

# *POLLOCK, MACOMBER, AND THE ROLE OF THE FEDERAL COURTS IN THE DEVELOPMENT OF THE INCOME TAX IN THE UNITED STATES*

CHARLOTTE CRANE\*

## I

### INTRODUCTION

The administration of the income tax in the United States is heavily legalistic. Although it is obviously hard to quantify such things, the income tax in the United States is clearly more legalistic than any other tax in the United States, and probably more heavily legalistic than the income taxes implemented in prior times and in other jurisdictions. The U.S. income tax is so intensely a matter of law and legal analysis precisely because many lawyers (especially judges) had such an extreme distaste for the tax when Congress first attempted to impose it as a source of revenue in times of peace. This distaste manifested itself most famously in the much-maligned decision of the Supreme Court in *Pollock v. Farmers' Loan & Trust Co.*,<sup>1</sup> in which the 1894 income tax was declared unconstitutional. This decision—decried by many as irrational and unprincipled—ironically resulted in an income tax that over much of its institutional life was in fact a more logically developed tax than its counterparts in other jurisdictions. A similar judicial aversion to the income tax was evident in the decision in *Eisner v. Macomber*,<sup>2</sup> in which the Court held that Congress was constrained in the design of the taxes that it could impose as “income taxes” under the authority of the Sixteenth Amendment. The Court’s assumption of a role for itself in the design of the income tax contributed substantially to the legal flavor of the tax today.

What is meant here by “legalistic”? Not that U.S. income-tax payers are more eager than others to let their disputes about the tax be resolved only after the interposition of a court and perhaps only after the hiring of litigators—facts that may be true, but are probably hard to prove. Nor, certainly, can the tax’s being “legalistic” mean that every aspect of the definition of “income” has been explicable, much less rational. But it seems clear that those who are most

---

Copyright © 2009 by Charlotte Crane.

This Article is also available at <http://www.law.duke.edu/journals/lcp>.

\* Professor of Law, Northwestern University School of Law.

1. 157 U.S. 429 (1895), *modified on reh'g*, 158 U.S. 601 (1895).

2. 252 U.S. 189 (1920).

familiar with the implementation of the income tax expect the income-tax law to be susceptible to common-law-like reasoning processes. Although the income tax is quintessentially a matter of statute, a significant number of its doctrines are entirely a matter of judicial definition.<sup>3</sup> This is especially true of those doctrines that make the income tax susceptible to logical deduction and analysis, including the tax-benefit rule, basis (as other than literal cost), the treatment of liabilities, and cancellation of indebtedness. We expect courts, furthermore, to have a substantial role in the determination of the tax base—both in the broad outlines and in the details.<sup>4</sup> These points may seem obvious, but these characteristics are not necessarily or even ordinarily attributes of other tax systems.<sup>5</sup> We seem to want to rationalize the contours of the income-tax base, simply for the comfort that such rationalization can bring, and we are frustrated when those efforts to rationalize inevitably fail.

Lawyers and courts<sup>6</sup> have always been involved in tax administration. (Who is better than lawyers at identifying economic rents, and where is the presence of such rents clearer than in tax collection?) But the role of lawyers in other tax systems has tended to be confined to the procedural aspects of tax administration: whether the tax was properly enacted, whether the taxpayer had notice of the assessment, or whether the actions taken by the collector were in accordance with his statutory powers. In the implementation of other taxes (and

---

3. I include here judicial definitions that were adopted after having been presented by the government in its arguments, since rarely does a court have an opportunity to construct a definition without some prior administrative practice. As I argue below, much of this administrative practice was in fact the result of a felt need to adhere to the constitutional definition.

4. Not everyone agrees that the Supreme Court and the rest of the federal courts of general jurisdiction are the best candidates for “courts” here. *See generally* Lee A. Sheppard, *Should There Be a National Court of Tax Appeals?*, 46 TAX NOTES 762 (1990). It seems like a good idea to try to keep the income tax sufficiently comprehensible that these judges, when tutored by Justice Department attorneys specializing in the area, could in fact play their role appropriately. We could, after all, have developed a doctrine that granted enormous deference to the IRS, to be overturned primarily by Congress. Indeed, that was the practical effect of the now largely abandoned reenactment doctrine. *See generally* Deborah A. Geier, *The So-Called “Legislative Reenactment” Doctrine*, 55 TAX NOTES 1549 (1992).

5. Richard Joseph cites this phenomenon as motivation for his work, *THE ORIGINS OF THE AMERICAN INCOME TAX: THE REVENUE ACT OF 1894 AND ITS AFTERMATH* (2004). He notes the transformation of thinking about the income tax from a history of “the transformation of society” to be considered “in terms of competing class claims and group interest” to an analysis of “abstract juridical norms and complex accounting principles.” *Id.* at 1–2. While I agree with these observations about the difference in the analytics, my hope here is to explain a part of the phenomenon not considered by Joseph, that is, the way in which the Court’s evolving role actually dampened the extent (or at least the speed) at which the income tax became the “multifaceted tax code, convoluted in character and incapable of reform.” *Id.* at 14.

6. Some poetic license has been taken here, since one need not be a lawyer in order to represent a taxpayer in the tax court, and the tax court does not exercise “the judicial power” of the United States as an Article III court. Upon passage of an examination and upon recommendation, a nonlawyer may be admitted to practice before the tax court. *See* RULES OF PRACTICE AND PROCEDURE, TAX COURT OF THE UNITED STATES R. 200(a)(3), *available at* <http://www.ustaxcourt.gov/rules/Rules.pdf>. Despite these formal distinctions, the process undertaken by the tax court is fully court-like, as seen in the approach the Tax Court has adopted both with respect to statutory interpretation and with respect to many of its procedural aspects. *See, e.g.,* *Ballard v. Comm’r*, 544 U.S. 40 (2005).

perhaps of the income taxes in other jurisdictions), the role of lawyers and their logic in establishing the rules used in determining the measure of the tax base, and the amount of the taxpayer's liability, seems considerably more limited than in the federal income tax.<sup>7</sup>

Why has there been so much room for lawyers and their particular modes of thinking in the administration of the U.S. income tax? Although there were some earlier opportunities for U.S. courts to consider income taxes,<sup>8</sup> the Supreme Court's decision in *Pollock*—that an income tax was a direct tax that could not, consistent with Article I, Section 2, Clause 9 of the Constitution, be imposed without apportionment—played a pivotal role.<sup>9</sup> This decision

---

7. See *infra* text accompanying notes 67–69.

8. The 1860s Treasury experience with income taxes may have been simply a matter of expediency under the pressure of war, but it also offers the possibility of an income tax defined primarily through legislative and administrative pronouncement, with relatively little room for judicial interpretation. An administrative pronouncement, for instance, resolved the tension between the provisions that taxed corporations on their income at 3%, but appeared not to include dividends paid to shareholders who should have been taxed at 5%, by requiring the inclusion for the purposes of applying an additional 2% rate. See Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 WM. & MARY L. REV. 447, 504 (2001) (explaining GEORGE S. BOUTWELL, A MANUAL OF THE DIRECT AND EXCISE TAX SYSTEM OF THE UNITED STATES 197 (1863)).

The Supreme Court during this era seems to have had little stomach for assuming a role supervising the collectors and the commissioner in the interpretive details of the income tax. See, e.g., *Grant v. Hartford & New Haven R.R. Co.*, 93 U.S. 225 (1876) (allowing the entire cost of new bridge as an offset to “profits” under the 1864 Act and taking the government’s position as all-or-nothing with no attempt to analyze further); *Collector v. Hubbard*, 79 U.S. 1 (1870) (finding a taxpayer is barred by a moderately retroactive statute from bringing the traditional suit against the collector for failure to have appealed the collector’s finding to the commission, and thus avoiding having to deal in a binding way with the extent to which the 1864 Income Tax included undivided corporate profits in an individual shareholder’s income). Perhaps the Court was a bit more engaged in *Little Miami & Columbia & Xenia Railroad Co. v. United States*, 108 U.S. 277 (1885), in which it directed that various offsets to profits be allowed as deductions, but the opinion shows no evidence of a willingness to participate in the development of a meaningful definition of “income.”

9. This apportionment must allocate the nominal burden of the tax among the states according to their population. In a loose federation of previously independent states, each jealous of the other’s political representation and anxious to retain power commensurate with financial contribution, such a formula might make sense. See Richard L. Morrill, *The Geography of Representation in the United Nations*, 24 PROF. GEOGRAPHER 297, 297–301 (1972). Thus, for instance, the federated republics of Germany throughout the early years of consolidation maintained a system of contribution and representation based on population.

But in a unified polity that accepts the historical basis of its representative institutions only because there seems to be no easy path to any other basis for representation, an apportionment of fiscal burden by population is not likely to be acceptable. This seems to have been the position reached relatively early in the United States, at least by the 1790s by those with nationalist tendencies, and within the general population certainly by the close of the Civil War era. Apportionment would necessitate a different rate imposed in each state, despite the fact that the tax was a federal tax. Even worse, the rate would be relatively higher in more populous states and those states less possessed of the particular object of the tax. A tax on the possession of gold, for instance, if apportioned, would produce a very high rate of tax on anyone unfortunate enough to own gold but live in a relatively populous state in which few others owned gold. Only a capitation tax—that is, a tax at a single rate on all individuals—would likely be politically possible, and even then, only if the burden of the tax was relatively small and the urge for progressivity correspondingly limited.

