

RETROACTIVE INCOME TAXATION

(So-Called)

CHARLES ROBINSON SMITH

The opinion prevails in Washington that a Revenue Bill taxing again as income the incomes reported and taxed during the War would be constitutional, and among many that it would be an excellent method for raising money for the Soldiers' Bonus.¹

Such bills have been offered with strong support in recent sessions of Congress and similar bills are likely to be pressed in the coming Congress. The proponents of these measures base themselves on the principle that Congress may legislate retroactively.

We all know that the vast stores of capital in the United States of today are, with the exception of bare land, wholly due to the accumulation of past income. A large portion of this must have been accumulated since 1913. Such legislation therefore, if successful, would as to all income saved since 1913 and much that was saved before, effect a repeal of Secs. 2 and 9 of Article 1 of the Constitution which provide that direct taxes, that is, taxes on "accumulated property," shall be apportioned among the states according to population.²

And this amazing consequence would follow from the adoption of the Sixteenth Amendment, an amendment which provided for no change of that kind. That Amendment merely said: "The Congress shall have the power to levy and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

Nothing was there said about taxing past accumulations of income that had become capital. Nothing to show that this Amendment was to annul any other part of the Constitution, least of all by indirection—nothing at all—except what every one knew, that this Amendment was designed to carry out the plan to have a complete system of Income Taxation which had been frustrated by the *Pollock* case.³ The Supreme Court in that case had gone so far in defense of these same constitutional provisions as to hold that an income tax on income from property was like a direct tax on the property itself and therefore void unless apportioned.

¹ See Foster, *Income Tax* (1913) 55-82; 59 CONG. REC. (1920) 6486-6491.

² U. S. Const. (1787) art. I. sec. 2. ". . . Representatives and direct Taxes shall be apportioned among the several States which may be included in this Union, according to their respective Numbers, . . ."; *ibid.* sec. 9. ". . . No Capitation, or other direct tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken. . ."

³ *Pollock v. Farmers' Loan & Trust Co.* (1895) 158 U. S. 601, 15 Sup. Ct. 912.

There is nothing in recent decisions to justify the levy of an income tax on accumulations of property—that is, on accumulated income—nothing that goes beyond those decisions uniform and consistent in every jurisdiction that an income tax law may affect the income of the next immediately previous taxable period. This limited degree of retroactivity, if it be such, is now laid hold of as authority for reaching back five or ten years to the incomes that have long since been spent or capitalized.

In truth and in substance the question of retroactivity does not arise in these cases. It is only the form that seems retroactive. Income cannot be determined until it has been received. For this reason it has been the uniform practice to enact income tax laws covering the current period or the most recently completed period of income receipts—the elapsed months of the current calendar year, or the entire calendar year previously elapsed.

When the right to reach back and tax income accruing from March 1, 1913, was questioned in the Senate in the summer of 1913 in the debate on the Revenue Bill eventually signed October 3, 1913, Attorney General McReynolds properly wrote:⁴

“The practice in the past, the necessity for moving along practical lines with respect to tax matters . . . are adequate to overthrow the contention.”

But when a Revenue law reaches back five years to a thing that was once income and which has since either been dissipated or capitalized, what is this but a tax on “accumulated property” and a direct tax forbidden by the Constitution? Does calling this tax an income tax and measuring it by what was once income but is now accumulated property, make it an income tax?

Since the proponents of retroactive income taxation aim to extend it beyond the limits of any previous application of it, let us consider the two constitutional principles which they thereby place in conflict—one or the other of which must give way unless the two can be harmonized.

The first principle is that Congress has power to enact retroactive legislation. The second is that Congress is prohibited from levying direct taxes, as on capital or “accumulated property” except in proportion to population and by apportionment among the states.

The first is an implied power—implied from the very fact of sovereignty. The second is an express limitation of power—secured by two separate provisions of the Constitution—one positive⁵ and the other negative.⁶ And if these principles really do conflict, so that one

⁴ Mr. McReynolds wrote August 6, 1913 to Senator Simmons in reply to a request by the latter for the Attorney General's opinion. The letter, together with a memorandum on the subject by T. M. Gordon, a special assistant to the Attorney General, are given *in extenso* by Foster, *op. cit. supra* note 1, pp. 63-70.

