No. 22-800

In the Supreme Court of the United States

CHARLES G. MOORE AND KATHLEEN F. MOORE,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF AMICUS CURIAE FREEDOMWORKS, INC. IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*[1]

FreedomWorks Inc. is a nonprofit, nonpartisan organization that advocates for economic and regulatory freedom by working toward a small government, low taxes, and personal liberty. FreedomWorks educates and advances policy at all levels of American government while building, educating, and mobilizing a network of activists around the country.

FreedomWorks has a long history of supporting, crafting, and advocating for financial and tax policies that are constitutionally sound and follow the letter of the law. Our belief is that the American taxpayer works hard and should have a say, and insight into, how their finances are taxed and spent.

Amicus has an interest in this case because FreedomWorks, along with its many supporters and activists around the country, are troubled by the lack of a clear definition of income, the threat of wealth taxation, the unwarranted expansion of the federal government's powers, and the effect of this case on families for years to come.

SUMMARY OF PROCEEDINGS BELOW

Congress included the MRT in the TCJA because it sought to tax historical deferred accumulated earnings as it transitioned the Code to a quasi-territorial tax regime going forward. The MRT

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[1] No counsel for a party authored the brief in whole or in part. No party, counsel for a party, or any person other than amicus and their counsel made a monetary contribution intended to fund the preparation or submission of the brief.

required U.S. shareholders who own at least 10 percent of a controlled foreign corporation to pay a one-time tax on their pro-rata share of income 1986 to 2017. Petitioners fell into this provision because they owned 11 percent of a controlled foreign corporation, Kisan-Kraft Machine Tools Private Limited in India. Petitioners never received any dividends from Kisan-Kraft, which chose to reinvest earnings into its business. Nevertheless, the MRT required petitioners to report $132,512 in income as their pro rata share of Kisan-Kraft's accumulated pre-TCJA profits, which produced an additional tax of $14,729.

The U.S. district court for the Western District of Washington upheld the constitutionality of the MRT and the U.S. Court of Appeals for the Ninth Circuit affirmed. The Ninth Circuit adopted without serious examination a broad reading of the Sixteenth Amendment that allowed Congress to tax the dividends even though petitioners had never realized the income. It also held that courts should defer broadly to Congress's definition of income and that it could routinely disregard the corporate form and tax shareholders directly.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Sixteenth Amendment states that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. Amend. XVI. In the 2017 Tax Cuts and Jobs Act (TCJA), Pub. L. No. 115-97, 131 Stat. 2054, Congress imposed a mandatory repatriation tax (MRT) on "accumulated post-1986 deferred foreign income" of a foreign corporation controlled by a United States taxpayer (CFC). This Court can find that the MRT falls outside the original understanding of the Sixteenth Amendment, preserve the basic structure of the current tax system, and avoid massive economic dislocation by accepting two core propositions.

First, the federal government cannot, with only narrow exceptions, tax unrealized income. It cannot rely on the definition of income proposed by the United States: the accession of wealth between any two points in time – known as the Haig test. Robert M. Haig, *The Federal Income Tax* 7 (1921). This formulation would allow the government to tax unrealized appreciation of all assets at any time. The government's test is utterly unworkable because it creates ruinous difficulties of valuation and liquidity for the holders of all productive assets. In practice it has never been used for productive assets.

Second, the history surrounding the adoption of the Sixteenth Amendment in March 1913 fortifies the first proposition. The Sixteenth Amendment overruled *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), which held that Congress had to apportion a tax of rental income derived from real estate according to the states by population. The Sixteenth Amendment followed *Pollock*'s dissenting opinions, which would have considered a tax on property and wealth as a direct tax under Article I, Section 9, but not a tax on the rental income derived from the assets. No significant supporter of the

Sixteenth Amendment ever suggested during the drafting and ratification process that the text allowed for the taxation of unrealized income from the appreciation of property. Its sole purpose was to overturn *Pollock*.

This Court should reject the government's expansive claims, which would work a revolutionary transformation of the basic constitutional limits on the federal government's taxing power since the introduction of the first income tax in 1913.

ARGUMENT

I. LEGAL DOCTRINE AND ECONOMIC THEORY SUPPORT A REALIZATION REQUIREMENT FOR INCOME

From its very beginning, practice has long recognized that a realization requirement forms as an essential part of the income tax system. *Eisner v. Macomber*, 252 U.S. 189 (1920). "'Long settled and established practice' may have 'great weight in a proper interpretation of constitutional provisions.'" *Chiafalo v. Washington*, 140 S. Ct. 2316, 2326 (2020). *See also NLRB v. Noel Canning*, 573 U.S. 513, 524 (2014) (quoting *The Pocket Veto Case*, 279 U.S. 655, 683 (1929)).