Some observers have suggested that the apportionment requirement was a deliberate attempt to limit the federal government’s choice of taxes. It would, for instance, make it difficult to impose a tax

necessitated, of course, the Sixteenth Amendment, which granted Congress the “power to lay . . . taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”<sup>10</sup> Today, the nature of the requirement for apportionment of direct taxes, the legitimacy of the *Pollock* decision, the need for the Sixteenth Amendment, the Amendment’s effect, and the constitutional restrictions that remain on Congress’s power to design tax bases are all still subjects of debate<sup>11</sup> (though primarily an academic one, given Congress’s distaste for enacting new taxes that might test these principles). The goal here is not to settle these debates but to recount how the unfolding of these debates affected the evolution of the income tax in the United States and, more specifically, the special role that the debate created for the federal courts and thus for legal analysis in the development of the income tax.

If the *Pollock* decision was to be taken seriously at the time of the Sixteenth Amendment’s ratification, any tax that could be considered a direct tax (rather than an excise or duty) had to satisfy the apportionment requirement unless the tax was also a tax on “income.” *Pollock* had held that a tax must be considered a direct tax even if it was only a tax on the return from property when, if that property itself were made the measure of a tax, it would be considered a direct tax. After the Sixteenth Amendment, such a tax could be imposed without apportionment, but only if the return taxed could be measured consistently with the concept of “income.” To put it more succinctly, after *Pollock* and immediately after the passage of the Sixteenth Amendment, any federal tax had to be either an excise, which *Pollock* seemed to insist could not be a tax on real or personal property or the recurring returns therefrom, a tax on property that was apportioned by population, or an income tax as anticipated by the Sixteenth Amendment.<sup>12</sup>

---

on the holding of slaves because such a tax would produce bizarre results in those relatively populous northern states in which few held slaves. This may in fact be a consequence of the requirement, but the contribution-should-equate-with-representation explanation, especially when combined with a state option to avoid the federal tax, is equally plausible as an explanation of the provision.

10. U.S. CONST. amend. XVI.

11. See Erik M. Jensen, *The Taxing Power, The Sixteenth Amendment and the Meaning of “Incomes,”* 97 TAX NOTES 99, 111 (2002) (arguing that the proponents of the Sixteenth Amendment saw an “income tax” as essentially the opposite of a “consumption tax”). Erik Jensen appears to have restarted the modern debate with *The Apportionment of “Direct Taxes”: Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334 (1997), answered quickly by Bruce Ackerman’s *Taxation and the Constitution*, 99 COLUM. L. REV. 1 (1999). See also Calvin H. Johnson, *Apportionment of Direct Taxes: The Foul-Up in the Core of the Constitution*, 7 WM. & MARY BILL RTS. J. 1 (1998) (arguing that the Framers did not appreciate that uniformity was incompatible with apportionment); Lawrence Zelenak, *Radical Tax Reform, the Constitution, and the Conscientious Legislator*, 99 COLUM. L. REV. 833 (1999). For a rebuttal, see Erik M. Jensen, *Taxation and the Constitution: How to Read the Direct Tax Clauses*, 15 J.L. & POL. 687 (1999).

12. As had been held in *Springer v. United States*, 102 U.S. 586 (1882) (upholding the Civil War Income Tax) and confirmed in *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911) (upholding the Corporate Tax of 1909), if a tax—even if measured by income—was an excise tax, it need not be apportioned. This thought is an elaboration of the proposition in *Flint* that the corporate income tax can be viewed as an excise tax for which reliance on the Sixteenth Amendment is not necessary.

Given this history, it seems hard to deny that—at least in the first decades of the U.S. income tax—there was constitutional content to the notion of an “income tax.” Given the possibility that this content existed, most observers at the time of the ratification of the Sixteenth Amendment would probably have expected that the Supreme Court would play an important role in defining Congress’s power under the Amendment. Most inside participants in the administration of the income tax would undoubtedly have thought so also. Even if they had thought otherwise on the initial ratification and enactment, once the Court made clear its willingness to continue to participate in the development of a definition of “income” in the cases leading up to and including *Macomber*, these administrators certainly would have seen some merit in avoiding positions that might keep the Court engaged in that question at a constitutional level. With its threat to claim the last word on the meaning of “income,” the Court thus played a significant role in the development of income-tax doctrine even when it was never actually asked to consider those certain circumstances in which the constitutional content would have the most bite. The shadow of *Pollock*—and the possibility of a justiciable constitutional content to the meaning of “income”—hung over the administration of the income tax<sup>13</sup> for a considerable number of years after the income tax had become permanent. Contrary to what many now seem to believe, the results of this shadow were not

---

This exegesis omits consideration of whether Congress must be seeming to invoke the proper power in order to rely on it. Can, for instance, a provision that fails as an income tax be resuscitated as an excise tax, despite evidence that Congress thought it was relying upon its power to impose an income tax? Ordinarily, as Joseph M. Dodge points out, this question does not arise because ordinarily provisions that broaden the tax base within the current income-tax statute rely in some way or another on what we take to be the statutory meaning of income. *Murphy and the Sixteenth Amendment in Relation to the Taxation of Non-Excludable Personal Injury Awards*, 8 FLA. TAX REV. 369 (2007).

Dodge presents the decision in *Pollock* itself as evidence that such labeling should not matter since the Court was willing to uphold the tax on service income as an indirect tax, even though it was labeled an “income tax.” *Id.* at 378 n.38. But at the time of *Pollock*, the designation “income tax” did not yet have legal significance; within Anglo-American practice, many different impositions were loosely called “income taxes” and the Court’s point was simply that the various taxes in the 1894 Act were both direct and indirect. There is, furthermore, the nagging question of the extent to which this part of *Pollock* was dicta. The case itself was allowed only as a shareholders’ derivative suit, brought to block the compliance of the Farmers’ Loan & Trust Co. with the obligations the statute purported to impose upon it. The only holding necessary to its decision was the Court’s decision regarding the inclusion in the tax base of the corporation’s return on its real property, its personal property, and that of its shareholders (for which there was a withholding requirement).

Finally, this argument overlooks the fact that, as a matter of logic, there must be some constitutional content to the distinction between an “excise” and a “property tax,” something akin to realization or a similar tax trigger. This question requires a more thorough examination of *Hylton v. United States*, 3 U.S. 171 (1796), than can be offered here. For such an examination, see Charlotte Crane, *Reclaiming the Meaning of Direct Tax* (2003) (unpublished manuscript) (on file with author).

13. I am not the first to notice this phenomenon. See, e.g., Marjorie Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1. (1992) (arguing that the process of eliminating this shadow began shortly after *Macomber*, and has, with the decision in *Diedrich v. Commisisoner*, 457 U.S. 191 (1982), been nearly completed); Ernest J. Brown, *The Growing “Common Law” of Taxation*, 34 S. CAL. L. REV. 235, 237–41 (1961) (pointing out the difference in approach to statutory interpretation, especially in tax cases, between British and American judges).

all bad: without the continued threat of Supreme Court intervention, the legalization and rationalization of the income tax might not have occurred.

## II

### WHAT DID “INCOME” MEAN?

The meanings of “income” and “income tax” at the time the Sixteenth Amendment was passed were surprisingly uncertain. Before the Civil War, Americans knew little of what an income tax might involve; although news reports from England had informed them of its existence since early in the century, there is little evidence of much understanding about how the British tax actually worked.<sup>14</sup> Several states had imposed faculty and property taxes that would be denominated “income taxes” by later advocates of more-sophisticated tax instruments, but the limited historical record suggests that these taxes were more in the nature of taxes on offices, franchises, and other identifiable loci of human capital, with neither the legislatures nor those charged with administering the taxes putting much effort into trying to define a coherent approach to the general nature of “income.” Such taxes are probably better thought of as early attempts—mostly abandoned in the middle of the nineteenth century, once monopoly and office became anathema in the United States—to broaden property taxes.<sup>15</sup>

These older faculty taxes bore some resemblance to the British “income tax,” in that both involved relatively few instances in which the actual net income of the taxpayer (that is, the tax base we in the United States generally take for granted) might be computed. Beginning with its earliest versions, and continuing well into the twentieth century, the British tax was experienced by many taxpayers as a tax not on “income” computed as such, but on the *sources*

---

14. *Direct Taxation: A Sketch of the Rise, History and Development of the British Income Tax*, N. Y. TIMES, Jan. 6, 1862, at 2; *Taxation and War Finances in England: Uprise of the Actual System—Its Loading Traits—Its Defects—Characteristics and Principles Appropriate to America*, N. Y. TIMES, Jan. 19, 1862, at 3. See generally JANE FLAHERTY, *THE REVENUE IMPERATIVE* 69–70, 113–14 (2009).

15. See EDWIN SELIGMAN, *THE INCOME TAX* 367–91 (1911). Although many of the early statutes made reference to “gains,” “income,” and “profit,” there is little evidence that anything more than a rough estimate based on the nature of a particular activity was used. Indeed, during most of the periods in which such measures were in effect, statutory obligations to reassess and reapportion property taxes were generally ignored. The chances that more-serious effort was put into establishing the proper measure of income under such taxes than was put into property tax assessments seem slim.