⁵ Art. I, sec. 2. See *supra* note 2.

⁶ Art. I, sec. 9. See *supra* note 2.

must yield, their relation to one another and the subject matter of taxation require consideration.

The Supreme Court has said:⁷

“. . . The power to destroy which may be the consequence of taxation, is a reason why *the right to tax should be confined to subjects which may be lawfully embraced therein.*”

It is significant that the implied power of retroactive legislation is itself in several ways expressly limited by the Constitution. Thus criminal laws that are retroactive, i. e., *ex post facto* laws, are prohibited.⁸ And so with bills of attainder. The right to pass laws impairing the obligation of contracts is also denied to the states.⁹

The chief object of retroactive legislation is remedial. Therefore remedial retroactive enactments “are construed liberally to accomplish the object, correct the evils and suppress the mischief aimed at.”¹⁰ On the other hand, the rarely enacted other kinds of retrospective statutes “have always been subjected to such a construction as would circumscribe their operation within the narrowest possible limits consistent with the manifest intention of the Legislature to be drawn from the language used.”¹¹

Contrast this reluctant suspicious attitude of the Courts toward retroactive legislation with the provisions governing direct taxation on capital. The Constitution gave Congress power to “levy and collect taxes, duties, imposts and excises,”¹² but it divided these into two great classes—direct taxes which must be apportioned among the states according to population, and “duties, imposts and excises which must be uniform throughout the United States.”¹² The income tax, although it be directly on income, is now regarded as in the latter class and an indirect tax so far as the source or property is concerned.¹³

Chief Justice Fuller, in an historical review of the subject, has shown the reasons for this classification.¹⁴ The original states had plenary power of taxation.

“They gave up the great sources of revenue derived from commerce; . . . They retained the power of direct taxation and to that they looked as their chief resource; . . . The founders anticipated that the expenditures of the states, their counties, cities and towns,

⁷ White, J., in *Knowlton v. Moore* (1900) 178 U. S. 41, 60, 20 Sup. Ct. 747, 755. Italics ours. See also *McCray v. U. S.* (1904) 195 U. S. 27, 24 Sup. Ct. 769.

⁸ Art. I, sec. 9.

⁹ Art. I, sec. 10.

¹⁰ 6 A. & E. Enc. Law (2d ed. 1898) 939.

¹¹ *Ibid.*, quoting Duvall, J., in *Hedger v. Renmaker* (1861, Ky.) 3 Metc. 255.

¹² Art. I, sec. 8.

¹³ *Brushaber v. Union Pac. R. Co.* (1916) 240 U. S. 1, 36 Sup. Ct. 236; *Stanton v. Baltic Mining Co.* (1916) 240 U. S. 103, 36 Sup. Ct. 278. And see Maguire, *Relief from Double Taxation of Personal Incomes* (1923) 32 YALE LAW JOURNAL, 757.

¹⁴ *Pollock v. Farmers' Loan & Trust Co.*, *supra* note 3, at p. 618 *et seq.*, 15 Sup. Ct. at p. 914.

would chiefly be met by direct taxation on accumulated property, while they expected that those of the Federal Government would be for the most part met by indirect taxes. And in order that the power of direct taxation . . . should not be exercised except on necessity and . . . so as to leave the states at liberty to discharge their respective obligations, and should not be so exercised unfairly and discriminately as to particular states or otherwise by a mere majority vote, possibly of those whose constituents were intentionally not subjected to any part of the burden, the qualified grant was made."

And in another place:¹⁵

"Nothing can be clearer than that what the Constitution intended to guard against was the exercise by the general Government of the power of directly taxing persons and property within any state through a majority made up from the other states" . . . but this inequality "was manifestly designed to operate to restrain the exercise of the power of direct taxation to extraordinary emergencies and to *prevent an attack upon accumulated property* by mere force of numbers."

Note the recurrent use here of the phrase "accumulated property." What was this property supposed to be accumulated out of? What else possibly but out of *Past Income*?

