haig, is "the closest practicable approximate of true income." *Id.* at 7.

Haig's broad definition of income was not unique to American economists. In the late 1800s, Georg von Schanz published his work, *The Concept of Income and Income Tax Laws*, 13 Pub. Fin. Analysis 1 (1896) (original German title, *Der Einkommensbegriff und die Einkommensteuergesetze*, 13 FinanzArchiv 1). In this seminal work, Professor von Schanz discusses at length the concept of income and the definition proposed by different scholars. Importantly, von Schanz defines income broadly as the quantity of goods or their value resulting from production or acquisition in a certain period of time, services to third parties, entitlements and *increases in value*. Schanz 1. (Translation from German by Professor Michael van Alstine). (The translated German sentences are "Eine Schwierigkeit ergibt sich, wenn es sich darum handelt zu entscheiden, ob auch Nutzungen, geldwerte Dienstleistungen Dritter, Berechtigungen und Werterhöhungen einzurechnen sind. Man wird diese Frage im allgemeinen bejahen müssen.")

Although Haig also defined income broadly, he understood that tax legislation would fail to tax many items that his definition of income includes. As he writes, "It is an equally long step for the economist between his general definition of income and the content of the category which in his opinion forms the best basis for the imposition of an income tax." Haig 13. Legislators, he recognizes, may decide not to tax an item for a number of reasons. *Id*. at 14. "Actual conditions,

under which the law must function . . . [may require] concessions made to the exigencies of a given situation." *Ibid.* He then notes that one may choose not to tax appreciated gains until sale, but that administrative concerns, not the meaning of income, shape that decision. *Ibid.*

Edwin R.A. Seligman, perhaps the leading academic advocate for a progressive income tax, also distinguishes Congressional power to tax under the Sixteenth Amendment from Congressional decisions as to what to tax under statutory provisions. For example, Seligman argued that taxing the income from state and local bonds was constitutional. Edwin R.A. Seligman, *The Income-Tax Amendment*, 25 Pol. Sci. Q. 193, 210 (1910). Seligman wrote that the drafters of the 1913 tax statute exercised prudence and caution in exempting from income tax the interest on state and local bonds, "although it was emphatically asserted that from the standpoint of equality of taxation such an exemption was illegitimate." See Edwin R.A. Seligman, *The Federal Income Tax*, 29 Pol. Sci. Q. 1, 13 (1914).

In his 1914 article on the 1913 income tax, Seligman observed, "It is easy to say that income should be taxed, but it is not so easy to define what is income." *Id.* at 3. Moreover, he explains, "The framers of the present law . . . thought it wise to follow the almost universal European example and to confine the term 'income' to the ordinary conception of actual money income." *Id.* at 4. He characterizes the decision as one of prudence and not of constitutional requirement. That is, his analysis assumes that the Sixteenth

Amendment permitted Congress to enact an income tax statute that taxed income broadly, even if it chose not to do so in 1913.

Petitioners quote from Seligman's article, *Are Stock Dividends Income?*, 9 Am. Econ. Rev. 517, 519 (1919), which asserted that, "If it is not realized, it is not income." Pet. Br. 31. Seligman wrote this piece shortly before the Supreme Court's second argument in *Eisner* v. *Macomber*, 252 U.S. 189 (1920), on whether stock dividends constitute income. *Id.* at 517. Seligman concluded that stock dividends are not income because they are not realized.

Importantly, Seligman did not argue that such a position is constitutionally required. As evidence for his position regarding unrealized income, Seligman cites the position of "almost all modern income tax laws," *id.* at 529, not the constitutional provisions on which they are based. He himself belies this point in the case of American tax law. In the very first paragraph of the article, *id.* at 517, he notes that stock dividends were treated as income in the Revenue Act of 1916, the issue before the Court, and under an administrative interpretation of the Revenue Act of 1913. Seligman acknowledged that the concept of income has changed over time so that it now includes not only money income, but also occasional earnings and gain derived from disposal of a commodity. *Id.* at 527-528. That is, he viewed the concept of income as a dynamic and changing one. Seligman's understanding that the meaning of income changes over time assumes

a constitutional amendment that permits such development.