It appears that only in Massachusetts was the imposition of something like an income tax officially continued throughout the nineteenth century. *Id.* at 390–93. Apparently, most local assessors simply ignored it, or treated it as if it were a modern cash-flow consumption tax, ignoring any income that was invested in a way that would reappear as assessable property. See A.Z. Brown, *The Income Tax, Why It Should Be Retained, and the Importance of Equally Enforcing It*, in MASS. COMM’N ON TAXATION, REPORT OF THE COMMISSIONERS APPOINTED TO INQUIRE INTO THE EXPEDIENCY OF REVISING AND AMENDING THE LAWS RELATING TO TAXATION AND EXEMPTION THEREFROM 441 (1874–75).

Other states sporadically reimposed taxes on profits and salaries, but the reports of the yields and duration of these impositions suggest that spotty and arbitrary administration was the norm. See SELIGMAN, *supra*, at 400–06.

*of income* available to the taxpayer. For many sources of income subject to tax, the amount of the tax did not depend upon the actual income earned or received in any given taxable period, but on the amount of income generally expected from that source.<sup>16</sup> Thus, holders of government offices, lords receiving quit rents, financiers, annuity holders, and lessors of land all would be taxed based on the value of their holdings, stated in terms of the annual expected income, and the tax was collected at the source based on these estimates.<sup>17</sup> The tax relied, furthermore, on a schedular system, which, for most taxpayers, not only involved withholding at the source and limited only deductions from gross receipts, but also guaranteed that no totaling of “income” in the modern sense could be made.<sup>18</sup> Such a system worked in an economy in which a substantial portion of the value sought to be taxed was held in forms that produced relatively constant annual income:

[T]he number of persons living on such incomes drawn from public funds, home or foreign, from rent charges, from mortgages, from farm rents and railroad shares, and varying little, if any, from year to year is large in proportion to those who draw their incomes from what we call “active business” . . . to a degree of which Americans have little idea. England is a country of enormous accumulated capital lent out in every direction all over the world, the yield of which supports a vast body of persons in complete or partial leisure.<sup>19</sup>

---

16. In 1910, much of the revenue collected under the British income tax was collected at the source, based primarily on the estimate of the annual income made by a viewing assessor, and with no declaration required of the taxpayer. For many types of income, only highly stylized types of deductions were allowed. See KOSSUTH KENNAN, *INCOME TAXATION: METHODS AND RESULTS IN VARIOUS COUNTRIES* 54–65 (1910).

17. Recall the confusion American readers sometimes experience in keeping straight values of offices and estates described in Victorian novels. The gentleman across the room is often identified in terms of his income in some number of thousands of pounds. The value of an estate is frequently stated as if the number that should be used as *the value of the estate* is the same as *the amount of the annual income* derived from that estate. In the late eighteenth century, when the first British tax referred to as an “income tax” was devised, for many property holders these annual returns would have been the only way in which the value of their holdings could as a practical matter have been realized. See PETER HARRIS, *INCOME TAX IN COMMON LAW JURISDICTIONS: FROM THE ORIGINS TO 1820*, at 29, 385–86 (2006).

18. Its success as a revenue source in Britain probably lies in several of its administrative advancements over the other revenue instruments available at the time. First, to the extent it relied on withholding, many of those actually paying over to the government had nothing to lose by complying, and everything to lose by not complying. If a creditor was owed £10,000 in interest, the debtor had to pay £200 to the collector and £9,800 to the creditor, paying no more than would have been paid without the tax. Second, the administration of the land tax could not be wrestled away from those who stood to gain the most from its maladministration. The introduction of the income tax allowed a fresh start. See Patrick O’Brien, *The Political Economy of British Taxation, 1660–1815*, 41 *ECON. HIST. REV.* 1 (1988); Peter Mathias & Patrick O’Brien, *Taxation in Britain and France, 1715–1810*, 5 *J. EUR. ECON. HIST.* 601 (1976).

19. *Income Tax Here and in England*, 26 *NATION* 287 (May 2, 1878), reprinted in *SELECTED ARTICLES ON THE INCOME TAX* 96 (Edith M. Phelps ed., 1909). The Phelps volume was part of the widely circulated “Debater’s Handbook” series on topics of public interest published by H. W. Wilson Co., which continues to be a resource for debaters, journalists, and the general public.

Whether or not this difference between the relevant forms of wealth in Britain and in the United States in fact existed, for the purposes of developing a satisfactory income-tax design, the important fact is that many believed that such a difference existed.

Although Congress had imposed taxes that included “income duties,” for something less than a decade during and after the Civil War,<sup>20</sup> there was debate even then about which parts of these measures were appropriately considered to be part of an “income tax.”<sup>21</sup> No clear understanding of how the Civil War “income duties” differed as an “income tax” emerged from Congress’s actions, the Court’s decisions, or Congress’s response to them. Indeed, in many instances, Congress appears to have been willing to leave the meaning of “income” entirely to the administrators.<sup>22</sup> Whether the cause was lack of expertise, the press of obviously more-important business, a failure of political will, or just a sense that such questions were best left to other political institutions, Congress in that era seemed unwilling to grapple with the variety of questions we now think fundamental to describing an income tax: how to include increases in value in income when they arise without taxing them again when they are distributed; whether and how to credit holders of interests in

---

Another similar exposition of the importance of the limited notion of the scope of the tax and of the “collection at source” on relatively predictable incomes requiring little input from the taxpayer can be found in Sydney Brooks, *Aspects of the Income Tax*, 197 N. AM. REV., 542 (1913).

20. For the summary of this history most well known at the time the Sixteenth Amendment was adopted, see EDWIN R.A. SELIGMAN, *THE INCOME TAX 430–80* (1911). Other accounts, which focus primarily on the congressional politics of the enactments, include STEVEN A. BANK, KIRK J. STARK & JOSEPH J. THORNDIKE, *WAR AND TAXES 23–47* (2008); HAROLD Q. LANGENDERFER, *THE FEDERAL INCOME TAX 1861–1872* (1980). This material has been published as a monograph: JANE FLAHERTY, *THE REVENUE IMPERATIVE* (2009). For a modern account of the Civil War tax bureaucracy, see Joseph J. Thorndike, *An Army of Officials: The Civil War Bureau of Internal Revenue*, 93 TAX NOTES 1739 (2001).

21. This debate was most explicit in the unbelievable confusion that surrounded the Civil War taxes as to which taxes should be allowed as credits or deductions against other taxes, or more precisely, which amounts were properly excluded from one taxpayer’s tax base because they had been the subject of some other tax, whether or not that other tax was nominally on the same taxpayer. From the earliest debates in Congress there was confusion about the extent to which the income tax was expected to be an additional tax on income sources and activities, rather than an interstitial tax only on sources and activities not otherwise taxed. *See, e.g.*, CONG. GLOBE, 37th Cong., 2nd Sess. 1531 (1862). Section 91 of the Act of June 30, 1862, 12 Stat. 473, allowed a deduction from income for all other federal, state and local taxes. But several of the federal taxes imposed by that act, specifically the tax on interest paid on railroad bonds in section 81, 12 Stat. 469, and the dividends paid by financial institutions in section 82, 12 Stat. 470, purported to be income taxes administered through collection at the source for these particular income streams, making a credit for the tax withheld the more appropriate device. Section 91 furthermore seems to provide that if an income stream or its source had been subject to tax, including the manufacturing excise, that income itself should be deducted. Edwin Seligman, in his summary of the Civil War income tax, notes that this provision might have threatened entire scheme: since virtually all manufactured goods were subject to separate excise taxes, most firms could claim exemption for their entire profits. Seligman, *supra* note 15. This potential problem was at least partially solved by language in section 1 of the Act of March 3, 1863, 12 Stat. 718, removing manufactured items from the income sources that would be excluded as already taxed. Not until the March 3, 1865, version of the statute, however, was the taxpayer required to include the income from the remaining already taxed sources in his income. *Compare* section 117 of the Act of June 30, 1864, 13 Stat. 281, *with* its replacement by the Act of March 3, 1865, 13 Stat. 479. *See* Letter from Joseph Lewis, dated April 4, 1865, reprinted in *THE INTERNAL REVENUE RECORDER*, Vol. 1, No. 15, April 15, 1865, at 116.