And again the learned Chief Justice says:¹⁶

". . . . The States varied in maritime importance and differences existed between them in population, in wealth, in the character of property and of business interests. . . . So when the wealthier States gave up for the common good the great sources of revenue, they did so in reliance on the protection afforded by the restriction on the grant of power."

The restriction thus referred to is this limitation of taxing directly "accumulated property" or "accumulated income"—for the terms are interchangeable.

If there be any real conflict here between the implied power of retroactive legislation and the express limitations on direct taxation, it is not difficult to foresee which, in the view of Chief Justice Fuller, would have to give way.

But there is no such conflict. There is merely a confusion of thought as between Income and Capital—an overlooking of the fact that Capital is evolved from Income and that the precise time when this change takes place is not always clear. The Supreme Court has defined Income:¹⁷

"Income may be defined as the gain derived from capital, from labor, or both combined,¹⁸ provided it be understood to include profit gained through a sale or conversion of capital assets."

¹⁵ *Pollock v. Farmers' Loan & Trust Co.* (1895) 157 U. S. 429, 582, 15 Sup. Ct. 673, 690 (on original hearing). Italics ours.

¹⁶ *Ibid.* at p. 557, 15 Sup. Ct. at p. 680.

¹⁷ *Eisner v. Macomber* (1920) 252 U. S. 189, 207, 40 Sup. Ct. 187, 193.

¹⁸ Quoting from *Stratton's Independence v. Howbert* (1913) 231 U. S. 399, 415, 34 Sup. Ct. 136, 140.

Professor Seligman's definition is:¹⁹

"Income as contrasted with capital denotes that amount of wealth which flows in during a definite period and which is at the disposal of the owner for the purpose of consumption, so that in consuming it his capital remains unimpaired."

All capital, excepting bare land, was in its origin income. What we now know and recognize as capital was originally wages or salary or profits or rents or interest or return or remuneration of some sort for effort or for the use of previous capital. Income is continually becoming capital. Accumulated income is capital. For purposes of this definition it is important to fix the time when this occurs, or at least its boundaries, because income that has once become capital, can no longer be taxed as income under the 16th Amendment unless we break down all the limitations of the Constitution—all distinction between income and capital—all distinction between income taxes and capital or direct taxes.

There is often no earmark to show what items of property or money are income and what capital. A man's wages, his salary, his interest or cash dividends, may be thus earmarked at the time of their receipt; but in industry, and especially in large industry, the gross returns indiscriminately include the return or repayment of the capital invested in manufacturing the goods as well as the profits thereon, and in such case a mere adding up of receipts does not show the income of the industry. The greater part of these receipts is capital return. Hence it becomes necessary to keep elaborate accounts and at fixed times determine for periods that have elapsed, that part of the receipts which is the return or restoration of the capital invested in materials, wages, and so on, in producing the goods, and that part, if any, left over for profits or income. But in either or any case, these returns thus constituting income unless consumed quickly become capital.

In industry it takes days, weeks and sometimes months, after the end of the year to compute what has been that year's income. Thus, some of the year's income open to taxation may have become changed into fixed forms of capital before the tax can be computed or levied; but that is a difficulty inherent in the income tax, and this difficulty only emphasizes the need in a true income tax of enacting and levying the tax as promptly as possible and before the income to be taxed can have been too largely changed in character.

It is for this reason that all our income tax laws and those of England also have appeared to be slightly retroactive, if we choose to call a thing retroactive just because one is incapable of action without a slight looking backward for the facts on which to base action. They all without exception taxed the incomes of the current period or the year just previously elapsed. But they were all well within the period that taxpayers required for a complete ascertainment of income.

¹⁹ *Income Tax* (2d ed. 1914) 19.

We borrowed the income tax idea from England. Her revenue bills were regularly reenacted each year in the midst of the taxable period to carry back to the beginning. This was the method of income taxation in vogue when we borrowed it. Everywhere else it is the same. Most laws are enacted to take effect immediately. How could an income tax law take effect immediately if a whole calendar year (or other taxing period) had to be lost before its application, and then another period for ascertaining the facts.

