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PRESENT TAXABLE STATUS OF STOCK DIVIDENDS IN FEDERAL TAX LAW†

HENRY ROTTSCHAEFER* 

STATUS UNDER THE 16TH AMENDMENT

The previous discussion has described the technique employed by the majority in the Griffiths Case for avoiding the issue as to the present constitutional status of Eisner v. Macomber. The minority of the Court rejected this approach and met that issue with evident eagerness. Its position thereon was that Eisner v. Macomber should be overruled. The dissenting opinion was written by Mr. Justice Douglas, and Messrs. Justices Black and Murphy joined him therein. This fact, coupled with that of the majority's disposition of the case, has led to a great deal of speculation as to what fate Eisner v. Macomber would meet if the issue of its constitutional status were to come before the Court. The preponderant view seems to be that it would be overruled. The attempt to do so is certain to encounter strenuous opposition from taxpayers and their counsel. The discussion that follows will aim at evaluating the probability of their success in preventing the views of the minority of the Court in the Griffiths Case from becoming the law of the land.

A consideration of the argument of that minority affords an easy introduction to the subject. The reasons urged therein to support the theory that all stock dividends are income within the meaning of the 16th Amendment are certain to be invoked if that issue ever reaches the Court. The first of these reasons rests on the major premise that the term "income" as used in that Amendment includes "everything which by reasonable understanding can fairly be regarded as income." Its minor premise is, in the language of the minority, that "Stock dividends representing profits certainly are income in the popular sense." The appeal to popular understanding on matters of this character is an appeal to something that is so vague that what its advocates will do is not to discover a fact but to create a "fact" consonant with the demands of their position. However, that alone will not prevent the argument from carrying considerable weight, particularly if reinforced by the consideration invoked by the minority in connection with it that

† For the first part of this article see (1943) 22 N. C. L. Rev. 1. This article also appears in (1943) 28 Minn. L. Rev. 106, 163.

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† The minority opinion uses this language taken from the dissenting opinion of Mr. Justice Brandeis in Eisner v. Macomber, 252 U. S. 189, 237, 40 Sup. Ct. 189, 204, 64 L. ed. 521, 541 (1920).
“the exclusion of stock dividends from income permits a person to increase his wealth indefinitely without ever being subject to an income tax.” 37 Nor will it be the only instance in which judicial creation constitutes the major factor in determining the meaning of constitutional language. However, it is unlikely that this approach will be given such a dominant position as it received in the dissenting opinion of Mr. Justice Holmes in Eisner v. Macomber. 38 That it will play a considerable part in the final determination of this issue is certain. It is too much in line with current political notions to be left unused. 39

The next argument of the minority may fairly be summarized as follows: (1) The decision in Eisner v. Macomber is based on the premise that the 16th Amendment precludes treating a corporate shareholder as having received income unless assets are severed from corporate capital and made available to the shareholder for his separate use, benefit and disposal. (2) The Koshland and Gowran Cases, 40 the Reorganization Cases, 41 and others, 42 establish the principle that a shareholder may receive income from the corporation though the corporation distributes no assets to him, and that, in general, a taxpayer may receive income though he receives neither money nor property. (3) The basic objection to treating stock dividends of the Eisner v. Macomber type as income within the 16th Amendment has thus been removed by the Supreme Court’s own decisions. (4) Therefore, that decision should be overruled. This argument will be evaluated later on in this article. Suffice it for immediate purposes to state that the minority does not limit itself, in supporting proposition (2), to decisions involving the constitutional issue involved in the instant problem. In fact, it relies in part upon decisions in which no constitutional issue was raised.

The minority’s final position is not so much an argument as a re-statement of the problem. It recognizes that the mere declaration and payment of a stock dividend does not normally increase the share-

37 The minority in this connection quotes from an article by Professor T. R. Powell, Income from Corporate Dividends (1922) 35 Harv. L. Rev. 363, 376.
38 Mr. Justice Holmes in Eisner v. Macomber stated that “the word ‘incomes’ in the 16th Amendment should be read in ‘a sense most obvious to the common understanding at the time of its adoption.’”
39 See on this general subject IRVING FISHER and H. W. FISHER, CONSTRUCTIVE INCOME TAXATION, Ch. XII.
holder’s wealth, but that the change in his wealth proceeds pari passu with the accumulation of corporate earnings. It, accordingly, states that “The narrow question here is whether Congress has the power to make the receipt of a stock dividend based on earnings an occasion for recognizing that accrual of wealth for income tax purposes.” However satisfactory such a method of formulating the problem may be, the minority’s reasoning in support of its affirmative answer leaves much to be desired. It amounts to little more than a statement that the minority “can see no constitutional reason for saying that Congress cannot” choose to compute “the ‘income’ to the stockholders at the ‘fair market value’ of the stock dividends received” since that “is one way—though perhaps at times a crude one—of measuring for income tax purposes the wealth which normally accrues to stockholders as a result of the earning of their corporation.” The emphasis in this line of reasoning is on the method for measuring the shareholder’s income when he receives a stock dividend based on earnings. The problem of its measurement would arise only if it be assumed that it has already been decided that the receipt of such a stock dividend does constitute the receipt by the shareholder of something which comes within the concept of “income” as that term is used in the 16th Amendment. There are several assumptions on which the minority’s reasoning becomes relevant and intelligible. If it be assumed that the 16th Amendment gave Congress the power to determine what should constitute income, there is in effect an end to judicial review of its decisions on that matter. This would involve a violent departure from principles that have long had the sanction of the Supreme Court, a wider departure than the minority intended to initiate by its attempt to overrule *Eisner v. Macomber.* Nor is the adoption of such an assumption required to give meaning to the minority’s argument. This can equally well be done if the 16th Amendment be construed to confer upon Congress the power to determine what shall constitute income if only its decisions thereon be not wholly unreasonable and arbitrary. The adoption of such a theory would furnish a rational explanation of the minority’s emphasis on the problem of Congress’ power to choose a measure of the income involved in the receipt of a stock dividend, even though the measure actually adopted by it might in some cases be a rather crude one. It is even conceivable that the minority would hedge Congressional discretion by the implications of its first argument in which popular conceptions of “income” entered so largely as the basis for determining the meaning to be given that term in the 16th

43 For a similar approach to other income problems see Rottschaefer, *The Concept of Income in Federal Taxation* (1929) 13 MINN. L. REV. 637, at pages 645, 646.
Amendment. While this is conceivable, it is improbable that the minority intended to shackle Congress by any such standard. It is probably necessary to ignore the first of the minority's arguments in evaluating its last one.