22. *See, for example*, the remarks of Senators Clark and Simmons on whether the 1861 imposition was to be on net or gross income. CONG. GLOBE, 37th Cong., 1st Sess. 315 (1861). *See also* LANGENDERFER, *supra* note 20.

enterprises with the taxes already imposed on the earnings of the enterprise; and which of the numerous gross receipts, profits, property, and license taxes that were enmeshed in the same pieces of legislation should be entitled to such credits. The administrative record<sup>23</sup>—which contains a surprising number of pronouncements for a tax of such short duration—might provide a starting point for an inquiry into the meaning of “income” but for the fact that many of the decisions seem not to fit well with any particular notion of “income.” Deductions were allowed in some places and limited in others, without much attempt at principled consistency. The urgency to collect whatever might be offered in the way of payment by a taxpayer seems to have led to the abandonment of any attempt to develop a consistent meaning for “income”: for example, a merchant’s sworn statement regarding his profits was to be accepted, apparently without imposing any consistent and principled method of accounting upon him.<sup>24</sup> Furthermore, Congress seems to have rejected these

---

23. The initial regulations may seem to evoke a strong Haig–Simons notion, requiring as they did the full inclusion of “the value of the produce of [a] farm” without regard to sales, and without reduction for his labor or for his family’s sustenance. A *MANUAL OF THE DIRECT AND EXCISE TAX SYSTEM OF THE UNITED STATES, INCLUDING THE FORMS AND REGULATIONS ESTABLISHED BY THE COMMISSIONER OF INTERNAL REVENUE, THE DECISIONS AND RULINGS OF THE COMMISSIONER, TOGETHER WITH EXTRACTS FROM THE CORRESPONDENCE OF THE OFFICE 196–97* (George Boutwell ed., 1863). But this illusion of principle disappears as one observes that these same regulations allowed a deduction for interest paid on “incumbrances upon the dwelling-houses or estate on which [the taxpayer] resides,” *id.* at 198, in addition to the provision in the statute allowing a deduction for rent for dwelling houses, and by extension, rooms, *id.* at 276. The first set of rulings allowed a deduction for interest and dividends that were subject to withholding and for the gross-receipts tax on advertising but not the various other gross-receipts taxes included in the 1862 Act. Later rulings, reported in a single list as Treasury Decision No. 110, dated (but probably erroneously) May 1863, provided that “a merchant’s return of income should cover the business of the year . . . , excluding previous years,” and that “uncollected accounts must be estimated.” *Id.* at 273. No deduction was allowed at all “because of diminished value, actual or supposed, of the coal vein or bed, by the process of mining.” *Id.* at 274. And no losses from fixed investments were allowed, either to offset other investments or business losses. *Id.* at 274, 301–04. Similar tensions existed between Ruling No. 9, requiring that the sale of cut timber be included, and a later ruling that standing timber sold would be income. *Id.* at 301.

A more complete set of tensions in the rulings may be available upon studying *INTERNAL REVENUE LAWS: INTERNAL REVENUE STATUTES NOW IN FORCE; WITH NOTES REFERRING TO ALL DECISIONS OF THE COURTS AND DEPARTMENTAL RULINGS, CIRCULARS, AND INSTRUCTIONS, REPORTED TO OCTOBER 1, 1870*, at 283–305 (Orlando Bump ed., 1870), which I have not yet been able to do. Two other similar manuals, *COMMISSIONER OF INTERNAL REVENUE, THE EXCISE TAX LAW* (Charles E. Estee ed., 1863) and *AMASSA A. REDFIELD, A HAND-BOOK OF THE UNITED STATES TAX LAW* (1863), were published in 1863.

24. “Assessors have no authority to prescribe rules to be observed by merchants and others for ascertaining the amount of income derived from their business. They (the assessors) can only require that each person shall make return as nearly as possible of the amount of his or her income, which amount may be ascertained in such manner as the party making the return may prefer. If, however, the assessor . . . has good reason to believe that any return is understated, he may increase the same to such amount as he may think proper; and if then the party is not satisfied, he may obtain relief by making oath to the amount on which he is liable to income duty, and such sworn return is to be accepted by the assessor.” Boutwell, *supra* note 23, at 302.

Apparently the practice changed somewhat in the ensuing years, and assessors did begin deeper inquiries, but such efforts seem to have remained controversial. *See, e.g., Doll v. Evans*, 7 F. Cas. 855 (C.C.E.D. Pa. 1872) (No. 3969) (rejecting a taxpayer’s assertion that reassessment after acceptance of his return, assessment, and payment was unlawful).

administrative interpretations with some frequency, and it introduced into the statute ad hoc language that addressed the particular complaint of a constituent without laying down any general principles upon which further interpretations might be based.<sup>25</sup> One aspect of the government approach, however, does seem consistent: It openly acknowledges the possibility that the tax might not remain in place, so that rules that accelerated inclusion were permitted, even if no guarantee could be made against double inclusion given some other expedient condition occurring at some point in the future. Thus, according to Treasury rulings, the tax could be triggered by the safe completion of a merchant voyage, apparently without regard for how the value associated therewith might actually be realized, and without explanation of how such later events might be taken into account.<sup>26</sup>

This free-for-all approach was dampened somewhat when, after the tax was no longer in effect but while collection efforts continued, the Supreme Court in *Gray v. Darlington*<sup>27</sup> considered whether gain on the sale of a capital asset should be included in income. The case was decided only in terms of statutory construction, but the language used indicates more: that the Court (or at least the opinion's author, Justice Field) considered a term such as "income" as having a single understood meaning within the law, albeit one that a legislature could alter.<sup>28</sup> The Court concluded that gains could not be included in this

---

25. The addition of language in section 116 of the 1864 Act, providing that capital gains should be included in income only to the extent that real property was purchased and sold in the same year and thus reversing the position attributed to the Commissioner of Internal Revenue on the floor of the House on April 25, 1864, is only the most striking of such provisions. CONG. GLOBE, 38th Cong., 1st Sess. 1875-78 (1864). The Commissioner's position had been, at least since Treasury Decision No. 110, that "gains or profits realized from the sale of property during the year 1862, which was properly purchased before the excise law went into effect, should be returned as income for the year 1862." Boutwell, *supra* note 23, at 273. According to a letter dated March 9, 1864, it was the position of the Commissioner that all gain beyond original price be included in income, regardless of the date of purchase, although carrying interest could be added to the original price, the property having been "sufficiently productive to pay interest and taxes." CONG. GLOBE, 38th Cong., 1st Sess. 1875-76 (1864). However, the ultimate amendment to the statute addressed only real estate, leaving intact the government's position that all gain on other property, including stock, should be included in income in the year sold. *See* Act of March 3, 1865, 13 Stat. 139, 479 (1866).

26. Treasury Rulings Nos. 18 and 19 assess the taxable earnings of an owner of a ship when the voyage is completed, and of whalers, "when the voyage has terminated," which may appear "at first view, to operate unjustly, but its results will be found equitable, for should a whaler who has recently returned and paid tax on his yield go to sea to-day, his voyage may not be terminated again until our authority to levy a tax upon his future earnings has ceased to exist." Boutwell, *supra* note 23, at 303.

27. 82 U.S. 63 (1872).

28. "This language has only one meaning, and that is that the [tax is] upon the annual products or income of one's property or labor, or such gains or profits as may be realized from a business transaction begun and completed during the preceding year" and thus "[t]he advance in the value of property during a series of years can, in no just sense, be considered the gains, profits, or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property." *Id.* at 65.

Congress had in fact altered the meaning that the Court took to be the understood meaning. It had provided that gains on real property purchased within two years would be included. The Court was willing to concede, furthermore, that because the statute had clearly included business profits, these

meaning of income. The opinion, for a deeply divided court, stated that the advance in value in the four years that the assets—U.S. government bonds—were held could not be treated as income in any one year.

An examination of the facts in *Gray*, however, will reveal that, apart from a common understanding of “income,” *Gray* presented some other interpretational difficulties. The taxpayer had acquired the bonds in exchange for notes at the end of the War in 1865. The government’s position seems to have been that in 1869, when the bonds were sold, the gain to be taxed should have been measured by the cost of the notes when initially received. But what of the transaction that had occurred in 1865? There had been an income tax in effect in that year, and, if the government’s argument that the meaning of “income” encompassed capital gains was correct, any gain on the notes should have been taken into account then. If there was instead a loss at that time, a determination would have been needed regarding whether such loss should have been allowed, and thus whether the taxpayer’s cost should have been the value of the notes given up in exchange for the bonds received. The historical record reveals no indication whether the Court or those arguing before it were concerned about such questions, but the case nonetheless reveals the incompleteness of thinking about what a permanent income tax making a serious attempt to target only “income” might actually look like.

Those few instances in which the federal courts considered the Civil War taxes hardly contributed to a coherent concept of income. In passages that foreshadowed the issues to be wrestled with in *Pollock* and under the Sixteenth Amendment, the Court struggled with (1) whether the income tax, as outlined by Congress, was a tax on the person receiving it<sup>29</sup> or on the property from which the income was derived (a conclusion more likely to be reached by one assuming the tax to be similar to the British tax); (2) whether dividend and interest income to be paid by a corporation should be included in the security holder’s income when it arose, when it became available as a separate fund, or

---

profits must be measured by transactions that spanned more than a single year; but it did not, in *Gray*, have to deal with any of the accounting issues that would be raised in attempts to measure such profits.