In short, economists writing before, during, and soon after the debate on the Sixteenth Amendment clearly understood the definition of income to be very broad. The definitions and discussions by early twentieth century economists demonstrate that, at the time of the drafting and adoption of the Sixteenth Amendment, economists and "the man in the street" both understood income to be a broad concept. Haig 2. At the same time, in the context of enacting an income tax, many of these economists understood that tax legislation would not tax many items that would be included in their definition of income. In reaching this conclusion, however, they do not rely on a limited definition of income. Instead, they recognize that, although an item may be within the definition of income, legislators may determine that it is not the proper subject of taxation. Such determinations are proper determinations for the legislature to make in crafting an income tax. They are not, however, constitutional principles limiting Congress's power to tax incomes without apportionment under the Sixteenth Amendment.

II. Similarly, accountants working in the early twentieth century recognized a broad definition of income.

Accountants working in the early twentieth century also viewed income as an expansive concept. For example, the "income statement" or "balance sheet"

was designed to reflect the health of a business. Roy Bernard Kester, *Accounting Theory and Practice: A Text-book for Colleges and Schools of Business Administration* 22 (2d ed. 1922). While accounting as a profession was still in its infancy, accounting concepts were already recognizing that an income statement and a business's books reflected more than a business's cash accounts. (For an explanation of how bookkeeping worked in the early twentieth century, see Arthur Lowes Dickinson, *Accounting Practice and Procedure* 13-30 (1914)).

In a leading accounting treatise from the time of the passage of the Sixteenth Amendment, *Accounting Practice and Procedure*, Arthur Lowes Dickinson describes accountants' understanding of realization. For accountants, an asset increases in value over time, as "partial realizations are continually taking place." *Id.* at 67. This increase takes place even if the profit is not taxed until the ultimate sale of the asset. Dickinson recognizes that in creating proper income accounts, an accountant cannot realize appreciable gain constantly, but that the value can be estimated over the period in question. *Ibid.* The profit or loss is therefore the "estimated increase or decrease between any two periods." *Ibid.* Accountants at the time recognized that to clearly reflect income, gain in the value of an asset should be allocated as accurately as possible over the period of the gain. *Ibid.* According to Dickinson, a business's yearly income would include its profit, which would be measured by its total assets at the beginning and end of the year. *Ibid.*

Dickinson also describes how in a single-entry bookkeeping system, which he notes was "adopted for years without bad results," a business can measure its profit by measuring the "surplus so ascertained at the commencement and the end of the year as its profit or loss. . . ." *Id.* at 67-68. Dickinson then clarifies, "In other words, every appreciation of assets is a profit, and every depreciation a loss." *Id.* at 68. Kester, while strongly advocating a double-entry accounting system, similarly recognizes in a single-entry system, profit is measured by "comparative net worth" for the period provided. Kester at 500-501. See also *In re Spanish Prospecting Co.*, 1 Ch. 92, 99 (1908-1910) All ER Rep. 573, 679 (Moulton, J.) (the best measure of a company's profits "can only be ascertained by comparison of the assets of the business at two dates.").

To clearly reflect a business's income, income statements in the early 1900s often reflected items of income that had not yet been realized. Dickinson 67-68. Decisions of the United States Supreme Court acknowledged and accepted this business practice. See *United States* v. *Anderson*, 269 U.S. 422 (1926) (involving accrual accounting and the 1916 taxable year), *Spring City Foundry* v. *Commissioner*, 292 U.S. 182 (1934) (same as to 1920 taxable year).