Attention has already been directed to the fact that the minority recognized that measuring the income involved in the receipt of a stock dividend based on earnings by the market value of the dividend shares might at times be rather a crude procedure. The basis for this view is to be found in the following considerations. The increase in a shareholder's wealth represented by his shares is a function of the corporate net earnings during the period of his ownership of those shares. There is no necessary equivalence between the increase in the value of any shareholder's stake in the corporate net assets attributable to the corporate net earnings during the period of his ownership of the shares and the market value of the dividend shares which he receives when a part of those net earnings are capitalized by the declaration and payment of the stock dividend. If the net earnings during his period of ownership of the shares is less than such market value, he will be charged with income in excess of the increase in his wealth represented by his shares, at least so far as that increase is due to corporate net earnings. It is true that this may give him an offsetting advantage when he later comes to sell either the shares with respect to which the dividend was received, or the dividend shares themselves, or both. But there is no assurance of any exact or approximate equivalence between the advantage at this point and the burden imposed when his income from the receipt of the stock dividend was measured in the manner employed in the Griffiths Case. The use of such measure in a case of the kind last described can be held valid under the 16th Amendment if that permits treating even a merely formal change in an ultimate owner's relation to a fund of accumulated income as a decisive factor for charging him with income in some amount as of the time when that formal change occurs. It is but a short step from that position to one that would dispense with even the transaction involving such formal change. This would imply that the corporate earnings could be directly charged as income to the shareholder's pari passu with their becoming earnings to the corporation. That the minority might be willing to press the principle at least that

44 This does not mean that it is the only variable on which such an increase in the shareholder's wealth depends. It means only that those net earnings are one of the variables on which said increase depends.

45 See, in connection with this aspect of the problem, E. H. Warren, Taxability of Stock Dividends as Income (1920) 33 HARV. L. REV. 885.

46 This is clearly inconsistent with the position of the majority of the Supreme Court in Eisner v. Macomber, 252 U. S. 189, 40 Sup. Ct. 189, 64 L. ed. 521 (1920).
far is evident from the following statement in its opinion: "The wealth of stockholders normally increases as a result of the earnings of the corporation in which they hold shares. I see no reason why Congress could not treat that increase in wealth as 'income' to them." The case of Collector v. Hubbard\(^*\) is cited in support of this point of view. There is language in the opinion therein which can be so construed, but the decision itself cannot be deemed to sustain the position that a shareholder receives income when his corporation earns income. In any event, if the minority construes "income," as used in the 16th Amendment, to permit what was done by the federal income tax act which was before the Supreme Court in Collector v. Hubbard, then it will be difficult to prevent that term from being construed to include any accretion of wealth, even unrealized capital gains. However, it cannot be denied that the minority's reasoning becomes relevant and intelligible if predicated on any one of the assumptions discussed in this and the preceding paragraphs. The possible implications of its theories extend far beyond the issue of whether stock dividends of the Eisner v. Macomber type constitute income within the meaning of the 16th Amendment. It is, therefore, a matter of considerable importance to taxpayers whether or not the minority view on this constitutional issue ultimately becomes that of a majority of the Supreme Court of the United States.

An investigation into the probability of the overruling of Eisner v. Macomber must cover a wider range of inquiry than an examination of the position of the Court's minority in the Griffiths Case. It demands a consideration of the course of judicial decision in dealing with problems of income under federal tax legislation since Eisner v. Macomber was decided. The cases that will have the most weight are those in which the constitutional concept of income was expressly in issue. However, it will be impossible to ignore those in which courts have supported their ideas of income by invoking the definition thereof which served as the major premise supporting the decision in Eisner v. Macomber. In what follows, the major decisions only will be considered.

The starting point is, necessarily, the concept of income developed in the opinion of Mr. Justice Pitney in Eisner v. Macomber. This has already received considerable attention in the first part of this article. The discussion at this point will be limited to such considerations as fit into the general lines of the argument hereinafter set forth. The essential element in the constitutional concept of income was found in the requirement of realization. This involved as one of its consequences

\(^*\)12 Wall. 1, 20 L. ed. 272 (1871). The majority opinion in Eisner v. Macomber, supra, overruled this case and rejected the contention that the adoption of the 16th Amendment had re-established its position.
that a mere increase in a person's wealth during a given period of time would not alone establish that he had received income which Congress could tax by methods permitted by the 16th Amendment. Although realized capital gains do constitute income,\textsuperscript{48} unrealized capital gains cannot be taxed as income. But, while \textit{Eisner v. Macomber} did decide that a particular transaction, namely the receipt of a stock dividend of the kind and under the circumstance involved in it, did not involve that type of realization essential to the receipt of income by the shareholder receiving such a stock dividend under such circumstances, the light which the opinion threw on what facts would establish the existence of the requisite kind of realization was rather meager. This was due, in large part, to the fact that the reasoning was formulated in terms applicable primarily to corporate distributions. However, since its meaning has received more consideration and development in that type of case than in any other, the decisions involving cases of that class will have to be considered somewhat more fully at this point than that accorded them in the first part of this article.

The first comprehensive treatment of this matter subsequent to \textit{Eisner v. Macomber} occurred in the \textit{Reorganization Cases}.\textsuperscript{49} It will suffice to discuss the Phellis Case only.\textsuperscript{50} The facts therein were as follows: \textit{A Co.} had organized \textit{B Co.} under the laws of a state other than that of its own incorporation. It transferred all of its assets to the latter in exchange for some cash, all of the preferred stock that \textit{B Co.} issued, and all of \textit{B Co.'s} common stock. The cash was used to pay off a part of \textit{A Co.'s} bonds; the preferred stock to redeem the rest of its bonds and preferred stock, the balance being retained to cover its own common stock par for par; the common stock was distributed to its stockholders. At the close of the reorganization the net assets of \textit{B Co.} available for its common stockholders were less than the net assets of \textit{A Co.} available for its stockholders prior to the reorganization by the extent of the preferred stock of \textit{B Co.} retained by \textit{A Co.} to cover its own common stock par for par, but an equal amount of \textit{B Co.'s} assets were in substance reserved for those stockholders through their ownership of \textit{A Co.'s} common stock. Since the distribution of the common stock of both companies at the completion of the reorganization was the same as in \textit{A Co.} before that time, the proportionality of the stockholders' interests in \textit{A Co.'s} original assets was, if substance and not form be regarded, maintained for the same group's interest in the same assets after their transfer to \textit{B Co.} The transaction, however, was held to have involved a realization of income by \textit{A Co.'s} stockholders to the extent of the value of the \textit{B

\textsuperscript{48} Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509, 41 Sup. Ct. 386, 65 L. ed. 751 (1921).
\textsuperscript{49} See footnote 41, \textit{supra}.
Co. shares received by them. In the formal sense, of course, those stockholders received from A Co. a dividend in property consisting of B Co. shares, so that there was an actual severance from A Co.'s assets for the separate use of its stockholders. However, the argument most strongly urged against the decision was that A Co.'s stockholders had realized no income because the old and the reorganized corporations were substantially identical, and that, therefore, there had been a mere distribution of certificates indicating an increase in the value of the stockholders' capital holdings. The Supreme Court denied this contention, holding that the stockholders of the new corporation had property rights and interests materially different from those incident to ownership of stock in the old company. It stated that the result of the distribution of the reorganized company's common stock had been to transfer to the stockholders of the original company "new individual property rights . . . in realization of their former contingent right to participate eventually in the accumulated surplus." The significance of this analysis lay in its indication that realization included the acquisition of an interest in a given group of assets differing from the former interest therein of those charged with having received income in the transaction which produced such a change of interest. In Marr v. United States, another of the Reorganization Cases and one in which the question of Congress' power to tax such transactions was squarely discussed, the Supreme Court expressly approved the government's contention that a stockholder realized income not only when he acquired "an interest in a different business enterprise or property" but also when he acquired "an essentially different interest in the same business enterprise or property." The result of the Reorganization Cases can be summed up in the proposition that a corporate stockholder realizes income from his investment in his stock whenever the corporation distributes to him, as stockholder, something which gives him an essentially different interest in the corporate assets than he had therein before the distribution. The decision that a dividend paid in the distributing corporation's own bonds constitutes income to the shareholder accords perfectly with this conception of realization. The result of such a distribution is to transmute the shareholder's former interest in the corporate assets from that of ultimate owner to that of creditor.