29. The answer was likely to be that the tax was a tax on the person receiving it. See *United States v. R.R. Co.*, 84 U.S. 322 (1873) (holding that Congress has no power to require withholding on the interest paid to the City of Baltimore); *N. Cent. R.R. v. Jackson*, 74 U.S. 262 (1868) (holding that Pennsylvania had no power to require withholding on the interest paid to nonresident aliens by domestic corporations doing business in the United States and interpreting a similar federal statute as not having been intended to impose such a tax). These cases called into issue not only the proper meaning to be given to “income tax” and the various provisions defining it, but also the power of Congress with respect to certain impacts of the provisions. But the Court was willing to treat essentially the same tax, collected under slightly amended language, to be a tax on the corporation in *Barnes v. The Railroads*, 84 U.S. 294 (1873) (holding that the changes made by amendments presumably to collect on the full amount of dividend and surplus while avoiding the nonresident-alien problem rendered the tax a tax on the corporation, not the interest owner, and as a result, the tax was due when the value arose within the corporation rather than when the dividend was declared and paid). Moreover, in *Bailey v. N.Y. Central Railroad Co.*, 89 U.S. 604 (1875), it was willing to consider whether certificates issued after the consolidation of a corporation were taxable as dividends. This second set of cases involved only the interpretation of language regarding the discontinuation of the tax.

only when it was paid; and (3) what it means to pay a dividend upon a corporate consolidation. But the administrators of the tax, and the courts that reluctantly reviewed their decisions, never had to face what might distinguish an “income tax” from any other tax, because little in the statute required such a distinction.<sup>30</sup>

It is difficult to assess how much disgruntled taxpayers may have tried to enlist the courts in their grievances with the federal collectors over the amount of tax they owed under the Civil War taxes, how often the federal courts rebuffed their efforts, and how often the courts would have found it appropriate to challenge the government’s or its collectors’ interpretation of “income.”<sup>31</sup> What little evidence exists suggests that, in the past, the federal courts had generally been unwilling to step into the vacuum to participate in the base-defining aspects of the administration of internal-revenue laws. Edwin Seligman, perhaps the most enthusiastic publicist for the income tax at the turn of the century,<sup>32</sup> acknowledged that the “decisions [of the commissioner of internal revenue] were in most cases final, and but little recourse was taken to

---

30. In the Civil War enactments, only section 49 of the Act of August 5, 1861 (under which no revenue was collected, *see* LANGENDERFER, *supra* note 20, at 237), presented the term “income” in a way that might have required any precision about its meaning, imposing as it did a tax “upon the annual income of every person . . . whether such income is derived from any kind of property, or from any profession, trade[,] employment[,] or vocation carried on in the United States or elsewhere, or from any other source whatever.” ch. 45, § 49, 12 Stat. 292, 309. This language was repealed in 1862 and replaced with language that, while it might ensure the widest possible tax base, would serve to obscure the meaning of “income”: the tax was now imposed upon “the annual gains, profits, or income of every person . . . which derived from any kind of property, rents, interests, dividends, salaries, or from any professional trade, employment, or vocation carried on . . . or from any other source whatever . . .” ch. 119, § 90, 12 Stat. 432, 473. The core concept behind this tax base was further confused by the provision in section 91 that the income-tax base defined in section 90 was to be reduced by any tax paid by any entity that was the source of the income, including the various gross receipts, ad valorem, and stamp taxes. Section 116 of the Act of June 30, 1864, repeated this language, with the added provision that “net profits realized by sales of real estate purchased within the year, for which income is estimated shall be chargeable as a income; and losses on sales of real estate purchased within the year, for which income is estimated, shall be deducted from the income of such year.” ch. 173, § 116, 13 Stat. 223, 281. Section 117 continued the deduction for taxes assessed “upon the property or sources of income” but excluded from this deduction “the national income tax,” and allowed as well a deduction for dividends and interest that would have been taxed in the income of the source entity. *Id.*

31. The only clear route to the federal courts for individual taxpayers was the suit against the collector or a suit otherwise challenging the legal effect of the collector’s actions. This route obviously involved considerable delay. For instance, *Springer v. United States*, 102 U.S. 586 (1882), involved a tax assessment made in 1865. This case began as a suit for ejectment brought by the government, in which the taxpayer challenged the tax sale of land when the tax had been imposed upon income. Although the opinion in *Springer* deals with the issues involving the collector’s remedies and the income tax as a direct tax separately, the case was likely presented to the Court as one in which the fact that the collector’s remedies included “distrain” against land changed the nature of the tax.

One of the few cases in which the courts considered the content of “income” was *United States v. Schillinger*, 27 F. Cas. 973 (C.C.S.D.N.Y. 1876) (No. 16,228), a suit brought by the United States (apparently in assumpsit) against the taxpayer. The court concluded that the receipt of an installment note in exchange for patent rights did not amount to “income.” *Id.* at 973.

32. Ajay Mehrotra, *Edwin R.A. Seligman and the Beginnings of the U.S. Income Tax*, 109 TAX NOTES 933 (2005).

the courts.”<sup>33</sup> In his survey of the remedies that might be available to disgruntled taxpayers in connection with the 1894 Act, one treatise writer similarly observed that federal courts did not see the details of tax-base definition as part of their business at all: “[T]he court will not interfere to correct an erroneous interpretation by aid of an executive department of a statute of doubtful meaning.”<sup>34</sup>

As the debate over the legitimacy of the 1894 Act intensified in the months between the Act’s initial passage and the beginning of its legal effect,<sup>35</sup> Congress seems to have been aware of the obstacles taxpayers might face in getting their challenges into court.<sup>36</sup> Opponents of the income tax, hoping to block the initial enforcement efforts, had included provisions that would more easily allow taxpayers to challenge the tax.<sup>37</sup> As it turned out, the device most commonly

---

33. EDWIN R.A. SELIGMAN, *THE INCOME TAX: A STUDY OF THE HISTORY, THEORY AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD* 469 (1911). Elsewhere he observed that the incomplete use of stoppage at the source rendered the tax mistaken in theory, and that “the law itself was very confused in parts and contained mistakes of principle.” *Id.* at 476.

34. ROGER FOSTER & EVERETT VERGNIES ABBOT, *A TREATISE ON THE FEDERAL INCOME TAX UNDER THE ACT OF 1894*, at 236 (1895). There is some irony in this writer’s complaint, since, as he is the author of a work that gathered virtually every possibly relevant authority that might be cited to a court, he clearly hoped that these questions would become matters for lawyers arguing before courts. This summary reflects the common sentiment that taxation more generally is a matter of legislative, and not judicial concern.

A similar sentiment—that Congress should be left to correct its own mistakes when it comes to taxation—can be traced back to the dicta offered by Justice Marshall in connection with the interpretation of the 1794 excise taxes. *See Pennington v. Coxe*, 6 U.S. 33, 60–62 (1804), *discussed in* Charlotte Crane, *Pennington v. Coxe: A Glimpse at the Federal Government at the End of the Federalist Era*, 23 VA. TAX REV. 417 (2003).

The full acceptance of the role of courts in tax administration and interpretation seems clearly to be a twentieth-century phenomenon, at least in some jurisdictions. Lest the early-twenty-first-century reader doubt it, consider the conclusions of a Kentucky court in 1889:

The exercise of the power of taxation is legislative in character, while the collection of taxes, when once authorized by the law-making power, is ministerial. The one is legislative and the other executive. Neither is a judicial act, and one department of the government should be careful not to encroach upon the domain of another. It is true that the judiciary may be called upon by the Legislature to enforce the collection of taxes in a judicial way, but it has not done so in this state.

*Louisville Water Co. v. Commonwealth*, 12 S.W. 300 (Ky. 1889) (refusing to assist in the collection of a property tax against a municipal water company, even though the collector’s traditional remedies of distraint and sale would be unavailing because of legislation forbidding the sale of the property of such entities).

35. *See, e.g.*, Amasa J. Parker, Jr., *Income Tax of 1894—Its Provisions and Constitutionality*, 50 ALB. L.J. 416, 421 (1894) (“humbly suggesting . . . one of the many grounds on which this vicious, socialistic and un-American law can be attacked and declared unconstitutional by the Supreme Court of the United States”); Robert Sewell, *The Income Tax: Is It Constitutional?*, 28 AM. L. REV. 808, 808 (1894) (exploring the reasons for abandoning those precedents that might be read to support the income tax, enacted only out of a “desire[] . . . to curry favor with the Populists and throw a sop to the Socialists”).

36. Under section 6 of the Judiciary Act of March 3, 1891, the decisions of the courts of appeals in revenue cases were final unless constitutional issues were presented. ch. 517, § 6, 26 Stat. 826.

37. Senators Hill and Quay joined in efforts to block the administration of the Act, including legislation that would have removed any obstacle to courts’ ruling on income tax, because they saw section 3224 of the Revenue Act of 1894, ch. 349, § 3224, 28 Stat. 509, as being likely to prevent suits for

used in such challenges was the derivative suit, in which shareholders sought to block a corporation from wasting its funds by unnecessarily paying an illegal tax.<sup>38</sup> This remedy—contingent as it was on each court’s perceptions of the equities involved in allowing the tax to be paid under protest and then challenged in a refund suit—seems to have provided the federal courts with a way to expeditiously reach some of the issues raised by a new tax without necessarily making a commitment to take all of the issues disgruntled taxpayers might raise. In other words, the federal courts found a way to hear those claims that seemed worthy early in the process, as legislation was passed and enforcement threatened, but before the taxpayer had paid. The courts could thereby avoid committing themselves to hearing every dispute before the taxpayer and the collector had had ample opportunity and incentive to settle their disputes.

What an income tax might actually entail had engendered more discussion earlier, in the years between the abandonment of the Civil War taxes and the enactment of the 1894 income tax.<sup>39</sup> For the more than fifty years preceding, supporters and detractors of the income tax had attempted to invoke “income tax” as a description of a wide variety of potential exactions. More-neutral commentators similarly used the term loosely to describe a wide variety of existing revenue measures.<sup>40</sup> But although Anglo-American legal-treatise writers in the nineteenth century had spent considerable time exploring the nature of the power to tax, their work had rarely included close analysis of the definition of any particular tax.<sup>41</sup> By the early 1890s several states had devised newer taxes labeled “income taxes,” which undoubtedly informed Congress of

---

injunction against tax administration itself. *Mr. Quay’s Fight on the Income Tax*, CHI. DAILY TRIB., Jan. 11, 1895, at 13. The Supreme Court agreed in *Dodge v. Osborn*, 240 U.S. 118, 121 (1916) (invoking section 3224 to dismiss an attempt to enjoin the income tax on grounds of unconstitutionality, despite the taxpayers’ urging that “unless the taxes are enjoined many [refund] suits by other persons will be brought”).

