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LET'S BE FRANK

The *Brushaber* Decision, Part VII

By Dick Greb

Redefining Income

In our current series, we've been looking into the 1916 Supreme Court case *Brushaber v. Union Pacific Railroad Company*.[1] However, because of a rather offhand comment from Justice Edward White in that decision, I've branched off into a discussion of "income" as that term is used in the 16th Amendment. As we've seen, the Supremes said in 1920, in *Eisner v. Macomber*:

> ***Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution***, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.[2]

After thus properly and permanently (except by way of the amendment process) constraining Congress to the definition of income as used in the Constitution, the court gave us that definition:

> '***Income may be defined as the gain*** derived from capital, from labor, or from both combined,' provided it be understood **to**

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Petitions without relief

This photo, donated to the Library of Congress and apparently dated December 1929 (just three months after the stock market crash) is described as:

Congress gets huge petition for reduction of federal tax on earned incomes. Led by many of America's outstanding personages in professional life, a parade marched down Pennsylvania Avenue today with a truckload of petitions bearing the signatures of millions of tax payers who demand a substantial reduction in the Federal Tax on earned incomes. The petition was presented to the chairman of the House and Senate Finance Committees. In the center of the photograph can be seen, left to right: William Howard Black, justice of the Supreme Court of New York; Mae Murray, movie star; Isaac Gans, Washington business leader; Senator Reed Smoot, chairman of Senate Finance Committee; Rep. Willis C. Hawley, chairman of House Finance Committee; and Rep. Sol Bloom of New York.

Perhaps one outcome of this petition stunt was the Smoot-Hawley Tariff Act of 1930, *raising* taxes on over 20,000 imported goods, judged by many to have worsened the Great Depression. Tariffs are, however, authorized by the Constitution, whereas direct taxation on property ("income") is *not*.

1. 240 U.S. 1 (1916).
2. 252 U.S. 189, 206 (1920). Internal citations omitted and emphases added throughout.

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include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case.[3]

To put it plainly then, *income* is simply *gain* or *profit*.

In the last installment, we saw that in the 1939 Internal Revenue Code (IRC), the characteristic of income consisting only of gain or profit — and not 'all that comes in' — was clearly maintained. However, a funny thing happened on the way to the 1954 Code. That distinction became obscured, seemingly transforming what once were 'sources of income' into actual 'income' instead. Of course, as we saw just above, the Supremes acknowledged that Congress has no authority to alter the definition of 'income.' Therefore, any attempt to do such a thing is a nullity, as the court also acknowledged way back in 1886:

> An unconstitutional act is not a law; it confers no rights; it imposes no duties; it affords no protection; it creates no office; ***it is, in legal contemplation, as inoperative as though it had never been passed***.[4]

Now, Congress knows this limitation, so perhaps it was merely a misunderstanding of what they intended. Luckily for us, we have some means to help us discover that intent. When bills make their way out of the House and Senate, it's a common practice for them to publish reports detailing various changes that each made in the bills being considered.[5] Since each house often makes amendments to the other's bills, those differences must be reconciled before final passage, and so sometimes there are reports of those conference committees as well.

Nothing to see here?

On one of my many trips to the law library over the years, I made excerpted copies of the Senate and House Reports on the bill to enact the 1954 IRC. We will only be referencing the House Report for our purposes here. Under the section entitled, "§ 61. Gross income defined," we find this:

> This section corresponds to section 22(a) of the 1939 Code. While the language in existing 22(a) has been simplified, the all-inclusive nature of statutory gross income has not been affected thereby. ***Section 61(a) is as broad in scope as section 22(a).***
>
> Section 61(a) provides that gross includes "all income from whatever source derived." ***This definition is based upon the 16th Amendment and the word "income" is used in its constitutional sense.*** Therefore, although the section 22(a) phrase "in whatever form paid" has been eliminated, statutory gross income will continue to include income realized in any form. ...
>
> ***After the general definition there has been included, for purposes of illustration, an enumeration of 15 of the more common items constituting gross income.*** It is made clear, however, that gross income is not limited to those items enumerated. Thus, an item not named specifically in paragraphs (1) through (15) of section 61(a) will nevertheless constitute gross income if it falls within the general definition in section 61(a).

We can see that it all starts off on the right foot. The House acknowledges that not only is the definition based on its constitutional sense as used in the 16th Amendment — that is, it's limited to *gain* or *profit*, but that it remains "as broad in scope" as was §22(a). And as we saw in the last installment, the breadth of that scope was that it encompassed only the *profits derived from* all the various sources — such as dealings in property, conduct of business, rent, interest, compensation, etc. Therefore, since §61(a) is "as broad" — but neither *more* broad, nor less — it also encompasses only the *profits derived from* all those sources.

However, in the last paragraph we see that the House completely contradicted those earlier statements. They now claim that the list in §61(a) are "common items constituting gross income" rather than merely the *sources of income* they represented in §22(a). So, they lied! While pretending to conform to the limitation inherent in the definition of income as established by the *Eisner* court (and incorporated into §22(a)), they completely obliterated it by eliminating the necessity of profit, thereby transforming a tax on *profits* into a tax on *receipts*!

The lower courts don't care

Of course, the assurance that an unconstitutional law is "in legal contemplation, as inoperative as though it had never been passed" is of little consequence when the courts ignore the principle

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3. *Ibid.*, at 207.
4. *Norton v. Shelby County*, 118 U.S. 425, 442 (1886).
5. These can be found in what are called the "Serial sets" for any given Congress. The debates appearing in the Congressional Record are also a valuable resource.