The last of the group of cases generally described as the Reorganization Cases was decided in 1925. The next important consideration of the constitutional status of corporate distributions under the 16th Amendment occurred more than a decade later when the Supreme

Court rendered its decision in the Koshland Case. The facts of this case were as follows: A, a preferred shareholder in B Co., was paid a dividend thereon in the form of common stock of B Co. He thereafter sold the preferred, and thus arose the question as to how to compute the gain on that sale. The Commissioner applying the applicable Regulations, treated the receipt of the dividend paid in B Co.'s common stock as the receipt of capital, and adjusted the gain basis for the preferred stock to reflect this factor. The issue was A's liability for the additional tax attributable to the resulting increase in gain from the sale of his preferred stock. It thus became necessary to determine whether the receipt of the common stock as a dividend on the preferred was a capital receipt or income within the meaning of the 16th Amendment. The Supreme Court held it to be the latter, not a capital receipt. It stated that "where a stock dividend gives the stockholder an interest different from that which his former stockholdings represented he receives income" within the meaning of the 16th Amendment. That is, such a distribution involves realization, a point of view completely consistent with the Court's theories as developed in the Reorganization Cases. There was no further development of the concept of realization in corporate distribution cases until the decision in 1943 of the Griffiths, Sprouse and Strassburger Cases. It will not be necessary to consider again the contribution that these cases made to the concept of realization in relation to stock dividends. Suffice it to say that under them realization is present whenever the distribution alters the recipients pre-existing proportionate interest in the corporation, and is present in the case of only such stock dividends as produce that effect. It is true that the opinions in none of the cases discussed in this paragraph use the term "realization." But each of them professed to be developing the implications of Eisner v. Macomber, and may, therefore, be treated as defining the tests for determining when a distribution of a stock dividend involves the realization of income by its recipient. The only other alternative is to treat the Court's failure to use the word "realization" as an abandonment of the requirement that only realized income is "income" within the meaning of the 16th Amendment. The Court may ultimately adopt that position, but it would be a most doubtful proceeding to conclude that it had done so in any of the stock dividend cases.


See discussion in first part of this article in (1943) 22 N. C. L. Rev. 1, 12-14.
The theory of the constitutional nature of income has received a more extensive discussion in this series of stock dividend and reorganization cases than in cases involving other types of situation. The views expressed by the courts in some of them have a certain amount of value in relation to the present problem. This is especially true with respect to Helvering v. Bruun, one of the cases relied upon by the Supreme Court's minority in the Griffiths Case. This was the last in a series of cases involving the treatment of improvements made on leased premises by a lessee who had no right to remove them. It cannot be gainsaid that the lessor in such a case may have his wealth enhanced as a result of such a provision in the lease. If the improvements have any value when he re-enters into possession of the leased premises, his wealth will have been increased by the amount of that value during the period beginning with the commencement of the leasehold and ending with the lessor's re-entry upon the premises. It will not be necessary to trace the history of the Commissioner's efforts to deal with this problem. The first case that needs to be considered is M. E. Blatt Co. v. United States. The Commissioner had included in the lessor's income for the first year of the term an amount computed by dividing the estimated depreciated value of the improvements at the end of the term by the number of years in the term. The only part of the Court's opinion here relevant is that in which it asserts that, while the lessor had an ownership interest in the improvements during the first year of the term (the year when they had been made), he had no present right to use them, and that the acquisition of such an interest as he then acquired did not amount to a contemporaneous realization of gain within the taxing statute. It was, accordingly, held that the lessor had realized no income from this series of transactions during the year in question. Although the Court made no pretense of deciding a constitutional question, its view as to the theory of realization of income embodied in the statute may well represent its opinion as to what constitutes realization of income within the meaning of the 16th Amendment. In any event, it is as likely to reflect its then view thereon as are its definitions of realization in many later cases in which no constitutional issue was involved but which are nevertheless invoked by proponents of the view that all stock dividends are income subject to taxation under the 16th Amendment.

This brings us to the case of Helvering v. Bruun. Its essential
facts were the same as those in the Blatt Company Case except that the lessor had retaken possession of the leased premises, including the improvements made thereon by the lessee, as a result of the forfeiture of the lease. The net fair market value of the building which the lessee had erected on the land, as of the time when the lease was forfeited, was $q$ dollars.\(^6\) The lessor contended that the added value due to the improvements could not be treated as a gain derived from capital or realized within the 16th Amendment meaning of income. His argument was, in substance, that it amounted at most to an unrealized capital gain which remained inextricably blended with the original realty to which it had been attached. This was merely a new form of the argument that realization required some type of severance of assets from the capital alleged to be the source of the gain, and was predicated on the reasoning of \textit{Eisner v. Macomber}. The Court answered this contention with the following language: "It is not necessary to the recognition of taxable gain that he (the lessor-taxpayer in the case before it) should be able to sever the improvement begetting the gain from his original capital. If that were necessary, no income could arise from the exchange of property; whereas such gain has always been recognized as realized taxable gain." It is clear that this was not intended by the Court to express a general proposition that "severance of assets" is never essential to that type of realization which the Court had held necessary to the existence of income within the 16th Amendment. Furthermore, the concept of "severance" at which the Court's answer was directed was the rather crude one illustrated by a cash dividend in which corporate assets are actually transferred to the shareholders. But long before \textit{Helvering v. Bruun} was decided, the Court had already substituted therefor the concept of the acquisition of an interest in an asset differing essentially from the recipient's interest therein before the occurrence of the income-producing transaction, or the acquisition of an interest in a new asset as a result of such a transaction. The latter is present in every exchange or sale of property. It is fairly arguable that realization of the former kind was present in \textit{Helvering v. Bruun}. Prior to the forfeiture of the lease the lessor had a bare legal interest that did not carry with it the right to the use or income from the improvements. Immediately thereafter he had the right to use it and to the income therefrom. The differences in his relations to the improvements that resulted from the forfeiture of the lease are as obvious as they are legally and economically significant.\(^6\) In fact, \(^6\) This had been arrived at by deducting from the fair market value of said building as of that time the unamortized cost of the old building thereon which the lessee had demolished in order to construct the new building thereon. \(^6\) It is, of course, arguable that the lessor's acquisition of the right to the income from the improvement would reflect itself in his current income for sub-
Helvering v. Bruun applies the doctrine of "severance of assets" in the sense that the Court itself had already given it in the Reorganization and the Koshland Cases. The only thing that was added (and it was not really an addition, but merely making explicit what was already implicit in the Court's prior decisions) is found in the Court's statement that the fact that the gain is a portion of the value of property received by a taxpayer in a transaction does not negative the realization of that gain.