38. This device had been used successfully in *Dodge v. Woolsey*, 59 U.S. 331 (1855), in a test case challenging the imposition by Ohio on the national banks. It was, of course, the device used in *Pollock*, as well as in *Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1 (1916), and *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1916). The taxpayer’s ability to sue in the court of claims for a refund of internal taxes when no such debt was acknowledged by the government was not clear until the Court’s decision in *United States v. Emery Bird Thayer Realty Co.*, 237 U.S. 28 (1915), which allowed suits for refunds of the 1909 Corporation Tax. Cf. *Gould v. Gould*, 245 U.S. 151 (1917) (involving the relatively rare circumstances in which the constitutional substance of the income tax sufficiently impinged upon the rights of private litigants—there, a divorce proceeding—that the Supreme Court reviewed through writ of error a decision of the New York courts).

39. The political story is told in STEVEN R. WEISMAN, *THE GREAT TAX WARS* (2002) and JOHN D. BUENKER, *THE INCOME TAX AND THE PROGRESSIVE ERA* (1985).

40. See, e.g., Joseph A. Hill, *The Civil War Income Tax*, 8 Q.J. ECON. 416 (1894).

41. See, e.g., THOMAS M. COOLEY, *A TREATISE ON THE LAW OF TAXATION, INCLUDING THE LAW OF LOCAL ASSESSMENTS* (1876); FRANCIS HILLIARD, *THE LAW OF TAXATION* (1875); ALFRED B. STREET, *A DIGEST OF TAXATION IN THE STATES* (1863). As grand as the aspirations of these treatise writers may have been, their work simply did not attempt to formulate the kind of conceptual foundation that those promoting and analyzing the income tax would begin to use fifty years later.

the variety of the issues to be resolved.<sup>42</sup> Some, but clearly not all, of those issues were addressed in the drafting of the 1894 Act.<sup>43</sup> All of this uncertainty did not discourage the treatise writers from offering their glosses on the statute, although much of this gloss was aimed not so much at compliance with the tax as it was an attack upon it.<sup>44</sup>

In the end, the 1894 experiment with the income tax provided only a little more guidance about what an “income tax” properly should be. The Court in *Pollock* had looked only at what the actual provisions of the 1894 tax had been—it had had no reason to consider whether the tax was in fact appropriately labeled an “income tax” within *any* definition of the term. It most certainly had not determined that everything Congress had made subject to the tax was in fact “income,” even though Congress and the general public may have referred to the tax as an “income tax.” Indeed, in parts of the opinion, the Court seemed to be doubting the appropriateness of the appellation “income” to the 1894 tax.

Nor had the very brief administration of the 1894 tax done much to shed light on that meaning. The tax was simply never stable enough or taken seriously enough to have established any general understanding of its scope. Although the possibility of its enactment had spurred much speculation in 1893, no specific language existed until late spring 1894. In the months after the bill became law in late August (without President Cleveland’s approval), opponents of the tax introduced, with some success, provisions that made small changes in the law, changes that would require wholesale revisions of such earlier efforts in education and compliance as those the Treasury Department might have undertaken.<sup>45</sup> Returns for the 1894 year were initially set to be due<sup>46</sup> only days before the first argument in the Supreme Court was made; a joint resolution dated February 19, 1895, purported to extend that deadline to April 15. Payment was not due until July 1.<sup>47</sup> In any event, collection was stopped and the

---

42. For a collection of such statutes, see ROGER FOSTER, A TREATISE ON THE FEDERAL INCOME TAX 657–70 (1913).

43. See RICHARD JOSEPH, THE ORIGINS OF THE AMERICAN INCOME TAX: THE REVENUE ACT OF 1894 AND ITS AFTERMATH 64–88 (2004) (focusing on the problems of corporate-interest-holder integration and collection at the source).

44. See AUGUSTUS B. CARRINGTON, THE INCOME TAX LAW OF AUGUST 24, 1894 (1895); ROGER FOSTER & EVERETT V. ABBOT, A TREATISE ON THE FEDERAL INCOME TAX UNDER THE ACT OF 1894 (1895) (apparently in print no later than February 1895); JOHN M. GOULD & GEORGE F. TUCKER, THE FEDERAL INCOME TAX EXPLAINED (1894) (first published no later than November 1894 and later with an appendix containing the Treasury regulations).

45. The Joint Resolution of Feb. 9, 1895, resuscitated some of these efforts by providing that “in computing incomes under said Act the amounts necessarily paid for fire-insurance premiums and for ordinary repairs shall be deducted,” as well as eliminating the double inclusion of dividends. Res No. 18, 28 Stat. 971.

46. Act of Aug. 28, 1894, ch. 349, § 35, 28 Stat. 509.

47. *Id.*

process of issuing refunds began immediately upon the Supreme Court's decision on rehearing.<sup>48</sup>

### III

#### HOW DID THE MEANING OF "INCOME" EVOLVE?

Even in this brief history, one can find considerable tension between what an early-twenty-first-century tax practitioner would think of as an "income tax" and the 1894 tax itself. The 1894 tax (like the Civil War taxes that preceded it) was something of a mongrel tax, an instrument somewhere between the nineteenth-century British "income tax" and the modern income tax.<sup>49</sup>

The debates on the Sixteenth Amendment did little to clarify the more-technical aspects of questions surrounding the object and measure of the tax.<sup>50</sup> Most of the debate on the language actually used in the amendment centered on the meaning of "from whatever source derived" and whether that language should be read as a removal of the judicially acknowledged limitation on Congress's power to tax the instrumentalities of the states and as an exception to the limit on Congress's ability to lower the pay of sitting federal officers.<sup>51</sup>

There was simply no single notion of what an "income tax" would be, either when the 1894 Tax was enacted or when the Sixteenth Amendment was drafted and ratified.<sup>52</sup> Nor was there any want of collections of expertise offered on the question, most of which were dedicated to the proposition that the definition of "income" clearly mattered as a constitutional matter.

---

48. *Will Return \$80,000 Collected*, N.Y. TIMES, May 21, 1895, at 3. Under earlier statutes, the problem of administering refunds of relatively small amounts might have been difficult. Previously there might have been no administrative authority to refund taxes without specific statutory authorization under each tax act, and even then, refunds might not have been available if no protest was made as the taxes were paid. But in 1895, the Treasury ruled that no new statutory provisions were necessary to authorize administrative refunds, since section 3220 of the Act of July 13, 1866, 9 Stat. 111, provided blanket authorization for the refund of wrongfully collected taxes. According to the *New York Times*, the collector for [the second district] of New York, John A. Sullivan, reported that more than ninety percent of the roughly 5,000 returns he had received had been paid under protest. *Will Return*, *supra*, at 5. The *New York Times*, with some relish, reported that ex-Senator Camden of West Virginia had filed an application for refund within five minutes of the Supreme Court's decision. *Id.* at 3; *Now Want Their Money*, N.Y. TIMES, May 21, 1893, at 5. Official forms for claiming refunds were circulated in June and refunds began in August. *See Blanks for Income Tax Repayment*, N.Y. TIMES, June 5, 1895, at 16; *Refunding the Income Tax*, N.Y. TIMES, Aug. 24, 1895, at 1. Ultimately, only \$77,000 was collected. *Receipts Fell Below Estimates*, N.Y. TIMES, Nov. 22, 1895, at 9.

49. The regulations and forms for implementing the 1894 Act can be found in FOSTER & ABBOT, *supra* note 44.

50. This position was most clearly previously stated by the Court in *Collector v. Day*, 78 U.S. 113 (1870).

51. *See* Walter E. Barton, *The Effect of the Sixteenth Amendment*, 4 NAT'L INCOME TAX MAG. 275, 282 (1926).

52. Doubts about prior characterizations of various tax instruments as "income taxes" remained in the literature. *See, e.g.*, Charles R. Metzger, *Brief History of Income Taxation*, 13 A.B.A. J. 662 (1927) (repeating doubts expressed in DAVIS RICH DEWEY, FINANCIAL HISTORY OF THE UNITED STATES 11 (1902) and KENNAN, *supra* note 16, at 203-04).