"The income of the preceding year may be and commonly is taken as the basis of the assessment."²⁰

"To tax is legal, and to assume as a standard the transactions immediately prior is certainly not unreasonable, particularly when we find this always adopted in exactly similar cases."²¹

When the bill which was signed October 3, 1913, taxed back to March 1, 1913, and when the Act passed February 24, 1919, taxed back through the whole year, 1918, it is probable that few incomes for those years had been fully ascertained.

Opponents of the retroactive idea sometimes themselves make unreasonable claims. And so the claim that "when income is received it immediately becomes principal" and can no longer be taxed as income, is one of these. Since it is impossible to establish toll gates and make all income pass through these and pay on passing, we must allow a little time for the ascertainment of the incomes of the latest taxable periods. Of course, income paid is in a sense property—but it is only accumulated income that has become principal—what Chief Justice Fuller calls "accumulated property."

Just when the change takes place from income to capital may not always be easy to determine. Border line cases occur here as in most other matters for judicial decision. But the broad differences between income and capital are known to everyone. And we all know that the incomes received in 1917, 1918 and 1919 are no longer income as such but accumulated income, that is, "accumulated property."

The "rule of reason" must be applied in these cases.

We might here appropriately quote the words of Marshall in *Brown v. Maryland*,²² a case of conflicting construction between a statute and the Federal constitution—a statute which taxed importers and a constitution which forbade the states to tax imports:

"The power and the restriction on it, though quite distinguishable when they do not approach each other, may yet, like the intervening colours between white and black, approach so nearly as to perplex the understanding. . . . Yet the distinction exists, and must be marked as the cases arise."

And he added almost as if referring to our case, that when the article

²⁰ 37 Cyc. 811.

²¹ Read, J., in *Drexel v. Commonwealth* (1863) 46 Pa. 31, 40.

²² (1827, U. S.) 12 Wheat. 419, 441.

imported has become incorporated into the mass of property of the country it has lost its character as an import. In other words, that which could not be taxed by the state whilst an import, could be so taxed along with other property after it had become merged in the general property of the state. So we say of Incomes. Merged with the general property they can no longer be taxed as income—but they may be taxed like other property.

The rule of reason was fully set forth in *Standard Oil v. United States*.²³ There again, two constitutional principles came in conflict and there again would naturally arise border line cases, a sort of twilight zone for judicial construction. One of these principles was the freedom of the citizen to contract. The other was the Police Power of the state to curtail that freedom when it tended unduly to restraints and monopolies. To decide these cases, White, C. J., said:²⁴

“Thus . . . contemplating . . . a standard, it follows that it was intended that the standard of reason which has been applied at the common law and in this country . . . was intended to be the measure used.”

Applying the rule of reason, it is seen that our income tax laws hitherto have not really been cases of retroactive legislation at all. This legislation properly understood has applied only to current events, and not to the past in any true sense of the word. For this reason the cases upholding our various Revenue Laws are no authority whatsoever for taxing as income what has really become “accumulated property.”

The proponents of this tax appeal to certain of the decided cases. Their leading case is *Brushaber v. Union Pac. R. Co.*²⁵ That case held valid the Revenue Act signed October 3, 1913, the act covering income from March, 1913. White, C. J., remarked²⁶ “and this *limited* retroactivity is assailed as repugnant to the due process clause of the Fifth Amendment and as inconsistent with the Sixteenth Amendment itself.”

And in *Billings v. United States* the same Judge said:²⁷

“Again let it be conceded that the causing the tax for the annual period to become due in September 1909 is to give it in *some respects* a retroactive effect; such a concession does not cause the act to be beyond the power of Congress under the Constitution to adopt.”

And in the *Brushaber* case the Court quotes²⁸ with approval from the old case of *Stockdale v. Insurance Companies*²⁹ where there had also

²³ (1911) 221 U. S. 1, 31 Sup. Ct. 502.

²⁴ *Ibid.* at p. 60, 31 Sup. Ct. at p. 516.

²⁵ *Supra* note 13.