The Court, however, mentions several other examples of transactions involving the realization of income. The first of these is relief from a liability. This must mean relief therefrom by means involving a transfer to the creditor of an amount of the debtor's assets less than the amount of the liability discharged thereby. What happens in a case of that kind is that the debtor's interest in his assets after the partial cancellation of his indebtedness, or after his advantageous discharge of his liability, is different from what it was before those transactions occurred. They are relieved of an economic liability, even though in a particular case the debtor's sole assets may have been legally exempt from being applied to the payment of his debts. It is clear then that, so far as his net wealth has been increased by these transactions, he has realized income within the constitutional sense of that term.62 A similar course of reasoning would show the presence of realization of income by a debtor whose obligations are discharged by the act of another or by the application thereto of income from property. These are the usual examples given in this connection.63 It may, therefore, be said that nothing in the Court's decision or opinion in Helvering v. Bruun justifies the view of the minority in the Griffiths Case that "severance of assets," in the sense of that phrase developed in the Reorganization and the Koshland Cases, need never exist in order that a transaction involve realization of income within the meaning of the 16th Amendment. Its reliance upon Helvering v. Bruun is most uncritical. It may well be that it will ultimately be decided that "severance of assets" in the foregoing sense is not essential to the realiza-

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tion of income. But the Court has not yet adopted that view. In fact, it has even gone so far as to hold that there may be transactions involving "severance of assets" in that sense which, nevertheless, do not involve realization of income.\textsuperscript{64} And, in any event, nothing in this line of decisions even suggests that unrealized gain may constitute income within the 16th Amendment.

There is another line of cases in which the Supreme Court has developed a theory as to what constitutes realization of income. At least one of them\textsuperscript{65} was cited by the minority in the \textit{Griffiths} Case in support of its view that all stock dividends should be treated as income to the recipient. These cases concerned the taxable status of income that had been assigned either directly or through resort to the trust device. The legal issue therein, which is relevant to the present inquiry, was that of construing Section 22(a) of the Internal Revenue Code or the corresponding provisions of other Income Tax Acts. That section contains the general definition of the expression "gross income" as used in these several statutes. The Supreme Court has stated on more than one occasion that the provision evidenced an intention on the part of Congress to exercise the whole of its constitutional power to tax income. It may, therefore, be assumed that any pronouncements as to the meaning of the concept "realization of income" found in the Court's opinions in this line of cases may be employed in attempts to determine the meaning of the term "income" in the 16th Amendment. The subsequent discussion proceeds on that basis.

The most significant of such pronouncements is found in the opinion in \textit{Helvering v. Horst}.\textsuperscript{66} The facts of this case were very simple.\(A\), who owned certain negotiable bonds, during 1934 detached the coupons therefrom shortly before their due dates, and gave them to his son, \(B\). The coupons were payable during 1934. The Commissioner charged \(A\) with income for 1934 in the amount of the face of said coupons, relying upon Section 22(a) of the Revenue Act of 1934. His action was sustained by the Supreme Court. It will promote an understanding of the significance of this case if the Court's reasoning is set forth somewhat at length. The issue was formulated as being whether the transaction described above involved the realization of income to the donor. It was stated that not all of a taxpayer's economic gain is income to him, but that all the revenue acts have been construed as making the realization of income the taxable event rather than the mere acquisition of the right to receive it.\textsuperscript{67} The question

\textsuperscript{65}Douglas v. Willcuts, 296 U. S. 1, 56 Sup. Ct. 59, 80 L. ed. 3 (1935).
\textsuperscript{66}311 U. S. 112, 61 Sup. Ct. 144, 85 L. ed. 75 (1940).
\textsuperscript{67}It should be here noted that the acquisition of the right to receive income
thus arose of what constitutes realization of income. No exhaustive answer was sought to be given, but the Court was satisfied at this point to affirm that "Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him." The general rule that a taxpayer who acquires a right to receive income is taxed when he actually receives the income is asserted to be a mere rule of administrative convenience, not "one of exemption from taxation where the enjoyment was consummated by some event other than the taxpayer's personal receipt of money or property." What, then, may be validly treated as the "last step" of a process by which a taxpayer "obtains the fruition of the economic gain which has already accrued to him," or as the consummation of his enjoyment of his right to receive income? The answer, stated in its most generalized form, is that these decisive events occur when the taxpayer "has made such use or disposition of his power to receive or control the income as to procure in its place other satisfactions which are of economic worth." That is, the exercise of one's power to dispose of one's right to income in order to satisfy one's wants or to procure a satisfaction obtainable only by an expenditure of money or property constitutes the realization of income. How extensive is the class of wants whose satisfaction by this device involves that enjoyment of the assigned income which constitutes its realization? It would seem to include all wants whose satisfaction "can be obtained only by the expenditure of money or property." The examples listed include the purchase of goods, the payment of the taxpayer's debts, the payment of a campaign or community chest contribution, and the payment of a gift to a favorite son.

The theory of realization developed in *Helvering v. Horst* has been applied in numerous other cases. The special field in which it has had its most extensive influence is that in which the question is whether given income shall be taxed to the assignor of the right to receive it or to the assignee who in fact receives it. The subsequent decisions in which *Helvering v. Horst* has been invoked have added nothing of importance to its theory of realization. They have, generally, merely reiterated its view that the power to dispose of income is equivalent to the ownership of that income, and that the exercise of that power to procure its payment to another for the purpose of procuring a satisfaction obtainable only by an expenditure of money or property involves

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is sufficient where the taxpayer reports on the accruals basis. The taxpayer in *Helvering v. Horst* reported on the cash basis.

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realization of that income by the person having the power to dispose thereof. The question is whether this theory of realization of income has any significance for the problem of the constitutional status of stock dividends of the *Eisner v. Macomber* type.\(^6^9\) It is apparent at once that the question whether income shall be taxed to \(A\) or \(B\) is at least sufficiently different from that of whether there is any income to be charged to either to warrant one in raising the question. It is true that the requirement that income must be realized to be taxable means it must be realized by some one whom the law recognizes as a person. But that seems to be the only point of similarity between the concept of realization developed in the cases in which the issue was whether a given receipt was income or capital and those cases in which the issue was whether something, that all the parties seem to have recognized as income to some one, should be treated as income of \(A\) or \(B\). In fact, the approaches to the definition of realization that these two lines of decisions reveal are wholly different. The former defines the concept by reference to the character of the transaction by which the taxpayer acquires that which is asserted to be income. The latter defines it by reference to what he does with it after he has acquired that which is alleged to be his income. It is in effect a theory that income is realized when the right to it is so used as to satisfy the taxpayer's wants. It would furnish an excellent constitutional support (were such a one needed) for the theory that a tax on expenditures for consumer's goods, services, and satisfactions, would be valid as a tax on income within the meaning of the 16th Amendment.\(^7^0\) That does not mean that it fits a case in which the transaction alleged to involve the realization of income contains no element of an exercise by the taxpayer of his control over a right to receive income. A shareholder who receives a stock dividend, whatever its character, is not exercising a power to control or dispose of a right to income which right he already possesses. If one wishes to invent a fiction and describe a shareholder's receipt of a stock dividend in that manner, well and good. But let it be plainly labelled as a fiction. So far as the decision in *Helvering v. Horst* is concerned, it merely enunciates a theory of what constitutes realization in a particular class of transactions. It is irrelevant for other types that do not possess the factor that makes it a reasonable theory for the transactions in connection with which it was developed and to which it has been applied. Its decision leaves intact the theories of realization devel-

\(^6^9\) This is on the assumption, made in the text, that the Court's theory is one that it would apply in an appropriate case involving the constitutional issue.