The first enactment after the ratification of the amendment was a poorly drafted hodgepodge that seems to have reflected none of the more-principled approaches to a fundamental definition of income that is now taken for granted. Indeed, none of the lessons regarding the need to specify certain fundamental aspects of the tax, lessons that might have been available from the prior rounds of income-tax administration, seem to have been learned very well.<sup>53</sup>

The initial pronouncements of Treasury officials interpreting the statute seemed willing to assume that their only problem was to give meaning to the literal language of the statute, not to find rational distinctions in the categories outlined in the statute. Thus, in the first years of the income tax, the Treasury confirmed that only those deductions specifically mentioned in the statute would be allowed to individuals. This meant, for instance, that investment gains were to be included in calculating income, but investment losses were not, for the statute provided no deduction for the latter.<sup>54</sup> Observers did not seem to object to this general approach, for they seem to have more often offered only suggestions for amendments to the statute, rather than suggestions for interpreting the provisions as originally proposed, in ways that would provide more overall coherence to the notion of “income.”<sup>55</sup>

Even as the Treasury was woodenly interpreting the 1913 provisions for individuals, the process of defining “income” for incorporated businesses was underway.<sup>56</sup> Business income had been made the subject of the 1909 Corporation Tax.<sup>57</sup> This tax, although measured by the income of businesses organized under state law, had been held by the Supreme Court to be a permissible excise tax on “doing business,” rather than a direct tax that would

---

53. The bill’s primary sponsor and apparent drafter seems not to have understood many of the issues regarding tax-base design that had been salient in the prior versions of the tax. See JOHN WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* 77 (1985). A good summary of these issues can be found in JEROLD WALTON, *THE POLITICAL ORIGINS OF THE U.S. INCOME TAX* 7–15 (1985), although, contrary to the impression the summary in this work may convey, these issues were barely addressed in the initial drafting of the Act and became more, rather than less, clear as the debate on the bill proceeded. Witte sums up the approach taken in the House debates: “In many of these confusing areas [including whether capital gains and dividends on mutual companies would be taxed] it was felt that the broad powers given to the Commissioner of Internal Revenue would allow later administrative clarification.” WITTE, at 77.

54. T.D. 2135, 17 Treas. Dec. Int. Rev. 39 (1915).

55. Thus, among the recommendations made by the Committee on the Federal Income Tax (chaired by Edwin Seligman, and further including Thomas S. Adams, Charles Bullock, Alfred E. Holcomb, Kossuth Kennan, Robert H. Montgomery & A.C. Rearick) was the recommendation that the losses and deductions available for individuals be expanded to include investment losses and business losses, because the statute had originally included only deductions for certain limited types of casualties. Report of the Committee on the Federal Income Tax; a Report Submitted to the Ninth Annual Conference of the National Tax Association, San Francisco, California, August 10–14, 1915.

56. T.D. 1606, 13 Treas. Dec. Int. Rev. 39 (1910).

57. Payne–Aldrich Tariff Act, ch. 6, § 38, 36 Stat. 11, 112 (1909). See generally Bank, *supra* note 8; Marjorie E. Kornhauser, *Corporate Regulation and the Origin of the Corporate Income Tax*, 66 IND. L.J. 53 (1990).

be impermissible under *Pollock*.<sup>58</sup> The interpretation of its provisions involved developing a definition of “income,” which was, on the surface, only a matter of statutory interpretation subject as an initial matter to administrative rulings, then to judicial review and, always, to congressional alteration. But the shadow of *Pollock* was in the mind of those administering the Act, as was evidenced by the observation of the Attorney General that when Congress devised the tax as a tax upon doing business, it “doubtless had in mind the decision of the Supreme Court in [*Pollock*]; and it was no doubt [Congress’s] intention to avoid every character of taxation that might be regarded as a direct tax.”<sup>59</sup> Justice Pitney, writing for the Court in *Stratton’s Independence v. Howbert*,<sup>60</sup> noted that the Constitution might serve as a limit on the interpretation of even the 1909 tax, since “if it were demonstrable that to read the [Corporation Tax Act] according to its letter would render it unconstitutional, . . . a reasonable ground would exist for construing it according to its spirit rather than its letter.”<sup>61</sup> In *Anderson v. Forty-Two Broadway*, Justice Pitney went out of his way to clarify that what might be within the power of Congress to establish as the tax base

---

58. See *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911); *Stratton’s Independence, Ltd. v. Howbert*, 231 U.S. 399 (1913). These cases repeated the approach that had been adopted in a number of challenges to various federal taxes, including *Spreckels Sugar Refining Co. v. McClain*, 192 U.S. 397 (1904) (gross-receipts tax on sugar manufacturing); *Nicol v. Ames*, 173 U.S. 509 (1899) (stamp tax on documents evidencing commodities transactions); *Knowlton v. Moore*, 178 U.S. 41 (1900) (succession tax); and *Patton v. Brady*, 184 U.S. 608 (1902) (tax measured by gross sales of tobacco products), which many have asserted indicated a willingness to retreat from *Pollock*.

The Court nevertheless attempted to take this distinction between direct taxes on property and excises on the privilege of doing business seriously, as seen in a series of cases that, at once, held that businesses conducted in legal entities that could in any way be viewed as “organized” under state statutes would be subject to the tax. See *Eliot v. Freeman*, 220 U.S. 178 (1911) (Day, J., for a unanimous Court) (concluding that certain trusts that were not creatures of statute were not “organized under laws” for purpose of the 1909 Corporate Tax—this may have been simply the path of least resistance, given the difficulties in identifying juridical entities that would be subject to the Tax under a different result—while at the same time holding that even corporations that were no longer doing business would not be subject to the Tax); *McCoach v. Minehill Co.*, 228 U.S. 295 (1913) (holding that a corporation that had no other activity except leasing all of its properties to another corporation, which itself was subject to the tax, was not subject to the tax); *Zonne v. Minn. Syndicate*, 220 U.S. 187 (1911) (holding that a corporation that had adopted new articles authorizing it only to hold title to assets and collect rents was not in business for the purpose of the tax). In these cases, the Court indicated its unwillingness to defer to the collector about the proper scope of activities covered by the tax, especially when the position urged by the government brought the tax closer to renewed constitutional challenge. The possibility that the definition of “doing business” was ultimately a constitutional question rather than a matter of statutory interpretation was broached by Justice Pitney in *McCoach* but seems never to have been squarely confronted by his colleagues. 228 U.S. at 306.

59. 28 Op. Att’y Gen. 138 (1910) (concluding that the 1909 tax base included interest on U.S. bonds because, unlike the earlier income taxes, no provision of the statute excluded such interest).

60. 231 U.S. 399 (1913) (holding that only those deductions allowed by statute would be permitted in computing the tax base of mining companies). This position was affirmed under the 1913 Act in *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1915).

61. *Id.* at 414. In *Anderson v. Forty-Two Broadway*, 239 U.S. 69 (1915), the Court restricted the deductions for interest on debt to the extent that it exceeded the corporation’s stated capital (presumed by the Court to be a measure designed to discourage thin, perhaps tax-motivated, capitalization) over the protests of the taxpayer, a realty company, that such costs were, for those in its business, ordinary business expenses.

under the Corporation Tax might not be permissible were the tax an income tax, rather than an excise tax.<sup>62</sup> Like the 1909 Corporation Tax Act, the 1913 Income Tax Act contained rather poorly assembled provisions that might be thought to address questions relating to timing, realization, and return of capital. The Court seems to have begun to lose patience with Congress in *Doyle v. Mitchell Bros.*,<sup>63</sup> when it concluded that the Treasury could not, particularly in the face of regulations that had provided otherwise, include gains from timber sales that reflected the value of standing timber before the effective date of the 1909 Act even when this value was not reflected on the corporation's books at the end of 1908.

When the Court first heard cases under the 1913 Income Tax Act itself, rather than those heard after 1913 but arising under the 1909 Corporation Tax Act, it did not seem to be interested in meditating very much about the definition of income. When it initially upheld the 1913 income tax against various constitutional challenges in *Brushaber v. Union Pacific Railroad Co.*<sup>64</sup> and its companion cases, the Court (whose views in this case were reported by Justice White rather than by Justice Pitney) gave no indication that it would find constitutional content in the Sixteenth Amendment's use of the term "income" in ways that might interfere with the discretion it had allowed Congress in defining the 1909 tax base. Similarly, in *Stanton v. Baltic Mining Co.*,<sup>65</sup> the Court indicated little interest in interfering with Congress's and the Treasury's definition of "income" despite complaints from the mining industry that the depletion allowed (five percent of income) inadequately reflected its costs and rendered the tax a tax on gross income, not the tax on net income contemplated by the Sixteenth Amendment.

But the blending of the provisions of the 1909 Act with those of 1913 Act had created more-vexing problems, at least for those on the Court who took seriously the need for the Sixteenth Amendment as authority to tax income differently from property. The classic problems of realization and periodicity were not addressed very well in either statute. If it was still possible that the increase in the value of an asset could be taken into account without adequate offset for costs incurred in generating that income, what was the difference between "income" and "property"? If the value of an asset that one assessor claimed had arisen in any one year, perhaps when the crops were first harvested, could be taxed again in another year (simply because that first year's

---

62. 239 U.S. 69, 72 (1915) ("[T]he act of 1909 was not in any proper sense an income tax law, nor intended as such, but was an excise upon the conduct of business in a corporate capacity, the tax being measured by reference to the income in a manner prescribed by the act itself.") Justice Pitney observed that the lower courts' mistake had been in "seeking a theoretically accurate definition of 'net income,' instead of adopting the meaning which is so clearly defined in the Act itself." *Id.*

63. *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179 (1918). This approach was confirmed, but with reaffirmation of the government's authority to set rules for determining the best method for implementing it, in *Hays v. Gauley Mountain Coal Co.*, 247 U.S. 189 (1918).

64. 240 U.S. 1 (1915). *See also* *Tyee Realty Co. v. Anderson*, 240 U.S. 115 (1915).