The Haig definition may make sense for cash received in wages, rents, interest, and dividends where a realization requirement is necessarily satisfied. But it results in massive over-taxation of other forms of productive assets when applied to unrealized appreciation of interests in property. It imposes intractable valuation problems for complex assets, and it can lead to a deadly cycle of forced liquidation that will upset the foundations of financial, real estate and business markets. Against this prospect, the Internal Revenue Code has always incorporated the realization requirement, which allows the taxation of a gain associated with a productive asset when it is transformed into another form. Where that gain is transformed into cash, the income tax works. But where the gain remains some alternative form of productive property, the income tax has carefully wrought a system of *nonrecognition* provisions that postpone taxation of these assets until, by some other transaction, they are reduced to cash or marketable securities (which must be taxed in order to avoid circumvention of the system). In rare situations, the Internal Revenue Code does allow for the taxation of unrealized gains or losses, but only in those cases where liquidity and valuation problems do not exist. By dismissing these concerns and the historic structure of the law, the government would erect a revolutionary system that would not only be administratively ponderous and ruinous to the economy but would also invite an unconstitutional wealth tax.

In this case, the Court could uphold the TCJA's grand repatriation scheme, which transforms the corporate tax to a territorial basis, but still allow those caught in petitioners' situation to be taxed at the time of the receipt of a cash distribution. But in its effort to justify the MRT's taxation of petitioner's unrealized gain, the United States makes an overbroad claim that the Constitution contains no "realization" requirement. The government claims the power to impose ordinary income or capital gains tax on unrealized income, presumably at any time.

The United States seeks support in economic theories of income, such as the Haig definition. Haig criticized *Macomber* for "leading toward a definition of income so narrow and artificial as to bring about results which from the economic point of view are certain eccentric and in certain cases little less than absurd." Haig, *supra,* at 1. The Haig definition does not require any change in the form in which wealth was held and appears to allow for the taxation of simple appreciation on every variety of capital asset.

The government also relies upon cases after *Macomber* for the proposition that realization is not a constitutional requirement, just a rule of statutory interpretation. The one later case that qualifies *Macomber* is *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955), which asked whether income included punitive damages in an antitrust case settlement. Punitive damages that did not obviously derive as gains from either capital or labor were a kind of "windfall." The Court held that it was necessary to give a "liberal" reading statute to reach its full constitutional extent. "It is conceded by the respondents that there is no constitutional barrier to the imposition of a tax on punitive damages," the Court observed. "Our question is one of statutory construction: are these payments comprehended by" the Internal Revenue Code. *Id.* at 429. This Court held that the income tax, as a matter of statutory interpretation, extended to punitive damages. "Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Id.* at 431.

Contrary to the government's claims, these cases do not undermine a realization requirement. Instead, they concern only the *timing* of realization. *Macomber* involved a stock dividend of 50 percent on shares of Standard Oil, so that taxpayers received new shares of stock, but, simultaneously and necessarily, the value of the original shares was cut to two-thirds of their original value. There was no change in the total value of the company, only in the number of shares. *Macomber* was a timing decision, which postponed the tax until some ready cash or other marketable securities (not shares in the original company) were received that reflected a transformation in the form of assets held. As the Court stated in *Peabody v. Eisner*, 247 U.S. 347, 249 (1918), a "stock dividend . . . in fact took nothing from the property of the corporation and added nothing to the interest of the shareholder, but merely changed the evidence which represented that interest." The Haig-Simons definition of income is not only over-inclusive but yields the same result in *Macomber* because it did not result in any change in asset values. *See also Macomber*, 252 U.S. at 211.