\(^7^0\) See in this connection the statement in *Helvering v. Independent Life Insurance Co.*, 292 U. S. 371, 375, 54 Sup. Ct. 758, 759, 78 L. ed. 1311, 1314 (1934), that "the rental value of the building used by the owner does not constitute income within the meaning of the Sixteenth Amendment."
oped in the various Stock Dividend and Reorganization Cases. No logical contradiction is involved in this dualism, nor will their co-existence involve any practical contradictions unless fictions are invented to produce them.\textsuperscript{71}

The discussion up to this point has been directed against the view that the decisions of the Supreme Court in cases not involving corporate distributions have so modified the meaning of "realization of income" as to render no longer applicable its theory thereof in \textit{Eisner v. Macomber}. It has also been directed against the position that its decision in cases involving corporate distributions, other than \textit{Eisner v. Macomber}, require its theory of realization expressed therein to be treated as obsolete. It amounts to no more than a denial of the validity of one line of reasoning urged in support of the plea to over-rule \textit{Eisner v. Macomber}. It does not follow that the Court will not rely upon the theories herein held inadequate should it over-rule that decision. The very fact that a decision is over-ruled involves a rejection of at least the basic premises upon which it was formerly supported. It, therefore, becomes necessary to inquire whether the course of decisions involving questions of what constitutes income, rendered since \textit{Eisner v. Macomber}, express or imply any principles, or reflect any judicial attitudes, relevant to our present problem. Does it reveal instances in which the concepts in which the Court has stated its definition of income have been given a content reflecting the influence of such factors as fairness in distributing the tax burden or the practical necessities of securing a workable income tax system? Does it reveal any tendency to uphold the Congressional interpretation of the 16th Amendment unless that is shown to be wholly arbitrary and unreasonable? It may well be that an inquiry along these lines will afford a safer basis for predicting the future fate of \textit{Eisner v. Macomber} than a more technical analysis of the meaning of decisions directly bearing on that issue.

The judicial definition of income within the 16th Amendment which has been quoted most frequently by the courts is that found in the prevailing opinion in \textit{Eisner v. Macomber}. Its substance is that income is the gain derived from capital, from labor, or from both combined, including the profit gained through a sale or conversion of capital assets. It is a definition in terms of the source of the right to receive something of value. The whole doctrine of realization as an essential element in the definition is based on the words "derived from," which the Court has frequently contrasted with the characteristic denoted by the language "accruing to" where the gain was from property sources.

\textsuperscript{71} The discussion of \textit{Helvering v. Horst} renders unnecessary the consideration of cases that deal with the treatment of income from revocable trusts, funded insurance trusts, maintenance trusts, alimony trusts, term trusts, etc. They add nothing to the contribution of \textit{Helvering v. Horst}.
The presupposition to the existence of income is the existence of gain. Despite this, it has been held that the event on whose occurrence taxable income arises need not itself involve any increase in the taxpayer's wealth. Thus a cash dividend is income although its distribution involves an equivalent diminution of the book value of the shareholder's capital interest in the corporation.\(^7\) It would constitute income even to a shareholder the value of whose capital interest in the corporation had not increased at all during his ownership of the stock.\(^7\) That is, the absence of any gain accruing to a shareholder in the transaction that began with his acquisition of the stock and terminated with the receipt of a cash dividend thereon does not prevent the cash dividend from being income within the 16th Amendment. The reasons given to support these results include (1) that such dividends are the appropriate fruit of stock ownership and are commonly reckoned as income, and (2) in the case in which the dividend exceeds the accretion to surplus during the shareholder's ownership of the stock, that he has stepped into the shoes of the person from whom he acquired the stock. The latter of these arguments also played a prominent part in \textit{Taft v. Bowers}\(^7\) and in \textit{Newman, Saunders & Co. v. United States}.\(^7\) The former of these held not violative of the 16th Amendment the statutory provision requiring a donee to take the gain basis of the last preceding owner who did not acquire the property by gift; the latter sustained against an objection based on that Amendment the provision requiring those who acquired property in a tax-free transfer to take the gain basis of the transferor. The taxpayer in each of them had contended that these provisions resulted in the taxation of capital as income. The ultimate basis of the argument that the 16th Amendment permits Congress to treat a taxpayer as though he stood in the shoes of a prior owner of the property whose ownership entitles him to its economic gains is found not in economic analysis but in what the Court considers the reasonable requirements of a fair and adequate income tax system. This is made so explicit as to leave it in no doubt by the following language in the opinion in \textit{Taft v. Bowers}: "The provision of the statute under consideration seems entirely appropriate for enforcing a general scheme of lawful taxation. To accept the view urged in behalf of petitioner (taxpayer) undoubtedly would defeat, to some extent, the purpose of Congress to take part of all gain derived from capital investments. To prevent that result and insure enforcement of its proper policy, Congress had power to require that for purposes of

\(^7\) 278 U. S. 470, 49 Sup. Ct. 199, 73 L. ed. 460 (1929).
\(^7\) 36 F. (2d) 1009 (Ct. Cl. 1929).
taxation the donee should accept the position of the donor in respect of the thing received. And in so doing, it acted neither unreasonably nor arbitrarily."

Reliance upon other than economic factors also explains the reasoning in *Burnet v. Sandford & Brooks Co.* The facts of the case must be stated in order to appreciate the full significance of the Court's statements. The taxpayer had incurred an operating loss in the performance of a dredging contract extending over a period including four taxable years. In one only of those years did it return net income. Its tax returns for the other three years showed net losses. In a subsequent year it recovered the amount of its total loss on the contract from the United States. The issue in the case was the taxable status of that recovery. It was admitted that it had made no gain on the contract even after including the recovery in its gross receipts therefrom. The amount recovered was held to be income for the year of recovery despite the taxpayer's contention that this violated the 16th Amendment. Here again the absence of economic gain from a transaction (or, if one prefers, from the series of transactions comprising the performance of the contract) was held not to prevent the receipt of something of value from being income although it merely recouped a prior operating loss. In reply to the constitutional objection the Court stated that the 16th Amendment "was adopted to enable the government to raise revenue by taxation"; that the "essence of any system of taxation" consists in the production of revenue "ascertainable, and payable" at regular intervals; and that "Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation." Starting from the undeniable premise that income is a function of time, the Court in effect asserts that it is for Congress to decide whether that period shall be defined in terms of each separate income producing transaction or some definite period, and that its choice of the latter is not invalid though it may involve treating income as derived from transactions which, separately considered, involve no economic gain for the taxpayer. The point of present interest is that this method and its results are justified by what Congress deemed reasonably necessary for devising an income tax system that would be administratively desirable and promote desirable fiscal policies.