²⁶ *Ibid.* at p. 20, 36 Sup. Ct. at p. 242. Italics ours.

²⁷ (1914) 232 U. S. 261, 282, 34 Sup. Ct. 421, 424. Italics ours.

²⁸ *Supra* note 13, at p. 20, 36 Sup. Ct. at p. 242.

²⁹ (1873, U. S.) 20 Wall. 323.

been a similar limited degree of retroactivity in a tax law, a new tax law covering income of the year last past and rectifying a confusion in the previous income statute. The legislation was essentially remedial.

The error of the proponents lies in the argument that because the courts have sustained income tax laws with a *limited* but necessary degree of retroactivity, never exceeding the period for ascertaining what the full incomes for the period were, therefore any degree of retroactivity would be lawful even if it reached back to a time the incomes of which had clearly become accumulated property.

They ignore the fact that time and circumstance may change substance; that a difference in degree becomes a difference in kind; that time changes imports taxable only by the United States into the general property of the country taxable by the state; that freedom to contract may become oppression and monopoly; that income may and does become "accumulated property."

The interpretations of the Sixteenth Amendment by Chief Justice White in the *Brushaber* case are pertinent. He declared that the Amendment did not confer power to levy income taxes in a generic sense, an authority already possessed, and that the Amendment was drawn with the object of "*maintaining the limitations of the Constitution and harmonizing their operations,*"³⁰ precisely what we are contending for here.

In both this case and that of *Stanton v. Baltic Mining Co.*³¹ the Chief Justice makes it clear that the Sixteenth Amendment merely takes taxes on incomes derived from property out of the class of direct taxes and places them with taxes on income from labor, the practice of the professions, and so on, in the category of indirect taxes no longer subject to apportionment. It thus for the first time makes possible a real and complete income tax, whilst "*maintaining the limitations of the Constitution*" as to direct taxes.

But except for that he holds in effect that the *Pollock* case is a correct interpretation of the Constitution with the Sixteenth Amendment included. A tax on property, a tax, as Chief Justice Fuller said, on "accumulated property," is still a direct tax and subject to apportionment. And this is so whether this personal or other property may have been accumulated out of income received before or after 1913. Nothing else is changed except the taxability of all current incomes from whatever source derived. Income that has become "accumulated property" can no more be taxed now than it could have been before the Amendment.

The Court has more recently expressed itself in *Eisner v. Macomber*.³² Mr. Justice Pitney there said:³³

³⁰ *Supra* note 13, at p. 19, 36 Sup. Ct. at p. 242. Italics ours.

³¹ *Supra* note 13.

³² (1920) 252 U. S. 189, 40 Sup. Ct. 189.

³³ *Ibid.* at p. 206, 40 Sup. Ct. at p. 193. Italics ours.

"As repeatedly held, this (the Sixteenth Amendment) did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on incomes."

"A proper regard for its genesis, as well as its very clear language, requires also that *this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, these provisions of the Constitution that required an apportionment according to population for direct taxes upon property, real and personal.* This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts.

"In order, therefore, that the clauses cited from article I of the Constitution (the direct tax clauses) may have proper force and effect, save only as modified by the amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not "income," as the term is there used; and to apply the distinction, as cases arise, according to truth and substance without regard to form."

What is this but the rule of reason?

And the learned Justice might have added that there is a further powerful, practical need for recognizing this distinction between income and accumulated property. That consists in the different rates of taxation applicable in practice. We have seen income taxes as high as 77%, but it is rare that a property tax exceeds 2%. A tax of even 77% of one's income still leaves 23% of it to the owner, and his capital unimpaired; while a tax of 77% of his capital means a permanent loss not only of that much capital, but a pro tanto reduction of all future income that might be derived from that capital.

Although the Income Tax must now be considered an excise or indirect tax, it is nevertheless levied *on* income. The Sixteenth Amendment so reads. The Revenue Law of 1921 in part II, secs. 210 and 211,³⁴ says: "*upon* the net incomes of every individual," and in part III, sec. 230,³⁵ "*upon* the net income of every corporation." The Courts so treat it. It was discussed on that basis in *Eisner v. Macomber*.