Macomber's realization rule is not even necessarily inconsistent with the Haig definition of income. First, the recapitalization in *Macomber* was instantaneous, so that it did not have any explicit time period as required under Haig. Second, even if two distinct points in time were fictionalized, defining income as increases in economic power "between two points in time" results in zero taxation in *Macomber* because the re-capitalization did not generate any accession to wealth. The Haig definition includes not just the fair market value of the shares received, but also the necessary decline in value of the shares retained (a "de-accession" of wealth, as it were). Those two figures exactly cancel out so that the net gain is zero, which reflects the accurate economic position. It is also important to note that in the conventional capital gains case, under Section 1001 of the Code, the tax is on the amount-received less the adjusted basis, *all* prior accessions to wealth are taxed wholly at time of sale without regard to Haig's qualifier of "between two points in time," no matter when they accrued. In contrast to this sensible position, the correct application of Haig requires the taxation of the unrealized appreciation between March 15, 1913 (typically on an annual basis), when the tax went into effect, and January 1, 1916 (when the stock dividend took place). No one has argued for that position.

Contrary to the government's arguments, *Glenshaw Glass* follows – rather than limits – this understanding of *Macomber*. Punitive damages represented a new infusion of cash and a clear accession to wealth. The Court read income to include not just funds "derived from" capital or labor, but also windfall profits. "Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature." *Glenshaw Glass*, 348 U.S. at 429-430. This Court has given a liberal construction to this language in recognition of the intention of Congress to tax all income except for specific exemptions. But in *Glenshaw Glass*, there was no parallel offset for any loss that paired with the gains from punitive damages, such as the decline in value from other retained shares that characterized the transaction in *Macomber*. The gain or loss was taxed solely at the time of receipt, even though it had accrued earlier. *Glenshaw Glass*'s cash receipt necessarily presents no problem of converting a noncash asset into cash, i.e. to avoid the twin problems of valuation and liquidity that frequently arise when noncash assets are received.

Indeed, *Glenshaw Glass* does not use the Haig definition of income. Haig renders the timing issue far more prominent, especially where, as there, the value of the antitrust claim was constantly in flux until its ultimate resolution. Haig would require any changes in the fair market value (if it could be determined at all) of the punitive damages claim to be reported as income for each of the taxable years from the onset of the litigation to its final payment. Thus, in the 1947 taxable year, Haig's definition would call for the annual taxation of the increment in wealth between 1946 and the settlement of the case. But *Glenshaw Glass* did not apply Haig's accession test at all, which is unworkable due to the unknown fluctuations over time in the value of the punitive damages claim. Instead, it based income upon realization, which occurred only upon the payment of money to satisfy the claim. The government's reliance upon the Haig theory of income is flatly inconsistent with *Macomber* and *Glenshaw Glass*.

It is not the case, however, that the Internal Revenue Clause requires the taxation of income on any realization event, especially when productive assets are received in an exchange. The receipt of an asset can come in a form that is both illiquid and difficult to value. The government wholly ignores the severe economic distortions caused by taxation at that time. From the earliest days of the Internal Revenue Code, provisions that allow for the *nonrecognition* of gain on statutory grounds parallel what *Macomber* did on constitutional grounds: they refused to tax the realization of gain prematurely. Instead, the Code defers the payment of a tax on the gain realized until some more appropriate time.

A prominent example is the reorganization provisions of the IRC, which treat recapitalization (as in *Macomber*) as a nontaxable event. 26 U.S.C. §368(e). *See* Corporate Finance Institute, Tax-Free Reorganization, available at https://corporatefinanceinstitute.com/resources/valuation/tax-free-reorganization. When a recapitalization occurs, the question is how to deal with the adjusted basis of the stock, with possible adjustments to take into account such matters as depreciation and improvements. The only proper way to calculate the adjusted basis is to take the basis of the initial stock, as in *Macomber*, and to reallocate it proportionately between the new and old stock. To do otherwise will invite taxpayers to engage in impermissible arbitrage. If the old shares that are worth $100 have a basis of $100, and the new shares are worth $50 but have a basis of $0, taxpayers will be tempted to sell the old shares to avoid a taxable gain. If there are loss carryforwards, the temptation will be to sell the new shares with a zero basis. These options allow the taxpayers to act strategically to minimize the tax burden. But if all shares carry the same adjusted basis, there is no longer any way for the taxpayer to arbitrage between two assets with the same identical economic value solely because of their tax treatment. *See* Richard A. Epstein, Realization and Recognition Under the Internal Revenue Code, 39 (1) Soc. Phi. Pol. 11 (2022).