The case just considered should be contrasted with the *German...*

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77 Interest on the amount of the recovery was admitted to be income and was not in dispute.
78 It does not appear whether the losses on the contract in question had resulted in any tax benefits to the taxpayer.
The taxpayer had borrowed money repayable in German marks. The proceeds of the loan had been used to finance the performance of construction contracts by its subsidiary, and were lost. In a subsequent year it repaid its loan in depreciated marks. The question was whether the difference between the dollar value of the proceeds of the loan and the number of dollars paid to acquire the marks that paid off the loan constituted income. The difference was less than the losses incurred by it in financing its subsidiary's construction contracts. It was this latter factor that led the Court to decide that the taxpayer had received no income through the advantageous discharge of its liability. On its face the decision seems inconsistent with the theory of *Burnet v. Sandford & Brooks Co.* The Court, in its opinion in that case, distinguished it on the score that the taxpayer in the *German Mark Case* "had neither made a profit on the transaction, nor received any money or property which could have been made subject to the tax." Since the former of these factors was equally present in *Burnet v. Sandford & Brooks Co.*, the sole basis for the distinction must be found in the latter factor. But that statement is true only of the final transaction, i.e., the repayment of the loan in depreciated German marks. But this can have no significance in view of the later decision that the repurchase by a taxpayer of its bonds for less than the consideration received on their issue involves gain and taxable income for the year of the repurchase. Hence, the *German Mark Case* can no longer be treated as requiring generally a correlation between the existence of gain and the existence of income in the constitutional sense. The theory of *Burnet v. Sandford & Brooks Co.* must be accepted as entitled to greater weight than that of the *German Mark Case*.

The discussion of the two cases last referred to furnishes a natural basis for considering the decisions involving the treatment of recoveries and surplus adjustments. It has always been the practice of the Treasury to treat as income for the year of recovery amounts recovered with respect to bad debts deducted during a prior year which is no longer open due to the running of the statute of limitations. The same statement applies to recoveries for expenses, taxes, and losses previously deducted. The real basis for such a procedure is that a taxpayer should not be permitted to gain an advantage to which the ultimate facts show him not to be entitled. In some of these cases he actually receives something of value with respect to the transaction in the year for which he is charged with income. But this is not essential to the application of the principle. In some instances he will have

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received the money or property in a prior year. Thus in one case the owner of gas lands received a bonus on the execution of a gas lease thereon. He deducted depletion on the percentage of gross method in computing his taxable income for the year of the receipt of the bonus. The lease was surrendered before there had been any production under the lease. It was held that he could be required to treat as income for the year of the surrender of the lease an amount equal to the depletion previously deducted.\(^8\) It was held that to require this adjustment did not violate the 16th Amendment, and stated that the only question involved was the year in which income shall be reported. In the situation involved in this case the taxpayer had in fact received something of value at the beginning of the series of transactions comprised of the making of the lease, the receipt of the bonus, taking a depletion deduction, and the surrender of the lease. But that this is not essential can be illustrated by the following example. Assume that a taxpayer on the accruals basis deducts a tax accrued but not paid during a given taxable year, and that said tax is never paid because the statute imposing it is held unconstitutional. There is no doubt but that he may be charged with income in the amount of said deduction for the year in which it is finally determined that the tax was invalid, at least if the year in which the deduction was taken is no longer open. Yet, in such case nothing occurs but a surplus adjustment; nothing is received by the taxpayer at any stage of this series of transactions. Does the taxpayer charged with income in connection with transactions of the character considered in this paragraph secure an economic gain therefrom? An affirmative answer alone is possible. This is so regardless of whether he has retained or lost the money or property received in connection with such a series of transactions if he received any at all. It is equally so in the last example, for in that case his net wealth is actually greater by the amount of the tax which was never paid than the figure at which he stated it. It is immaterial that the effect of other transactions occurring during the same period may have reduced his net wealth at the end of that period below what it was at the beginning thereof. The 16th Amendment permits Congress to require the adjustment to be made in the manner indicated because subsequent events have negativied the factual basis on which alone the prior deduction of the item was permitted. The question whether the 16th Amendment demands that the amount includible in income as a result of transactions of this character shall be limited by the tax-benefit rule has never been definitively settled by the Supreme Court.\(^8\) It is practically cer-

\(^8\) Sneed v. Com'r of Int. Rev., 119 F. (2d) 767 (C. C. A. 5th, 1941). See also Lamont v. Com'r of Int. Rev., 120 F. (2d) 996 (C. C. A. 8th, 1941).

\(^8\) See the discussion of this matter in Dobson v. Com'r of Int. Rev., U. S. ——, 64 Sup. Ct. 239, 88 L. ed. —— (1943).
tain that that Amendment will never be held to impose that limit where the recoveries or surplus adjustments are connected with the prior deduction of operating expenses or losses. It is doubtful that it will be construed to impose that limit even where the recovery is of a part of the cost of a capital asset which had been sold during a prior taxable year at a loss. It should be construed to impose such limit if the principle that the cost of capital investments must be recovered before there can be a capital gain taxable as income still prevails.\(^3\)

It has already been stated that the Supreme Court's classical definition of the term "income" as used in the 16th Amendment presupposed the existence of gain in order that there be income. It has been shown (1) that, despite this implication of that definition, income may be treated as arising on the occurrence of an event though the taxpayer's wealth is not increased as a result thereof; (2) that a person may be charged with having received income from his ownership of property though no gain has accrued to him with respect thereto during the period of his ownership up to the occurrence of the event on which income is charged to him; (3) that one person may be charged with gain accruing during a predecessor's ownership of the property; and (4) that he may be charged with income on the occurrence of a given event solely because it is a proper moment for adjusting understatements of his net wealth resulting from deductions made in connection with prior income tax computations. It must be admitted that the course of the decisions summarized in those propositions reveals a tendency to interpret the term "gain" rather liberally in favor of the government, and thus a like tendency in defining income within the meaning of the 16th Amendment. But even more important are the factors that induced the courts, particularly the Supreme Court, to reach the decisions that lie back of those propositions. These were pointed out in connection with the discussion of the cases themselves, and need not again be stated. It suffices to say that the Court has recognized that the 16th Amendment may be, and must be, interpreted in the light of ideas of income prevailing in the community at the time of the adoption thereof; that it permits Congress to define income in such manner as to produce an income tax system that will be capable of practical administration; that it permits Congress to so define it as to insure a tax contribution from all increases in wealth accruing since the adoption of the Amendment; and that its concept of income permits a transaction to be treated as one involving the realization of income when this is a just and reasonable method for preventing a taxpayer from obtaining an unfair advantage merely because subse-

quent events have negativsed the factual basis on which the right to a
deduction was conditioned. It is, furthermore, implicit in the proposi-
tions set forth above that the element of "realization of income" must
have been deemed present in all the transactions, or series of trans-
actions, summarized by them. For example, the accruals basis tax-
payer who accrued a deduction for a tax, from whose payment he was
relieved by subsequent events, must be deemed to have realized income
in the year when it was finally determined that he would never be called
upon to pay that tax, despite the fact that he received no money or
property either then or when he took the deduction. It is not at all
improbable that the Court may adopt the same liberal attitude in con-
struing the expression "derived from," found in its definition of income,
that it has adopted in construing the meaning of the term "gain" as
used in that definition. It is not at all unlikely that it could thus revise
its concept of "realization" by invoking considerations of policy or by
accepting Congressional decisions thereon as beyond review unless
clearly unreasonable and arbitrary. Resort to considerations of tax
policy has become an accepted procedure when the Supreme Court has
had to define the jurisdictional limits imposed on states by the due
process clause of the 14th Amendment. The 16th Amendment does
not give as sweeping opportunity for the employment of that technique
as does the 14th Amendment, but it does afford some opportunity for
it. Since it has already been used by the Court in developing the scope
of one of the essential elements in its definition of income within the
meaning of the 16th Amendment, there is every likelihood that it will
use it in developing the meaning of the expression "derived from"
found in that same definition. And that would mean that considerations
of tax policy may become the dominant factors in redefining "realization
of income." And that, in turn, would mean that they may become the
decisive factors in determining the extent to which the 16th Amend-
ment permits the taxation of stock dividends as income.