Chief Justice White in the *Brushaber* case expressly said that the purpose of the amendment was to prevent what he called "a direct tax on the income" from being a "direct tax on the source itself and thereby to take an income tax out of the class of excise duties and imposts and place it in the class of direct taxes."³⁶

The Income Tax must not be confused with those other indirect taxes generally in use and upheld long before the Sixteenth Amendment, known as business or occupation taxes or corporate franchise taxes. In those cases the tax was always held to be not on the income or earnings, but on the business or occupation or franchise, and earnings were but the measure of the value of the thing taxed.

³⁴ Act of November 23, 1921 (42 Stat. at L. 227, 233). Italics ours.

³⁵ *Ibid.* at p. 252. Italics ours.

³⁶ *Supra* note 13, at p. 19, 36 Sup. Ct. at p. 242.

For this reason in those cases the income of non-taxable property could be included in the measure, income from state bonds, interstate commerce and the like, which could not have been taxed separately, and the inclusion of such income was upheld on the ground that the income itself was not the thing taxed but only the measure of its value.³⁷

But when the Sixteenth Amendment was in course of adoption a genuine fear arose lest these same rulings should be applied to the Income Tax and so interfere with the instrumentalities of the States. But the Supreme Court said on this point in *Evans v. Gore*:³⁸

"Governor Hughes . . . in a message . . . expressed some apprehension lest it (the amendment) might be construed as extending the taxing power to income not taxable before; but his message promptly brought forth from statesmen who participated in proposing the amendment such convincing expositions of its purpose, as here stated, that the apprehension was effectively dispelled and ratification followed."

And in accordance with these facts the Court held a Judge's salary to be non-taxable as income.

It is therefore clear that the income tax is a tax on income, and those other taxes are taxes on businesses or franchises where income is merely used as the measure of value.

This does not mean that the income tax must necessarily be paid out of the income itself. The income tax becomes a general debt of the taxpayer like most other taxes, local taxes on personalty, for example. But just because the income tax is a tax on income it becomes necessary, as Mr. Justice Pitney says,³⁹ "to distinguish between what is and what is not 'income' . . . according to truth and substance without regard to form." The name of the tax is unimportant. And Chief Justice Fuller said in the *Pollock* case:⁴⁰

"If it be true that by varying the form the substance may be changed, it is not easy to see that anything would remain of the limitations of the Constitution, or of the rule of taxation and representation so carefully recognized and guarded in favor of the citizens of each state. But the constitutional provisions cannot be thus evaded. It is the substance and not the form which controls. . . ."

The proponents of this new tax would go through the form of taxing once more former incomes, but this form ignores substance. For these incomes have been spent or become "accumulated property" and a tax on such would be a direct tax.

Congress tried something similar in its law of September 8, 1916,⁴¹

³⁷ See Corporation Tax Law. Act of August 5, 1909 (36 Stat. at L. 11, 112). The constitutionality of this act was upheld in *Flint v. Stone Tracy Co.* (1911) 220 U. S. 107, 31 Sup. Ct. 342. See *U. S. Express Co. v. Minnesota* (1912) 223 U. S. 335, 32 Sup. Ct. 211.

³⁸ (1920) 253 U. S. 245, 261, 40 Sup. Ct. 550, 556.

³⁹ *Eisner v. Macomber*, *supra* note 32, at p. 206, 40 Sup. Ct. at p. 193.

⁴⁰ *Supra* note 13, at p. 581, 15 Sup. Ct. at p. 689. And see *Phila. S. Co. v. Pennsylvania* (1887) 122 U. S. 326, 7 Sup. Ct. 1118.

⁴¹ 39 Stat. at L. 756, 757.

expressly taxing stock dividends as income, but the Supreme Court having regard to the very truth of the matter, "to substance and not to form," held a stock dividend not to be income and that the tax upon it was a direct tax on property and a violation of art. I, secs. 2 and 9 of the Constitution.⁴²

The Court also took occasion to over-rule *Collector v. Hubbard*⁴³ which had upheld the tax law of June 30, 1864,⁴⁴ taxing stockholders on undivided shares of corporate earnings never received by them as dividends, the ground being that these were not income of the stockholders.