This approach to recapitalization recurs throughout American tax law. Recapitalizations, as in *Macomber*, are not the only kind of reorganization. Similar treatment is given to various forms of mergers, whether by share swaps, 26 U.S.C. §368(b), or by asset swaps, *id*. at §368(c). It also applies to the spinoff (or split up) of shares in an existing or preexisting subsidiary, *id*. at §355, so that the distribution of new shares to existing shareholders do not generate taxable income. Similarly, the IRS Code allows the deferral of tax on unrealized gain for appreciation on transfers to corporations, 26 U.S.C. §351, the receipt, exercise, or sale of stock options regulated under 26 U.S.C. §83, and the like-kind exchange of real estate under 26 U.S.C. §1031. These provisions avoid heavy taxation on parties with illiquid assets that are hard to value. Those gains can be taxed at a later realization when cash or marketable assets are received, with lower administrative costs. The government mistakenly limits *Macomber* to stock dividends because it ignores Section 368 and other nonrecognition of income.

Sound tax policy depends on far more than the resolution of a dispute over the definition of income, which is only the first stage in the inquiry. Using the wrong timing mechanism will cause excess resources to be spent policing and complying with a system. The structural nonrecognition provisions allow for the tax-free recombination of corporate assets in forms that maximize their value. The ability to reorganize tax-free where there are no shenanigans results in greater revenues, higher employment levels, higher dividends, and further opportunities for the efficient allocation of economic resources. Focusing solely on the definitional elements of realization and accession miss these key economic issues. All these provisions are built-in structural features of the Code which have been refined but never challenged.

By the same token, the structure of the IRS Code also contains safeguards against taxpayer abuse. It does not allow, for example, for the deferral of taxes in cases where new shares received are the equivalent to cash or marketable securities. In *Helvering v. Gregory*, 293 U.S. 465 (1935), a taxpayer formed a new subsidiary to which it then transferred marketable shares of the stock of an unrelated company. The newly formed subsidiary was then promptly liquidated, and the taxpayer sought to offset the basis of those shares against the income received, and to claim the lower capital gains rate for the net gain from the transaction, with a substantial reduction in tax. An alternative scenario would have treated the transaction as one where the parent company abstained from the intermediate transactions and just paid a dividend fully taxable as ordinary income. It was clear that the reorganization provisions were now being abused solely for tax avoidance without any independent business purpose. That result would not have been the case if the subsidiary contained productive assets that could continue to be used in a separate and more efficient business transaction—to allow a lender to lend solely on the strength of certain dedicated assets, without impairing the other assets of the parent that were better used in other business transactions. In that scenario, the imposition of a large tax on the spin-off would compromise the entire business operation with the consequence that a taxpayer would have to sell off real assets and undermine the total value of both corporations.

There are also cases under the traditional framework in which the taxation of gain or loss without realization makes good sense. It is thus a uniform feature of the IRC that taxpayers can take depreciation on assets used in a trade or business, but always and only by a fixed formula, 26 I.R.C. §167 (depreciation) & *id.* §168 (accelerated depreciation). These provisions make adjustments to the cost basis. *See generally*, Marvin A. Chirelstein & Lawrence Zelenko, *Federal Income Tax* ch. 6.09 (15th ed. 2023). This deduction allows the taxpayer to put together a fund to purchase a replacement for the original asset when it wears out. There are legitimate disputes about the optimal depreciation rules, and surely the government is under no obligation to match these deductions with any annual reduction in asset value. It could allow for depreciation of assets that have appreciated in value under the Haig definition of income. But the use of any fixed formula eliminates valuation obstacles in a loss situation where no liquidity constraint applies.

A second set of deviations from strict realization involves derivatives, futures contracts, or options that have exact financial value and are not working assets of the firm. The typical trader has an extensive portfolio of such financial assets and using a mark-to-market system is easy. The ready liquidity of these type of assets avoids any wealth crunch, as there is no need to sell off productive assets in ways that necessarily distort business decisions. Thus mark-to-market schemes that tax gain without realization are used, for example, for securities held by dealers not for investment but as inventory, 26 U.S.C. §475(a), and also on "segregated assets" held by life insurance companies, *id.* §817A(b). But these limited exceptions do not detract from the unshakeable presumption in favor of a realization requirement when valuation and liquidation is required of productive assets held by businesses or private individuals.

As a matter of both theory and practice, the government's approach has never prevailed. Only a tiny fraction of assets held by private parties are bought and sold each year. If this Court were to relax the realization requirement as a general matter, the volume of cases could easily increase by a thousand-fold or more—no one can exactly say—in ways that can swamp administration of the tax system. The valuation and administrative problems of a tax based on unrealized gains are so large that society would be left far worse off following such a rule.[2]

[2] A legal regime that imposes these costs on everyone, without giving them some equivalent benefit in return should be regarded as either a confiscatory tax or as a taking, not from any one person, but from everyone in the country, because everyone is left worse off with the adoption of this scheme. *See* Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain* ch. 18 (1985).