In *Anderson*, the corporation "set up on its books of account all the obligations or expenses incurred during the year whether they fell due and whether they were paid during that year." 269 U.S. at 436. That is, the Court in *Anderson* explicitly recognized that items not yet received in cash, money, or money equivalent

would be considered "income" and subject to tax. Under petitioners' definition of income, items not yet received, like those referenced in *Anderson*, would escape taxation because they were not realized. *Anderson* indicates that as early as 1916 the definition of income did not require realization. *Id.* at 436, 441.

Similarly, in *Spring City Foundry*, 292 U.S. at 189-190, this Court concluded that accounts receivable were income in 1920, the year the obligation to pay was incurred, not in the year it was paid. The Court approved the accrual method of accounting to include the accounts receivable in income even though the actual payments had not yet been received. *Id.* at 190.

Tax administrators also relied heavily on financial reports prepared by accountants to determine "income." For example, early on, Treasury counted increased valuations as income, but only if they had been recorded on the books of the corporations. Regulation No. 33, Art. 107, *Law and Regulations Relative to the Tax on Income of Individuals, Corporations, Joint Stock Companies, Associations, and Insurance Companies, Gov't Printing Office* 65 (Jan. 5, 1914). Treasury also directed Internal Revenue agents to look at financial reports to audit income. Memorandum from Royal E. Cabell, Comm'r of the Internal Revenue Serv., to Revenue Agents (Apr. 19, 1910), *reprinted in* The Commercial & Financial Chronicle (Apr. 30, 1910), 1142-1143.

Accountants clearly understand that the definition of income is far broader than realized income.

Petitioners' myopic definition fails to recognize the broad concept of income that was prevalent at the time of passage of the Sixteenth Amendment. Congress has the authority to limit the definition of income in particular statutory provisions or even in the Internal Code generally to the one suggested by the petitioner. But the history and tradition of the way the term has been used both in the early part of the twentieth century and today indicates that the legislative choice is not one forced by the Constitution.

III. The leading legal treatises of the time also acknowledged the broad meaning of income.

Like economists and accountants, legal scholars also distinguish statutory choices regarding "income" from the potential reach of the concept of income. In his important late nineteenth century treatise, *Law of Taxation* (1876), Thomas Cooley discusses the Civil War income tax. He observes, "In the United States, such a tax is unequal because those holding lands for the rise in value escape it altogether—at least until they sell, though their actual increase in wealth may be great and sure." Cooley 29. Contrary to petitioners' assertion (Br. 30), Cooley is not asserting that changes in wealth are beyond the reach of any income tax. To the contrary, he is pointing out that, as enacted, the Civil War income tax was unequal because changes in wealth escaped tax. This analysis is better read as an endorsement by Cooley that future income tax laws could reach changes in wealth.

Henry Campbell Black, in his influential *Treatise on the Law of Income Taxation Under Federal and State Laws* (1913), has a nuanced understanding of "income," contrary to petitioners' assertion. Pet. Br. 29-30. In the first page of his treatise discussing income, Black notes "it is not a tax upon accumulated wealth, but upon its periodical accretions." Black 1. This understanding directly supports the notion that changes of wealth, not the wealth itself, fall within the broad definition of income. In his history of the income tax, Black also notes that the Revenue Act of 1870 "elaborately defined and described" income and included "interest accrued within the year but unpaid, if collectible" and "a stockholder's proportionate share of the undivided profits of the corporation." *Id.* at 15. This statement once again shows that Black understood income to be far broader than realized income.

Black also recognizes that Congress has broad discretion with regard to taxation. In his discussions regarding the breadth of Congress's power to tax incomes, he notes,

> We must not forget that the right to select the measure and objects of taxation devolves upon the Congress, and not upon the courts. Such selections are valid unless constitutional limitations are overstepped. "It is no part of the function of a court to inquire into the reasonableness of the excise, either as respects the amount or the property upon which it is imposed."

Black 28 (*citing Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 166-167 (1911)).