The retroactive legislative power of Congress cannot help here. For the weakness lies not in the retroactivity, but in the fact that the proposed law seeks to impose a property tax by calling it an income tax. If there were nothing to this proposed piece of legislation but its retroactivity, it might possibly be made lawful—by complying with the limitations of the Constitution.

Unless the Fifth Amendment bars the way, a law that would tax again the incomes of 1917 or 1918, and recognize them as "accumulated property" by providing for an apportionment among the states in proportion to population, although it would go far beyond any retroactive taxation yet enacted, might be sustained by the Courts. But the power to pass retroactive legislation does not carry with it the power to override the express provisions of the Constitution. Consequently, as the income tax is levied upon income, a tax levied upon accumulated income is a tax on what Chief Justice Fuller calls "accumulated property" and is a direct tax and void unless apportioned.

It will no doubt be argued that this proposed legislation would respect the direct tax limitations since it would not tax the specific real and personal property into which the incomes of other years have passed, but only tax once again those non-existent incomes as though they still existed. But of what comfort is this sophistry to the man, who, having paid his income tax in 1917, has saved \$10,000 and put it into a house, when he is told that although Congress may not tax his house, he must be prepared to pay another tax on the \$10,000 of his saved income which he has put into it?

While this subterfuge substitutes form for substance, it does worse. It substitutes fiction for fact.

It may further be urged that the proposed legislation is not confined to accumulated income; it covers the whole of past incomes, including the portions spent or destroyed. But this fact can hardly sustain its constitutionality. It would be enough to vitiate the whole of any scheme of past income taxation, that so large a part as the tax on the accumulated incomes was void as a direct tax.

⁴² *Eisner v. Macomber*, *supra* note 32.

⁴³ (1870, U. S.) 12 Wall. 1.

⁴⁴ 13 Stat. at L. 223, 281.

In the *Pollock* case, the Court said:⁴⁵

"If the different parts (of the Revenue Act) 'are so mutually connected with, and dependent on each other . . . as to warrant a belief that the legislature intended them as a whole and that, if all could not be carried into effect the legislature would not pass the residue independently and some parts are unconstitutional, all the provisions which are thus dependent . . . must fall with them.'"⁴⁶

And taking those parts of past incomes spent or lost in business or otherwise destroyed, a tax on these alone would not only be a legislative monstrosity, it would not even be an income tax at all. It would be like a tax exclusively on the buildings existing in 1917 and since burned down—or like a poll tax exclusively on the men of 1917 who had since died.

Such taxes could hardly be deemed to "be confined to subjects which may lawfully be embraced therein."⁴⁷

But to exhaust our suppositions, suppose that Congress in order to reach again the incomes of, say, 1917, should recognize the force of all this criticism, and to avoid it, attempt to tax in two parts—one, the part saved and accumulated, taxing this directly by apportionment among the states—the other, the part spent, as an excise or sumptuary tax.

Such a tax would present great practical difficulties, and it would frustrate the original idea of the income tax entirely, for it would leave nothing of it but its retroactivity. It could be paid only out of existing property, and yet the rates would be based on the property one had had, or on the money one had spent five, ten, or fifty years before.

If we consider substance and not form, such a levy would seem to overstep the domain of taxation, and to be but a taking of property for a public use without compensation or without due process of law, a violation of the Fifth Amendment and perhaps of the Fourteenth. And this confiscatory measure would have to be upheld not under any express constitutional power, but by judicial construction, giving this enormous scope to the implied power of retroactive legislation.

People write glibly about the broad power of retroactive legislation in tax matters, yet it is astonishing how meagre both the enactments and the authorities are to illustrate this power. These are almost entirely confined to cases of remedial justice; like the assessment or re-assessment of property which by fraud, evasion, neglect or undervaluation had escaped its just share in the past.⁴⁸

⁴⁵ *Supra* note 3, at p. 636, 15 Sup. Ct. at p. 920.

⁴⁶ The quotation is from Shaw, C. J., in *Warren v. Charleston* (1854, Mass.) 2 Gray, 84.