The government seeks to avoid this conclusion by relying on *College Savings Ass'n v. Commissioner*, 499 U.S. 554 (1991) and *Helvering v. Horst*, 311 U.S. 112 (1940) for the proposition that the realization requirement is only an "administrative convenience." Neither case, however, involved the simple taxation of unrealized appreciation. In *College Savings,* a savings bank held a book of long-term, low-interest mortgages, all of which had declined in value. The Federal Home Loan Bank Board would not allow the bank to sell these mortgages without going into regulatory default. But the Board allowed the bank to swap theses mortgages with similar mortgages from another bank without triggering that default. The losses that were not recognized for banking law purposes were recognized for tax purposes. Similarly, *Horst* involved a realization event when the taxpayer gave away bond coupons before that were cashed by his son. This Court taxed the money received by the son to the father in order to avoid an illicit form of income splitting. *See also Lucas v. Earl*, 281 U.S. 111 (1930) (income earned by husband payable to wife, taxed to husband); *Corliss v. Bowers*, 281 U.S. 376 (1930) (revocable trust, income tax to settler). None of these cases presents any issue of valuation or liquidity.

The government's position that realization is never necessary for the recognition of income suffers from additional flaws. First, its rule would apply to any form of asset, such as artwork, intangible property, goodwill, and stock in closed corporations where both liquidation and valuation problems are acute. If the elimination of the realization requirement allows the taxation of any asset appreciation, the number of transactions will multiply, perhaps by a thousand-fold or more.

Second, the administration of a comprehensive unrealized gains tax would require a massive increase in the power of the federal government to allow it to enter homes and shops to detect valuable assets with no ready market value held in safes and homes. The situation will only worsen because the tax for the first year will not be determined when the tax for the second year is due, which will only compound the uncertainty and disruption.

Third, Congress would have to provide for the deduction of unrealized losses, given that the Haig definition of income covers losses as well as gains. A decline in the stock market, for example, could trigger refunds whose precise amount could not be determined until the last day of the taxable year. As an alternative, the government could forsake the accession principle in loss situations by letting these losses be carried over, but it will be uncertain how long the wait will be before the taxpayer receives new gains to offset those carryover losses.

Fourth, an unrealized gains tax will have deeply negative consequences for long-term capital formation. New ventures with high levels of risk are best handled by investors who seek a higher rate of return but with a higher risk of failure. Once investors and entrepreneurs have created stable assets, it is best for them to sell to a larger public that seeks more reliable returns, which in turn allows them to return to their natural market niche. Break that cycle and the nation loses its lead in innovation and economic growth. That reluctance to go public will be exacerbated if the government seeks in practice to tax only publicly traded stocks. Slawson, *Taxing as Ordinary Income the Appreciation of Publicly Held Stock*" 76 Yale L.J. 523 (1967). A shrunken tax base will require even more prohibitive rates of taxation. No wonder that limited proposal has never been adopted.

The government argues that this Court should avoid any examination of a wealth tax as premature. It is important, however, to explain how that tax works and why a wealth tax will give rise to grave constitutional concerns. Many academics and politicians argue in favor of a wealth tax on rich individuals. Senator Elizabeth Warren, for example, has proposed a wealth tax that would raise an estimated $2.75 trillion over ten years. Senator Warren Unveils Proposal to Tax Wealth of Ultra-Rich Americans, https://www.warren.senate.gov/newsroom/press-releases/senator-warren-unveils-proposal-to-tax-wealth-of-ultra-rich-americans (January 24, 2019). She relies on the work of Professors Emmanuel Saez and Gabriel Zucman, https://www.warren.senate.gov/imo/media/doc/saez-zucman-wealthtax.pdf. Yet the wealth tax would suffer from the same administrative and liquidity challenges as an unrealized income tax. It would require the untangling of multi-party webs of unique financial assets—interests in partnerships and closed corporations, patents, royalties, options, leases, mortgages, and more, which must be offset by the full range of immediate and contingent liabilities.