Admittedly, Black prefers taxing only money received. See Black 76-78. He advocates that income, for purposes of a *statute* taxing income tax, should be limited to all that person "receives in cash during the year." *Ibid.* (emphasis added). His history of the income tax, however, clearly evidences an understanding that in certain instances income has been interpreted more broadly than his preference. He notes, for example, that Wisconsin's income tax law of 1911 provided that "'income' shall include the estimated rental value of residence property occupied by the owner." *Id.* at 84. See also *State* v. *Frear*, 148 Wis. 456 (1912). In addition, Black recognized that the original Acts of 1864 and 1870 specifically excluded from income the rental value of a home. Black pointed out that, in contrast, "English and Scotch courts hold that the annual rental value of a house which a man owns and in which he lives . . . is a part of his income for purposes of taxation," and that on economic grounds such a policy is "more easily defensible." *Id.* at 85. That is, he acknowledges that a statute could define income more broadly than he himself would prefer.

Finally, petitioners misconstrue a quotation in Black's treatise to imply a connection between "realization" (Br. 30) and something that would be "shocking to the common sense of business men." To reach this conclusion, petitioners need to cobble together partial quotes that appear over thirty pages apart in Black's treatise. See Black 77, 110. Petitioners cite language in

Black's treatise that a security's unrealized gains are not taxed and then note it would have been shocking to call "that" income. Pet. Br. 30. The language that petitioners cite as "shocking" has nothing to do with the sale or holding of a security. Instead, the language references unequal treatment in the tax code, and Black was arguing for parallel treatment between income and deductions. Black's endorsement of equal treatment differs sharply from a determination that the very definition of income requires realization. In fact, businesses were following accrual accounting at this time without shocking common sense.

Black favors a realization requirement as a statutory matter in constructing an income tax. But he also recognizes that at the time of the Sixteenth Amendment, the definition of income did not require realization. Realized income is a type of income, but income as a concept does not include only realized income.

In discussing Godfrey Nelson's book, *Income Tax Law and Accounting* (1918), petitioners once again conflate comments made regarding a statutory income tax and the Constitutional meaning of the term "incomes" in the Sixteenth Amendment. Pet. Br. at 33. Petitioners refer to Nelson's treatise, *id.* at 19, 36, for the notion that "an increase in the book value of assets" is not 'taxable as income.'" Pet. Br. 33 (quoting Nelson 36). Petitioners imply that income for purposes of the Sixteenth Amendment excludes the change in value of an asset.

Nelson, however, is not discussing the Sixteenth Amendment. In his book, Nelson is specifically discussing the Revenue Acts of 1913 and 1916 as passed by Congress. He states, "[a]n increase in the book value of assets to conform with appraisal values, or for other purposes, does not render such increase taxable as income." Nelson 36. He makes this statement because the Treasury Regulation promulgated under the 1913 Act had originally taxed the appreciation of some assets. This Treasury Regulation provided that "gross income embraces not only the operating revenues, but also income, gains, or profits from all other sources . . . and *appreciation in values of assets; if taken up on the books of account as gain*. . . ." Regulation No. 33, Art. 107 (emphasis added).

In other words, the Treasury Regulation promulgated immediately after the passage of the Sixteenth Amendment and the Revenue Act of 1913 taxed the appreciation in the value of assets in certain circumstances. The Department of the Treasury later modified this regulation, and Nelson in his treatise is describing the current tax treatment. Nelson 36. No part of his treatise limits the definition of "incomes" in the Sixteenth Amendment to realized gains. In fact, Nelson specifically recognizes that accrual accounting taxes some unrealized income. See Nelson 39 (accrual method taxpayers should include rent in income when earned even if it is not received); 198 (recognizing the use of accrual method); 45 (recognizing interest not yet received is included if on the accrual basis). In his 1918 treatise, Nelson carefully distinguishes the provisions

of the 1913 and 1916 Revenue Acts. He is simply clarifying that, under the Acts passed by Congress, unrealized gains often escape taxation.

Properly interpreted, none of the statements in Cooley's, Black's, or Nelson's treatises argue that the Sixteenth Amendment required Congress to lay income taxes on only realized income. Instead, the treaties analyze specific tax acts and, in some cases, express their own preferences as to what statutes should tax.