⁴⁷ *Knowlton v. Moore*, *loc. cit. supra* note 7.

⁴⁸ 1 Cooley, *Taxation* (3d ed. 1903) 492 and cases cited; *Cross v. Milwaukee* (1865) 19 Wis. 509; *State v. Pors* (1900) 107 Wis. 420, 83 N. W. 706.

The best comment on confiscatory measures such as here proposed is found in the dictum of Evans, J., in the case of *Bank v. Covington*.⁴⁹

"If the power to do this exist at all, there is no limit to it; and it might illustrate the subject to consider the result if church property now exempt should, as it lawfully might, be made subject to taxation in the future, and not only so, but retroactively, for ten, or twenty, or even fifty years back. Here would be a practical confiscation of such property for public use. Nor does the court mean to deny that where the law in fact imposes taxation upon property which, however, is overlooked by the assessor or otherwise omitted from the assessment, or some other step is taken which is faulty, the defects may not be cured by legislation."

It seems hardly worth while to consider a sumptuary tax based solely on that part of past income used up in living expenses.

Notwithstanding the fact that a business or franchise tax differs from the income tax and that in the former the income is merely the measure and not the thing taxed; and that therefore incomes from non-taxable sources may be included as a part of the measure, it is not to be doubted that even a franchise tax law which would use as its main or exclusive measure non-taxable incomes would be void.

A law that would so base a franchise tax on state and other non-taxable securities, would be wholly void, and while interstate earnings may be included with other earnings as the measure of a state franchise tax,⁵⁰ a state law that would base the franchise tax wholly or mainly on the earnings of interstate commerce would be void.⁵¹ On these same principles "accumulated or past incomes" being capital and protected by art. I, secs. 2 and 9, could not be used as the measure or principal measure even of a Federal corporation or business tax. Besides which, retroactive franchise taxes would seem to collide with both the Fifth and the Fourteenth Amendments.

Another consideration which forbids any new tax on these so-called incomes of other days is, that they have all paid their taxes for their respective years and their recipients have fairly bought the right to consider the residue as capital and to invest it as such.

In *Brown v. Maryland* the state had imposed a business tax of \$50 a year on importers, which the Court held void as being indirectly a tax on imports. Chief Justice Marshall said:⁵²

"The counsel for the plaintiffs in error contend that the importer purchases, by payment of the duty to the United States, a right to dispose of his merchandise, as well as to bring it into the country, and certainly the argument is supported by sound reason. . . . The object of impor-

⁴⁹ (1900, C. C. D. Ky.) 103 Fed. 523.

⁵⁰ *U. S. Express Co. v. Minnesota*, *supra* note 37.

⁵¹ *Phila. S. Co. v. Pennsylvania*, *supra* note 40; *G., H., & S. A. Ry. Co. v. Texas* (1908) 210 U. S. 217, 28 Sup. Ct. 638; *Eureka Pipe Line Co. v. Hallanan* (1921) 257 U. S. 265, 42 Sup. Ct. 101.

⁵² *Supra* note 22, at p. 442.

tation is sale; it constitutes the motive for paying the duties; and if the United States possess the power of conferring the right to sell, as the consideration for which the duty is paid, every principle of fair dealing requires that they should be understood to confer it."

What would Marshall be likely to say today of a revenue law to tax the imports of 1917 a second time after they had passed to consumers; or of one to levy a further income tax on the incomes that had paid their taxes for that year and become re-invested?

Looking at substance and not at form, if an income tax on the accumulated income of years gone by is sustained there would have come to pass as to the greater part, and an annually increasing proportion of the wealth of the country, the danger of "an attack on accumulated property" which the Founders tried to prevent by those two express and explicit clauses in the Constitution.

The Government already has ample undisputed power of taxation without encroaching on those limitations which protect the states. This is seen in its financial success in waging the greatest of all wars and also in the great sums it is raising today through lawful taxation. There is therefore no occasion for a strained construction to sweep away constitutional provisions upon which the states and their municipalities principally depend for the protection of their means of raising revenue.