This Court should also be wary of the government's boundless theory of income because it would allow Congress to use a tax on unrealized income as a wedge into wealth tax. See Daniel Hemel, *The Low and High Stakes of Moore*, 180 Tax Notes 565 (July 24, 2023). Under the government's approach, Congress could attempt to tax all accumulated unrealized income retroactively under the guise of an income tax. Such a tax would violate Article I, Section 9's and the Sixteenth Amendment's prohibition on an un-apportioned property tax. As noted above, that accrued income tax gimmick would also trigger massive dislocations in the capital markets. The new higher base would then set the stage for major tax losses in the subsequent period, which would render the entire strategy untenable. This Court can make clear that the Constitution does not allow indirectly – adopting an unbounded Haig theory of income to become a wealth tax – what it prohibits directly.

To avoid these drawbacks, the pure wealth tax of Professors Emmanuel Saez and Gabriel Zucman advocate a pure wealth tax of some unspecified level. That tax would not depend on changes in wealth. It could be imposed at any level at any time, based solely on the current size of the taxpayer's assets, not on its changes in value during the previous period. It would include wealth acquired by gift or inheritance that is currently exempted from the income tax under 26 U.S.C. §102(a). It also applies to wealth even when taxpayers have lost income. It could be imposed every year, at any level, on sums above any stated amount. This approach admits of no limiting principle; Congress could raise it the annual tax to the same 40 percent as the estate tax in order to raise revenue. At this point, the tax becomes confiscatory because it is not tied to any kind of coherent taxable event.[3]

In an effort to avoid this challenge, some scholars have defended a wealth tax on the ground that it is akin to the progressive federal estate tax (running from 0.75 percent to 3 percent on the size of the estate) upheld in *Knowlton v. Moore*, 178 U.S. 41 (1900). *Knowlton* followed *Magoun v. Illinois Trust & Savings Bank*, 170 U.S. 283 (1898), which had upheld a *state* inheritance tax. Both *Magoun,* 170 U.S. at 288, and *Knowlton*, 178 U.S. at 55, justify these succession taxes on grounds antithetical to a wealth tax. In identical terms they state: "1. An inheritance tax is not one on property, but one on the succession. 2. The right to take property by devise or descent is the creature of the law, and not a natural

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[3] As Thomas Cooley wrote in *Constitutional Limitations* 695 (1st ed. 1868):

> Everything that may be done under the name of taxation is not necessarily a tax; and it may happen that an oppressive burden imposed by the government when it comes to be carefully scrutinized, will prove, instead of a tax, to be an unlawful confiscation of property, unwarranted by a principal of constitutional government.

This Court expressed similar sentiments at the time of the Sixteenth Amendment in *Brushaber v. Union Pacific RR*, 240 U.S. 1, 24-25 (1915): "where although there was a seeming exercise of the taxing power, the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation but a confiscation of property, that is, a taking of the same in violation of the Fifth Amendment, . . ."

right—a privilege, and therefore the authority which confers it may impose conditions upon it." *Knowlton*, 178 U.S. at 55. The first point is decisive. Succession is a taxable event that involves the transfer of property, unlike a wealth tax that requires no event or transfer at all.

II. THE ORIGINAL UNDERSTANDING OF THE SIXTEENTH AMENDMENT SUPPORTS A REALIZATION REQUIREMENT

The text and history of the Sixteenth Amendment support Part II's strong presumption in favor of a constitutional realization requirement. The Framers of the eighteenth century would not have understood the original document to allow the taxation of property or wealth. Nor would the framers of the Sixteenth Amendment have deviated from the view that their text only permits a limited exception to Article I, Section 9's restriction on direct taxes.

The Constitution's text does not itself define income. The relevant history shows, however, that the Framers of Article I's Tax Clauses and the Sixteenth Amendment would have understood "income" to include only salary, dividends, interest, rents, and realized gains. As this Court has recognized, the Framers included Article I, Section 9's direct tax requirement to make clear that Congress could not impose a tax on property or other forms of wealth without satisfying the apportionment requirement. Congress's limited powers contrasted with those of the states, which had plenary authority to tax property and wealth, as well as many other forms of economic activity. Article I, Section 8, clause 1 preserved the reach of state taxing power by carefully restricting federal power to indirect taxes, such as excises and duties. *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 621-22 (1895). "The founders anticipated that the expenditures of the states, their counties, cities, and towns, would chiefly be met by direct taxation on accumulated property," the *Pollock* majority observed, "while they expected that those of the federal government would be for the most part met by indirect taxes." *Id.* at 621. Thus, this Court has held that "direct taxes, within the meaning of the Constitution, are only capitation taxes … and taxes on real estate." *Springer v. United States*, 102 U.S. 586, 602 (1880). *See* Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 Colum. L. Rev. 2334, 2393-97 (1997).