IV. Prior to and during the drafting and ratification of the Sixteenth Amendment, both its drafters and supporters characterized it as having the potential to tax more than realized income.

The history surrounding the passage of the Sixteenth Amendment highlights that the Amendment was intended to provide Congress with broad authority to tax incomes without apportionment. For both Republicans and Democrats, the Sixteenth Amendment offered a means of reducing the country's reliance on a regressive system of tariffs, which taxed consumption but not capital. Sheldon Pollack, *Origins of the Modern Income Tax, 1894-1914*, 66 The Tax Lawyer 295, 329 (2013). The legislative history demonstrates that the constitutional meaning of "taxes on incomes" authorized by the Sixteenth Amendment had the potential to address more than realized income.

After the Supreme Court's decision in *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895),

holding that the 1894 Income Tax was a direct tax requiring apportionment, debate arose in the Congress and the country regarding the proper way to implement an income tax in light of the Court's decision. Some favored passing another statute with the hope that the Court would change its mind, while others proposed a Constitutional Amendment to allow for a broad-based income tax.

The income tax was a response to an exceedingly regressive tariff-based tax system. Progressives joined with tariff opponents in the South to create a system that would rely less on tariffs and more on taxing the incomes of wealthy individuals. See Pollack at 312 & n.102 (quoting *Democratic Party Platform of 1908*, in National Party Platforms, 1840-1972, at 144, 147 (Donald Bruce Johnson & Kirk H. Potter eds., 5th ed. 1975) (platform endorsed "a constitutional amendment specifically authorizing congress to level and collect a tax upon individual and corporate incomes, to the end that wealth may bear its proportionate share of the burdens of the Federal Government")).

In the spring of 1909, prior to the introduction of the Sixteenth Amendment and President Taft's June 16, 1909, support of a constitutional amendment authorizing an income tax, debate on tax legislation focused on inclusion of an income tax in a tariff bill. Representative Cordell Hull (D-Tenn.) expressed his support for an income tax because it was important for the wealthy in society to pay their fair share. In his comments supporting the income tax, he indicated "[the wealthy] of the country should bear its just

share of the burden of taxation and that it should not be permitted to shirk that duty." 44 Cong. Rec. 533 (Mar. 29, 1909). A few weeks later, moderate Republican Senator Borah from Idaho endorsed an income tax to be enacted "not for the purpose of putting all the burdens of government upon property or all the burdens of government on [the wealthy] but that it may bear its just and fair portion of the burdens of this government." 44 Cong. Rec. 1682 (May 3, 1909). Senator Borah also asserted that the income tax proposal should be seen "not as an assault upon wealth, but as an assault upon the vicious principles of exemption of wealth." 44 Cong. Rec. 4000 (July 1, 1909).

The drafters and supporters of the Sixteenth Amendment sought to provide sufficient revenue to the government, while increasing progressivity and fairness by enacting an income tax. Promoters wanted to tax the incomes of those at the top. They would not have sought to exclude even the possibility of taxing unrealized income such as stock appreciation. In fact, shortly after passage of the Amendment, Congress sought to tax stock dividends, and the original Treasury Regulation implemented immediately after the passage of the Sixteenth Amendment provided for the taxation of unrealized appreciation of capital assets. Regulation No. 33, Art. 107. There is no clear evidence for concluding that, at the time of passage of the Sixteenth Amendment, Congress intended the limited definition of income promoted by petitioners.

A drastic limitation of the word "incomes" to include only realized income would have reduced the

progressivity of the income tax and would have shifted the tax from a tax on the wealthiest in society to one where large holders of capital could avoid tax and high wage earners could not. A limited definition of income would run counter to the Congressional goal of having the wealthy pay their fair share and enacting a progressive income tax.