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as much as Congress does in enacting such garbage in the first place. As quoted in the last installment:

> Compensation for labor or services, paid in the form of ***wages or salary, has been univer-sally held by the courts of this republic to be income***, subject to the income tax laws currently applicable.[6]

This came from the Ninth Circuit, but as it says, the position is universally held by the lower courts. However, I did come across a 1969 District Court decision from southern Texas that at least recognized the concept that *income* can only mean *gain*:

> Accountants and economists may differ greatly as to what is or is not income. It is not, however, their theories that have guided the courts throughout the years. Instead, the courts have chosen to use the meaning given the term "income" by its everyday use in common speech. And the meaning of income in its everyday sense is "a *gain* or recurrent benefit usually measured in money that derives from capital or labor; also: the *amount of such gain* recovered by an individual in a given period of time." Webster's Seventh New Collegiate Dictionary, p. 425. ***Income is nothing more nor less than realized gain. It is not synonymous with receipts.***
>
> Whatever may constitute ***income***, therefore, ***must have the essential feature of gain to the recipient***. This was true when the sixteenth amendment became effective, it was true at the time of the decision in *Eisner v. McComber*, it was true under section 22(a) of the Internal Revenue Code of 1939, and it is likewise true under section 61 (a) of the Internal Revenue Code of 1954. ***If there is no gain, there is no income***.[7]

Notice that the court explicitly acknowledged here that *income is not synonymous with receipts*. And the judge also addressed the transition from the '39 Code to the '54 Code:

> ***The language of section 61(a)*** of the Internal Revenue Code of 1954, set forth above, ***might at first glance appear to have broadened the definition of gross income by the omission of any reference to gain. This, however, is not so***, because the Supreme Court had before it the then recently enacted 1954 Code of Internal Revenue when it decided *Commissioner v. Glenshaw Glass Co*. It noted that, although the definition of gross income had been simplified, "no effect on its present broad scope was intended."[8]

Now, as favorable as this decision might seem, the fact of the matter is that this case dealt with reimbursement of expenses connected with an insurance claim for damages incurred from a house fire. Thus, it doesn't actually contradict the Ninth Circuit's declaration that *wages or salaries* have universally been held to be income by the lower courts. But at least it shows some understanding of the principles behind the position we've been examining.

HIGH COURT DOESN'T CARE EITHER

In the meantime, the Supremes seem to have simply avoided deciding the specific issue of income with respect to wages and salaries, seeing as how they get to pick and choose which cases they'll deign to hear. A search of Supreme Court cases for those which contain "wage" and "income" within the same sentence resulted in only two that really even came close.

The first case concerned a lawyer and his wife who entered into a contract by which all property which either acquired in any way was to be "received" by them in equal shares. Guy Earl was assessed by the Commissioner of Internal Revenue for income taxes on the whole of his salary, and he challenged it on the basis of his contract whereby he only received the half of it. The Commissioner won in Tax Court, but it was reversed in the Circuit court, and so came to be decided by the infamous Justice Oliver Wendell Holmes. He said:

> ***There is no doubt that the statute could tax salaries to those who earned them***

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6. *United States v. Romero*, 640 F.2d 1014, 1016 (9th Cir. 1981).
7. *Conner v. United States*, 303 F. Supp. 1187, 1190 (S.D. Tex. 1969).
8. *Ibid*.

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and provide that the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it.[9]

Thus, Holmes claimed that it was right and proper to tax Earl on the entirety of his earnings even though, by law, he only ever received half of them. Yet the government could have simply assessed Mrs. Earl for the half of her husband's earnings that she received too. Even if it resulted in less tax being collected, Earl was within his rights to arrange his affairs in a way which reduced or eliminated his tax burden. The bottom line though, is that while this case dealt with wages or salaries, the question of whether they, or merely the profits from said wages or salaries were 'income' within the constitutional meaning of the term was not actually before the court.

The second case concerned lunch reimbursements made by a company for their own benefit to their employees, and whether they constituted 'wages' for the purposes of withholding.

> The income tax is imposed on taxable income. [26 U.S.C. §1] Generally, this is gross income minus allowable deductions. [26 U.S.C. §63 (a)]. Section 61(a) defines as gross income "all income from whatever source derived" including, under §61(a)(1), "[c]ompensation for services." The withholding tax, in some contrast, is confined to wages, §3402(a), and §3401(a) defines as "wages," "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash." ***The two concepts — income and wages — obviously are not necessarily the same. Wages usually are income***, [FN5: There are exceptions. E. g., 26 U.S.C. §911(a).] ***but many items qualify as income and yet clearly are not wages.*** Interest, rent, and dividends are ready examples. And the very definition of "wages" in §3401(a) itself goes on specifically to exclude certain types of remuneration for an employee's services to his employer (e.g., combat pay, agricultural labor, certain domestic service).[10]

As you can see, while the court acknowledged that "income and wages obviously are not the same," they immediately claimed that wages *are* income. The distinction drawn is akin to the relationship between rectangles and squares — that is, all squares are rectangles, but not all rectangles are squares. Again, the case did not involve the question of whether wages or only the profit *from* wages constituted 'income,' but the black-robed liberty thieves certainly do not distinguish them here. The fact is that I'm not aware of any Supreme Court case which directly addresses this question, but I also don't hold out much hope that they'd deign to hear one even if given the chance, and so the issue may never be *rightly* decided. However, this subversion of the Constitution by Congress was still some forty years in the future at the time of Brushaber's case, so I'll let the issue go for now.

In the next installment, we'll get back to Justice White's opinion and begin looking at his treatment of some of the additional issues Frank raised in his suit.

9. *Lucas v. Earl*, 281 U.S. 111, 114 (1930).
10. *Central Illinois Public Service Co. v. United States*, 435 U.S. 21, 25 (1978).