Article I thus represented a compromise. It granted Congress the power to tax individuals directly, which it had lacked under the Articles of Confederation. But the Constitution adopted the Articles of Confederation's method for calculating the taxes – in proportion to their population in Article I, Section 9. Because state and federal taxation would be concurrent rather than exclusive, the Framers sought to exclude the federal government from taxing property and wealth, which formed the basis for state revenues. *See* Federalist No. 32, at 154-55 (George W. Carey & James McClellan eds. 2001) (Alexander Hamilton). Indirect taxes permitted by Article I, Section 8, clause 1 refer instead to "duties and excises on articles of consumption." Federalist No. 36, at 174 (Alexander Hamilton).

Historians observe that Article I, Section 9's prohibition on direct taxation also advanced the Lockean philosophy prevalent in the United States that "emphasized individualism, celebrated the pursuit of private self-interest and financial gain, and regarded with suspicion any governmental initiatives that might impede the search for individual gain." W. Elliott Brownlee, Federal Taxation in America: A History 34 (3d ed. 2016). It would also help prevent the new national government from fomenting factionalism. Federalists worried that Congress might use an un-apportioned tax power to favor some interests over others: rural states feared the taxation of land; Southern states feared the taxation of slaves; merchants feared taxation of their inventories. Article I, Section 9 "prevented Congress from singling out a particular state or group of states for higher rates of taxation on trade." *Id.* at 36.

Government practice followed this understanding. Tariffs and excise taxes formed the foundation for federal finances during the antebellum period. Alexander Hamilton's financial program contained no direct taxation on wealth or income. Instead, it relied upon high tariffs and an excise tax on alcohol to fund the national debt and provide for federal expenditures. In 1798, the government financed the Quasi War with France with a direct property tax, but apportioned it based on state population. The Madison administration similarly funded the War of 1812 with a direct tax on houses, land, and slaves, but again obeyed Article I, Section 9's apportionment requirement. Despite these temporary examples, the American fiscal system retained the structure designed by the Framers and implemented by Hamilton – federal revenues provided by low tariffs and excise taxes, with no direct taxation except during emergencies. Brownlee, *supra*, at 48-49, 51.

The events leading to the ratification of the Sixteenth Amendment underscore that the income tax was understood as an exception to Article I, Section 9's limits on a direct wealth and property tax, rather than a revolution in the constitutional tax structure. During the unprecedented emergency of the Civil War, Congress passed in August 1861, 1862, and 1864 taxes on income that "the annual income of every person residing in the United States, whether such income is derived from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever." Revenue Act of 1861, sec. 49, 12 Stat. 292, at 309 (August 5, 1861); Revenue Act of 1862, sec. 92, 12 Stat. 432 (July 1, 1862). Revenue Act of 1864, sec. 116, 13 Stat. 223 (June 30, 1864). Even under the pressure of war, however, Congress never attempted to tax land, property, or other wealth based on their value or the increase in their value. Instead, the Civil War income tax included only "income, gains, and profits," in other words salaries, dividends, interest, and rents. Congressional leaders never fell afoul of Article I, Section 9 because it did not directly tax property, only the profits, interests, and rents realized by owners. This Court initially upheld the tax in *Springer v. United States*, 102 U.S. 586 (1880), on the ground that a direct tax would be one on the "whole personal estate" of a taxpayer – in other words, his or her wealth and property – rather than one on "income, gains, and profits." *Id.* at 598. Instructively, the Court implicitly excluded from the scope of an income tax an increase in the value of property, rather than rents produced by the property. *Id.* at 602. These taxes expired during Reconstruction.

In the following years, populists and progressives advocated for a broad property tax to attack the concentration of wealth. But when these proposals failed, they turned to an income tax as a second-best option. The tax would apply only to the largest personal incomes and corporate profits and would thereby redress an imbalance in economic power brought by industrialization. Brownlee, *supra,* at 79-80. Democrats took both houses of Congress in 1893 and enacted a tax in 1894 of two percent on incomes of more than $4,000.

In *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 638 (1895) this Court struck down the 1894 income tax for failure to apportion the tax by state population. Based on its review of the original understanding of Article I, Section 9, this Court found that "all internal taxes, except duties and excises on articles of consumption, fell into the category of direct taxes." 158 U.S. at 624-25. Chief Justice Fuller distinguished between a tax on "real estate" or "personal property," on the one hand, and a tax on the "rents" or "income" derived from that property, on the other. *Id.* at 637. A tax on income as well as wealth therefore required apportionment because both were direct taxes, but the Court also made clear that wealth and income were different.