Ignoring capital appreciation and other unrealized gains and taxing only realized income does not ensure a just and fair share for those whose wealth far exceeds income. Statements from the amendment's supporters strongly suggest that, at the time of its adoption, the amendment was broadly understood as permitting taxation of more than realized income. The income tax was designed to reach the annual accretions of wealth, not the wealth itself. That accretion of wealth is income, and it is income whether or not it has been realized.

V. The phrase "from whatever source derived" became part of the Sixteenth Amendment to ensure its breadth, not to constrict its reach.

President Taft sent a message to Congress on June 16, 1909, recommending an amendment to the Constitution "conferring the power" upon Congress to levy an income tax. 44 Cong. Rec. 3344-3345 (June 16, 1909). The next day Senator Norris Brown (R-Nebraska) introduced a resolution proposing the following amendment: "The Congress shall have the power to lay and

collect direct taxes on income without apportionment among the several states according to population." 44 Cong. Rec. 3377 (June 17, 1909).

Senator Brown's proposed amendment was referred to the Finance Committee, chaired by Senator Nelson Aldrich (R-Rhode Island). On June 28, 1909, the Committee reported a proposed amendment with revised language: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." 44 Cong. Rec. 3900 (June 28, 1909). Thus, the amendment as proposed by the Finance Committee and ultimately adopted by both the Senate (44 Cong. Rec. 4121 (July 5, 1909)) and the House (44 Cong. Rec. 4440 (July 12, 1909)) removed the word "direct" from Brown's resolution and added "from whatever source derived." The legislative record does not include any explanation for these changes. See Edwin R.A. Seligman, *Income Tax: A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad* 595 (1911).

The phrase "from whatever source derived" quickly became controversial. In his message of submission to the legislature in 1910, New York Governor Hughes stated that, while he was in favor of granting the power to levy an income tax to the federal government, he nonetheless opposed ratification of the amendment because he viewed the phrase as permitting taxation of income derived from state and municipal bonds. According to Governor Hughes, " 'To place the borrowing

capacities of the state and its government agencies at the mercy of the Federal taxing power . . . would be an impairment of the essential right of State. . . .'" John D. Buenker, *The Ratification of the Federal Income Tax Amendment*, 1 Cato J. 183, 190 (1981) (quoting New York Times, Jan. 6, 1910). That is, Hughes challenged the breadth of the Amendment.

Republican Senators Elihu Root, William Borah, and Dennis Brown, Democratic Representative Cordell Hull along with influential economist Edwin R.A. Seligman countered Governor Hughes. They argued that Congress had the power to tax the income from state and municipal bonds for over a century but had chosen not to exercise it. "Seligman, Brown and Hull further argued that, since the income from all securities would be taxed equally, it would not be unconstitutional to tax that from state and municipal bonds." Buenker 190. Nonetheless, governors and legislators in Connecticut, Massachusetts, Louisiana, South Carolina, and Utah echoed Governor Hughes's concern. Buenker 191. New York's legislature rejected the amendment three times in 1910, but ratified it in 1911, after Governor Hughes was appointed to the Supreme Court and New York elected a new Democratic administration and legislature. Ajay Mehrotra, *Making the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation*, *1877-1929*, at 275-276 (2013).

However, in 1916, in an 8-0 decision including former New York Governor Hughes, now an Associate Justice, the Supreme Court in *Brushaber* v. *Union*

Pacific Railroad, 240 U.S. 1 (1916), rejected a challenge to The Revenue Act of 1913. "[T]he whole purpose" of the Sixteenth Amendment, the Court wrote, was to overrule the principle of *Pollock* that the determination of whether a tax on income was direct depending on "a consideration of the source from whence the income was derived." 240 U.S. at 18. The phrase "from whatever source derived" accomplished this goal. See also 44 Cong. Rec. 3344-3345 (June 16, 1909) (President Taft endorsing constitution amendment to undo Supreme Court income-tax cases); 44 Cong. Rec. 4401 (July 12, 1909) (Rep. Hull of Tennessee) (amendment as adopted by the House overruled *Pollock*); 44 Cong. Rec. 4408 (July 12, 1909) (Rep. Bartlett of Georgia) (same).