The conscious resort to considerations of policy in defining "in-
come" as used in the 16th Amendment will be greatly facilitated in
connection with the question of the constitutional character of stock
dividends if the issue is stated in the manner in which the minority
formulated it in the Griffiths Case. It was framed as being whether
the 16th Amendment permitted Congress to "make the receipt of a
stock dividend based on earnings an occasion for recognizing that
accrual of wealth for income tax purposes." The question, as con-
ceived by the minority, is not whether the receipt of such a stock

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84 See, for example, State Tax Commission of Utah v. Aldrich, 316 U. S. 174,
62 Sup. Ct. 1008, 86 L. ed. 1358 (1942); Curry v. McCanless, 307 U. S. 357, 59
Sup. Ct. 900, 83 L. ed. 1339 (1939); New York ex rel. Cohn v. Graves, 300 U. S.
308, 57 Sup. Ct. 466, 81 L. ed. 668 (1937).
dividend constitutes income, but whether that event furnishes an occasion for subjecting an accrual of wealth to an income tax. The prior method for stating the issue focused attention on the meaning of the term “income,” a term about which economists and financial experts had been battling for an indefinitely long time. It was quite natural that the courts should find themselves enmeshed in the same disputes when they were forced to define it. It was to be expected that their reasoning would recognize technical considerations developed by the experts. The minority’s form of stating the question has no tendency to stress such theorizing about income as the decisive factor in determining whether Congress may treat a particular event as the occasion for taxing the owner of corporate shares with respect to an increase in their value due to the accumulation of corporate net earnings. It is a practical certainty that the minority is willing to decide the issue on the general reasonableness of making the receipt of a stock dividend paid from earnings the occasion for imposing an income tax on the recipient. It has already indicated what its answer will be if the Court should ever have the issue before it for decision. The question then is whether a sufficient number of the majority in the Griffiths Case are likely to approach the issue from the same general point of view. The very fact that the majority avoided the constitutional issue may well signify its dissatisfaction with Eisner v. Macomber, but an unwillingness to give a change in law on that matter an unjust retroactivity. If that be the correct interpretation of the majority’s decision, it implies its rejection of the kind of reasoning on which the majority in Eisner v. Macomber based its decision. This does not necessarily mean its willingness to adopt in its entirety the approach and reasoning of the minority in the Griffiths Case, but it is a highly probable inference that it means just that. If so, Eisner v. Macomber is doomed.

There is always the possibility that the present Court may follow the line of reasoning employed by Mr. Justice Brandeis in his dissenting opinion in Eisner v. Macomber. The likelihood of this can best be appraised if the reasoning of that opinion is first stated and analyzed. It consists of a series of separate arguments that vary markedly in the degrees of their plausibility and cogency. The basic premise of the most important of them is that a stock dividend (i.e., one charged against earned surplus) is a device by which a corporation “can, without increasing its indebtedness, keep for corporate purposes accumulated profits, and yet, in effect, distribute those profits among its stockholders.” It is stated that this method, and that in which the corporation issues rights and concurrently declares and pays a cash dividend which can be applied on the purchase price of the share to which the right entitles the shareholder, are in substance equivalent and had al-
ways been recognized as equivalent by financiers before and at the
time of the adoption of the 16th Amendment. It is quite true, as Mr.
Justice Brandeis states, that "the financial results to the corporation and
to the stockholders of the two methods are substantially the same" if
the results are measured by their effect upon the net wealth of the
stockholder. But it is undeniable that resort to the second method gives
the stockholder a choice that he is denied under the first of them, and
that may not be an unimportant consideration for at least some of the
stockholders. The second premise of this argument is that the 16th
Amendment should be liberally construed in favor of the taxing power
unless there is something in its language or in the nature of corporate
dividends requiring a different approach. There follows a long argu-
ment that there is nothing in the nature of corporate distributions de-
manding a strict construction of the Amendment. A considerable part
of this part of the reasoning stresses the fact that the form in which
corporate earnings shall be distributed is a matter of financial policy
having no bearing on the character of the distribution as income or
capital. Another part follows the pattern of stating a case involving
a corporate dividend paid in its own stock, asserting that such a divi-
dend would be recognized as income, and then drawing the inference
that such a case is indistinguishable from the dividend involved in
Eisner v. Macomber. It is unfortunate for this particular approach that
some of the distributions which Mr. Justice Brandeis categorically
affirms would be admittedly income within the 16th Amendment have
since been held not to be such. In any event the general effect of this
first major argument is far from convincing. The argument in effect
asserts that the capitalization of an earned surplus by the payment of a
stock dividend is a distribution of the earnings thus capitalized. Its
force is not greatly enhanced by the argument that no prior decision
of the Court requires it to adopt what is described as the narrow in-
terpretation of the 16th Amendment on which the decision of the
majority of the Court was based. However, it contains many elements
that the Court of today will deem valid.

The line of reasoning just analyzed relied in some measure upon
the common understanding of the character of stock dividends prevail-
ing in the financial community when the 16th Amendment was adopted.
In line with this appeal is the reference to the treatment of stock divi-
dends under the Massachusetts income tax law, and in the life tenant-
remainderman cases. The argument is within the limits of permissible
legal reasoning. The appeal to the common or general meaning of the
word "income" has been often used in income tax cases. However, it
is at least questionable whether there ever existed that general under-

standing of what constitutes income, and of the character of stock dividends as income or capital, to rate this line of reasoning as anything but a general invitation to the courts to engage in imaginative exploits. However, it is likely to play a considerable part in the ultimate decision of the constitutional status of stock dividends under the 16th Amendment.

This view that the meaning of the term "income" in the 16th Amendment is to be found in the intention of the people when adopting it is one element in the last of Mr. Justice Brandeis' argument. It is asserted that the exclusion of stock dividends representing profits from what can be constitutionally taxed as income affords the opportunity to "the owners of the most successful businesses in America ... to escape taxation on a large part of what is actually their income," since, "So far as their profits are represented by stock received as dividends, they will pay these taxes not upon their income, but only upon the income of their income." It is concluded that it is inconceivable that the people intended such a result when the Amendment was adopted, especially since stock dividends representing profits were regarded as income "not only by the plain people, but by investors and financiers, and by most of the courts of the country." This method of defining "income" within the 16th Amendment is likely to be favorably received today not only by the lower courts but also by the Supreme Court. They are very likely to accept not only this general approach but also the particular employment thereof found in this one of Mr. Justice Brandeis' arguments.