65. 240 U.S. 103 (1916).

base was used again as the measure of the tax), and then again when the value was transformed into a security, and then again when that security was transformed into cash, what was the difference between a property tax and an income tax? But perhaps of more concern to the Court—if only because shareholders were more likely to raise the issue—the Acts did not spell out whether income from securities would be taxed to shareholders and corporations. The situation was further complicated by the fact that in many cases, the 1913 Act called for collection at the source.<sup>66</sup> Under these confused provisions, it was easy to imagine that a corporation might be required to pay income tax when its profits were added to the corporation's surplus, and then again when it declared a stock dividend, and then again, perhaps, when cash dividend payments were made—all without the shareholder himself being certain that he would not be called upon to prove that he need pay no additional tax at any of these points in time. Furthermore, nothing in the 1913 Act limited the shareholder's income from corporate profits to those arising after 1913, nor did anything in the 1913 Act limit gain on assets (if they were to be taxed at all) to gain arising after 1913. Finally, nothing in the Act or in the early Treasury rulings seemed to provide any assurance that, even if a sensible rule on any of the points was established in one year, such rule would remain in place in implementing the tax in subsequent years.

As the explanation above reveals, these questions in tax-base design were not really new questions. They had been lurking in the drafting and attempted implementation of the two other attempts at imposing a federal income tax. But they had proven too difficult to be resolved in a consistent and stable way by normal political processes. The failure to develop clear answers early on was undoubtedly vexing to those members of the Court who only begrudgingly acknowledged the constitutional status of the tax.<sup>67</sup>

Seen in this light, the interaction between Congress, the Treasury, and the Court that led up to the decision in *Macomber* seems far more explicable.<sup>68</sup> *Macomber* and the realization requirement it introduced provided a grounding point around which other questions could be given stable answers. So long as

---

66. Collection at the source was altered in the 1916 Act, but enforcement under the 1913 Act remained problematic.

67. The possible answers to these questions were outlined in what may seem to a modern reader surprisingly sophisticated terms in a series of papers commissioned for the purpose by the Columbia Business School, published as *THE FEDERAL INCOME TAX: A SERIES OF LECTURES* (Robert S. Haig ed., 1921). As sophisticated as these contributions are about the nature of the problems inherent in defining the income-tax base, particularly those of Thomas S. Adams (who had been working at the Treasury) and Thomas Reed Powell (who was a rising constitutional scholar who had spent a brief stint as a practicing lawyer, during which he served in the treasurers' offices at several colleges), none of them show much appreciation for the institutional and political problems inherent in the adoption of their preferred solutions.

68. In *Constitutional Aspects of Federal Income Taxation*, in *THE FEDERAL INCOME TAX: A SERIES OF LECTURES* (Robert S. Haig ed., 1921), Thomas Reed Powell, seemingly in an effort to downplay the possibility of intervention at the constitutional level by the Court, reviews the numerous kinks and discontinuities that the Court had allowed to persist at the time of the *Macomber* decision.

the Treasury and the lower federal courts thought there was a single standard, which must be met in defining “income,” the process of providing consistent content could begin. Some may have thought that this development “result[ed] in a regrettable tying of the hands of the legislator and an undue curtailment of legislative discretion.”<sup>69</sup> But only after the assurance that these base-definition questions would be resolved in a way that gave some semblance of meaning to “income” would the federal courts let the evolution of the tax law through more-normal legislative and administrative channels continue. The threat of continued holdings insisting upon giving constitutional content to the meaning of “income” forced Congress and the Treasury to commit to a far more consistent and coherent set of rules for defining the tax base.

#### IV

#### CONCLUSION

After the earliest of the stock-dividend cases, and upon the realization that the Supreme Court would not stay out of the business of defining an income tax, there was much retrenchment based on the idea that “income” should be interpreted to mean only what would ordinarily be treated as income and should not include mere readjustments of capital. Many of the wooden interpretations of the 1913 and 1916 statutes were rethought. Thus, for instance, the earliest ruling on damages for physical injury was reversed in favor of an interpretation that required a return on capital, not just a return of capital.<sup>70</sup> It is true that most of these retrenching administrative decisions were written as if statutory interpretation, not constitutional interpretation, was the only question at hand. But the fact that the language used is so limited does not mean that those making these decisions were not anxious to avoid further confrontation and further limitations on the design of the tax that further Court involvement

---

69. Edwin R.A. Seligman, *Introduction, in THE PROBLEM IN GENERAL IN THE FEDERAL INCOME TAX: A SERIES OF LECTURES* (Robert S. Haig ed., 1921). Seligman’s later observation in the same work summarizes well the already formed sense that the need for legal consistency would distinguish the administration of the U.S. income tax from the British income tax:

In the first place, a broader discrimination is vested by the British law in the administrative authorities than is the case in the United States. This lack of administrative discretion and the virtual tying of the hands of the administrator are responsible for not a little of our existing embarrassment. On the other hand, however, the attitude of the official toward the taxpayer is different . . . Whereas the British administrator seeks primarily to do even-handed justice, as between the individual and the government, the American administrator has as his paramount aim the interests of the Treasury. In the one case we have a more or less successful accommodation with the particular taxpayer; in the other case we have, frequently, a more rigid and inelastic interpretation of the law.

*Id.* at x. If the U.S. income tax was going to be administered through the application of relatively determinative rules, rather than through individualized negotiations, a constitutionalized vantage point that operated as a mild constraint on the “American administrator,” although initially appearing “rigid,” actually allowed both the process to become more regularized and the rules to evolve in an orderly way.

70. 31 Op. Att’y Gen. 304 (1918) (reversing position on inclusion of damages for physical injury in Treasury Decision 2747, 20 Treas. Dec. Int. Rev. 457 (1918)).

might bring. It was not clear, furthermore, that any of the administrators involved would have claimed the power to conclude that a congressional act was unconstitutional.<sup>71</sup> So interpretations that avoided the question were clearly the path of least resistance.

Congress, too, felt the shadow of *Pollock*, preferring to accept limitations on the tax it could impose rather than continue in its tussle with the courts. But by then, the federal courts were more comfortable with their role in helping to define the income-tax base, and taxpayers were certainly accustomed to asking them to do so.<sup>72</sup>

The shadow of *Pollock* and *Macomber* lingered for at least three more decades.<sup>73</sup> Many late-twentieth-century tax scholars have downplayed the possibility that the Court will ever again find constitutional content in “income” as used in the Sixteenth Amendment.<sup>74</sup> In general, these scholars have assumed that such content obstructed the operation of the income tax in the early twentieth century. The opposite may instead be true: Without such a possibility, there might never have been a coherent, much less comprehensive, income-tax base at all.

#### POSTSCRIPT

The diligent reader may properly take away from this article another conclusion, one probably more significant than any previously offered. The experience of the Sixteenth Amendment cannot help but show the futility of an

---

71. See *Op. Att’y Gen.* 213 (1918) (concluding that “as there is not a plain and obvious conflict between the provisions of the Constitution and the [provisions of the 1916 and 1918 Acts dealing with stock dividends], it is the duty of the administrative office to comply with the provisions of the statute, leaving the question of its constitutionality to be determined by the courts”).

72. The Board of Tax Appeals, designed to provide a legalistic approach to dispute resolution within the administrative process, was created by the Revenue Act of 1924, ch. 234, § 900, 43 Stat. 253, and renamed the Tax Court in 1942.

73. Not until 1937 did the Supreme Court fail to cite the Sixteenth Amendment in at least one of the cases it considered involving the income tax. Many constitutional-law casebooks included *Macomber* as a leading case in the first dozen years after it was decided. See, e.g., CHARLES W. GERSTENBERG, *CONSTITUTIONAL LAW: A BRIEF TEXT WITH LEADING AND ILLUSTRATIVE CASES* (PrenticeHall 3d ed., 1932); JAMES P. HALL, *CASES ON CONSTITUTIONAL LAW* (West 1926); DUDLEY MCGOVNEY, *CASES ON CONSTITUTIONAL LAW* (Bobbs Merrill 1930). Others included it only as a note case. See, e.g., WALTER DODD, *CASES AND OTHER AUTHORITIES ON CONSTITUTIONAL LAW* (West 2d ed., 1937); OLIVER P. FIELD, *A SELECTION OF CASES AND AUTHORITIES ON CONSTITUTIONAL LAW* (Callaghan 1936). The references in Dodd’s work suggest that by the middle of the 1930s, questions about the possibility of limits on the power of Congress to impose taxes to regulate, rather than strictly raise revenue, loomed far larger than questions about the meaning of “direct taxes” or “income taxes.”

The only government-sponsored, annotated version of the Constitution, furthermore, still contains a dozen pages analyzing the implications of the Supreme Court’s holdings on the constitutional nature of the income tax. See CONGRESSIONAL RESEARCH SERVICE, *CONSTITUTION OF THE UNITED STATES: ANALYSIS AND INTERPRETATION 2067* (2002).

74. Although these scholars are undoubtedly correct that there have been several suggestions by the Court that the actual holdings in *Macomber* and *Cuba Railroad* regarding the nature of “realization” and the need for a return on labor or capital would not be repeated, the Court has never suggested that there is no constitutional content to “income.”

attempt to develop a universal approach to constitutional interpretation. If we cannot draw clear inferences about the meaning of “income tax” as used less than one hundred years ago in the Sixteenth Amendment, it seems unlikely that we would be able to do as much with respect to any other provision of the Constitution. The amendment, after all, was ratified in an era in which we have considerable confidence about the nature of the materials that were publicly and privately available to all the political actors, and it dealt with a relatively narrow matter, which Congress, in two separate rounds, had attempted to address.