Not long after the adoption of the Sixteenth Amendment, Harry Hubbard published an article in the Harvard Law Review arguing that the words "from whatever source derived" had a broad meaning and "clearly gives power to Congress to tax income from bonds and other securities issued by states, cities, and other subdivisions of states and from salaries and wages paid by them." *The Sixteenth Amendment*, 33 Harv. L. Rev. 794, 812 (1920). Hubbard wrote another article later in 1920, prompted by the decision in *Evans* v. *Gore* that the income tax could not reach the salaries of federal judges. Harry Hubbard, *From Whatever Source Derived*, 6 Am. B. Ass'n J. 202, 203 (1920). There Hubbard reported that after publication of the Harvard Law Review piece, he received two letters from Senator Knute Nelson, who was a member of the

Senate Judiciary Committee in 1909. *Id.* at 203. Senator Nelson was also disturbed that *Evans* v. *Gore*, 253 U.S. 245 (1920), ignored the phrase "from whatever source derived." Senator Nelson wrote:

> The words "from whatever source derived" were inserted in the amendment in the Senate at my instance and on my insistence. . . . The record may not show it but I introduced the amendment and the facts are that at that time Mr. Aldrich was Chairman of the Finance Committee and I discussed the matter with him and insisted on the amendment being inserted and he concurred with me, and reported the bill with the phrase "from whatever source derived."

Ibid.

Hubbard then concludes, "The word 'direct' was taken out, in order not to limit income taxes to those which were 'direct,' . . . and the words 'from whatever source derived' were inserted, in order to make the power to tax incomes *as broad as 'incomes' themselves could possibly be.*" *Ibid.* (emphasis in original). See also Edwin R.A. Seligman, *The Income-Tax Amendment*, 25 Pol. Sci. Q. 193, 198 (1910) ("To say 'from whatever source derived' is simply another way of saying 'irrespective of source,' or a shorter way of saying 'from all sources alike, whether the source be one that previously made apportionment necessary or not.' ").

Such is what the drafting history demonstrates, and such was the drafters' intent. Many factors, among them political and administrative concerns, will shape

a statute. A broad understanding of "incomes" includes both realized and unrealized income, even if the 1913 implementing legislation establishing an income tax chose not to tax unrealized income broadly. Congress is not required to enact legislation that inhabits the full constitutional space granted it.

CONCLUSION

Economists, accountants, and lawyers in the early twentieth century all defined income in broad terms, embracing the definition of income as more than money income and including unrealized gain. The legislators who passed the Sixteenth Amendment also envisioned a broad definition of income and clearly understood the word income to include unrealized income. The income tax statutes that existed before and directly after ratification taxed some unrealized gains, and legislators were familiar with those statutes when they crafted the Sixteenth Amendment.

The powers granted by Article I and the Sixteenth Amendment provide Congress with broad taxing authority. During the time period near the enactment of the Sixteenth Amendment, the debate centered around what should be taxed pursuant to an income tax statute. Critiques of a particular tax act or statutory provision, including the extent to which a tax act did or should tax unrealized gain, were arguing about legislative policy decisions, not the reach of the power granted Congress in the Constitution. Congress must

exercise its judgment in legislating particular tax provisions, including the extent to which they tax unrealized income. The Constitution grants Congress the discretion to make such choices. In this case, where the Constitution specifically grants authority to the Congress, the Court should not substitute its judgment regarding tax policy for that of the Congress.

The Court should affirm the Ninth Circuit Court of Appeals and clarify that the word income as used in the Sixteenth Amendment is broadly defined, and that a realization requirement is not a component of the definition of income. Realization figures importantly in the concept of income and thus in its taxation. It is, however, within the discretion of Congress in implementing the Sixteenth Amendment to determine when the taxation of income requires realization.

Respectfully submitted,

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