What is the likelihood that the present Supreme Court will adopt, or at least follow, the line of reasoning of Mr. Justice Brandeis? Its probable response to his particular arguments have already been indicated. It is also likely to accept his position that the 16th Amendment might well permit Congress to treat corporate shareholders in the same way in which partners are treated with respect to partnership income. In any event, the Supreme Court of today is much more likely to adopt the reasoning of Mr. Justice Brandeis in his dissent in *Eisner v. Macomber* than it is to follow that of Mr. Justice Pitney in the majority opinion of that case.

It is difficult, if not impossible, to escape the conclusion that *Eisner v. Macomber* will be over-ruled as soon as the issue of its status comes up for decision before the Supreme Court. This will happen not because anything in its decisions since the case was decided require that result, but because of a changed attitude on its part with respect to those constitutional limitations concerned with the protection of individual property rights, whether those are based on express limitations or are implicit in the language in which a grant of power is made. It
was the aim of the discussion up to this point to present the reasons that lend support to that point of view. The implications of this change in the judicial construction of the 16th Amendment deserve at least a brief treatment. These will depend upon the reasons which the Court will urge in support of its over-ruling of *Eisner v. Macomber*. The minority opinion in the *Griffiths* Case never once employed the expression “realization of income,” nor is the concept denoted thereby any necessary element in its argument. The opinion does, however, aim to show that the decisions subsequent to *Eisner v. Macomber* have eliminated the necessity for the existence of that type of realization denoted by the expression “severance of corporate assets for the separate use of the shareholder.” Its position in that respect is correct. It is silent as to the other denotations of the “realization” concept. The question arises whether this treatment of the former requirement for the existence of income within the 16th Amendment may be taken as intended to eliminate the requirement of realization. The only alternative is to interpret its opinion as evidence that it believes realization to be present in the receipt of a stock dividend of the *Eisner v. Macomber* type, that is, that it is revising the concept without intending to eliminate it. There is nothing in the opinion itself that conclusively establishes which of these two possible positions represents its real view. It is, of course, true that the shareholder did receive a stock dividend, and that the minority would still require some similar event before it would hold that an “accrual of wealth” could be subjected to an income tax. If that be its theory, then the theory of realization has been merely expanded to include situations formerly held not to involve its presence. This would still leave much of the former concept unimpaired. However, if the minority’s opinion be construed to eliminate the requirement, then there would be no reason why unrealized capital gains could not be treated as income within the 16th Amendment. The direct taxation to the shareholders of the corporate annual net income would then also be possible under the 16th Amendment. It is to be hoped that, if and when the Supreme Court does overrule *Eisner v. Macomber*, it will make its position on this point clearer than has the minority in the *Griffiths* Case.

It has been hereinbefore suggested that the Court might overrule *Eisner v. Macomber* on the basis of the reasoning in Mr. Justice Brandeis’ dissent therein. That opinion, as does the dissent in the *Griffiths* Case, supports the taxability of stock dividends with an argument ultimately based on the theory that the 16th Amendment permits Congress to ignore the corporate entity in taxing the shareholders. The analogy of the partnership is invoked in support of that position. The net result is that Mr. Justice Brandeis would permit Congress to tax the
corporate net income directly to the shareholders. And it is fairly arguable that the minority in the Griffiths Case supports that position. If this argument is accepted by the Court if and when it overrules Eisner v. Macomber, it will be an added reason for permitting what would also be permissible were the requirement of realization abolished. But this argument would furnish no basis for concluding that unrealized capital gains in general could be deemed income within the 16th Amendment. It may be stated here that the annual taxation of the corporation's annual net income directly to shareholders might well be used to eliminate some of the injustice to shareholders inherent in taxing both corporate net income and the dividends paid therefrom.

REDEFINITON OF "DIRECT TAX"

It was suggested in the first part of this article that a decision that stock dividends of the Eisner v. Macomber type did not constitute income within the 16th Amendment would not mean that they were not taxable unless it were also determined that a tax on their receipt would constitute a direct tax. Their receipt could be taxed even were such tax a direct tax, but in that case the tax would have to be apportioned among the states on the basis of their respective populations. This would interpose an insuperable practical difficulty to their taxation, and this type of tax will, therefore, be ignored in the subsequent discussion. In Eisner v. Macomber the Government had argued (as an alternative theory for sustaining the tax on stock dividends) that the taxing statute imposed the tax not upon the stock dividend but upon "the stockholder's share of the undivided profits previously accumulated by the corporation; the tax being levied as a matter of convenience at the time such profits became manifest through the stock dividend." The majority of the Court rejected this on the score that the stockholder's interest in the earned surplus is capital, that a tax thereon would be a tax on property because of its ownership and that such a tax would be a direct tax which could be imposed only subject to the apportionment requirement applicable to direct taxes. The question arises whether the judicial theory as to what constitutes a direct tax has so changed since Eisner v. Macomber as to justify the conclusion that the above theory is no longer valid. The decisions holding a tax on persons because of their general ownership of property to be a direct tax are still recognized as good law. But it is still equally good law that a tax upon a particular use of property, or upon the exercise of a "single power over property incidental to its ownership," is an indirect tax. Formally at least, a tax on the receipt of a stock dividend is not imposed because

PRESENT TAXABLE STATUS

of the recipient's general ownership of the shares on which the divi-
dend is paid. It may be conceived as a tax on the exercise of a single
right inhering in the ownership of the shares, namely, that of receiv-
ing the dividend shares. The tax might then be held to be an excise
subject only to the requirement of geographical uniformity. The fact
that Mr. Justice Brandeis in his dissenting opinion in *Eisner v. Macom-
ber* viewed the Government's argument (referred to above) favorably
increases the likelihood that it would secure the assent of the present
Court. It is true that he appears to have treated it as relevant to decid-
ing what Congress could do under the 16th Amendment, while in the
present discussion the issue is what Congress could do apart therefrom.
But this distinction can readily be ignored, particularly when it is re-
called that the basis of the Government's view was found in *Collector
v. Hubbard*, a case decided long before the 16th Amendment. It is
the writer's opinion that the device hereinbefore suggested as one for
converting the tax on the receipt of a stock dividend from a direct tax
into an excise would be an extremely specious evasion of the direct tax
provisions of the Constitution. It may be said in concluding the dis-
cussion of this approach to the treatment of stock dividends for tax
purposes that it is quite unlikely that it will ever be adopted by the
Court. The reason therefor is that it is likely to so interpret the 16th
Amendment as to permit subjecting stock dividends of every type to
income taxation. That will render the approach that has just been
considered unnecessary.

**CONCLUSION**

It is fairly obvious from the preceding discussion that the likelihood
is very great that *Eisner v. Macomber* will be overruled on the first
opportunity. The problems that will arise if and when that has been
done will concern the implications thereof. These will depend upon
the reasoning on which the overruling decision will be based. Some
of these have been indicated in the preceding discussion, but others
are likely to arise that are not now foreseeable. The old landmarks
of constitutional law have been gradually obliterated in other fields.
It is only a question of time before *Eisner v. Macomber* will have
joined other time-honored decisions.

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89 12 Wall. 1, 20 L. ed. 272 (1870).