Justice Harlan's dissent also followed this distinction. Comparing income to the rent from land, he described income taxes as "duties on income derived from every kind of property, real and personal." *Id.* at 663 (Harlan, J., dissenting). Justice Harlan did not claim that an income tax would reach the increase in the value of land itself, only the rent that it would throw off. *See also id.* at 696 (Jackson, J., dissenting). Justice White's dissent also maintained that Article I, Section 9 prohibited taxation of real estate, but not the rent received therefrom. But he, like Justice Harlan, further argued that the apportionment requirement did not apply to "personal" property, by which he meant other forms of wealth, and the income generated therefrom. *Id.* at 706-07 (White, J., dissenting).

In light of this history, the Sixteenth Amendment is best understood to allow the taxation not just of rents and salaries, but also the income of all assets other than land. In other words, if the Sixteenth Amendment adopted the principle of Justices Harlan and White that direct taxation only referred to a tax on real estate, it would allow for taxation of all forms of non-land wealth. But this was not the vocabulary used by the Sixteenth Amendment when read against the backdrop of the *Pollock* dissent. The *Pollock* dissenters do not use the word "income" to include unrealized gains in the value of property. Instead, the dissent, like the majority, refers to property as either land or personal property, and then refers to income as the money received from those assets, such as rent in the case of land or interest or dividends in the case of personal property (which would take the form of cash deposits, stocks, or bonds). Neither the majority nor the dissents in *Pollock* ever conceived of income as including the growth in the value of property, such as an increase in land, commodity, or stock prices.

The Sixteenth Amendment cannot routinely extend beyond rents, salaries, and realized gains because it builds on the core understanding of all the justices in *Pollock,* none of whom included in the definition of income unrealized changes in asset value. Their key move was to distinguish between the income via rents received from the property and the value of the property itself. The Sixteenth Amendment mirrors that narrower claim of the *Pollock* dissents. The Congress that overrode *Pollock* never referred to changes in asset values and wealth as proper subjects for an income tax.

This conclusion receives support from the history of the ratification of the Sixteenth Amendment. *Pollock* did not provoke an immediate campaign to amend the Constitution. Instead, opposition built steadily over almost 20 years. The populist movement led by William Jennings Bryan—the author of the "Cross of Gold" speech—accused the Court of taking sides with the wealthy against the poor and included an income tax in their platform to limit judicial power by imposing election, term limits, and recall on judges, creating a statutory means to override Court decisions, and making constitutional amendment easier. David E. Kyvig, *Can the Constitution be Amended?: The Battle Over the Income Tax*, 20 Prologue 140, 190 (1988). After the Spanish-American War, progressives demanded that the government fund the conflict not just with borrowing, but with income, inheritance, and corporate taxes. President Theodore Roosevelt, for example, endorsed an income tax in his 1906 and 1908 Messages to Congress. In June 1907 Roosevelt declared that "most great civilized countries have an income tax and an inheritance tax. In my judgment both should be part of our system of federal taxation." Quoted in *id*. at 191. William Howard Taft accepted the 1908 Republican Party nomination by agreeing with T.R. on the income tax.

Wealthy individuals who profited from this nation's rapid industrialization and were located in a few states, such as New York and Pennsylvania, became principal targets of a progressive income tax code. Some progressives and populists sought to force the Court into reversing the *Pollock* precedent by re-enacting the 1894 income tax. But northeastern Senators, led by Senator Nelson Aldrich of Rhode Island, headed off this move by proposing instead that Congress send a constitutional amendment to the states for ratification. *See* Kyvig, *supra*, at 191-92. President Taft, who did not want to support an attack on the Court, threw his support behind the amendment. Aldrich's proposal cornered income tax supporters into dropping their revived 1894 tax idea and supporting the amendment instead. Indeed, the Senate approved the proposed Sixteenth Amendment 77-0 on July 5, 1909, and the House soon followed suit by a vote of 318-14, ending the effort to pass a new income tax bill.

Historical records do not mention even one major supporter in Congress who argued that the text would allow the taxation of unrealized gains in property and other assets. Instead, income tax advocates sought the restoration of the 1894 tax, which had taxed income such as rents and salaries, but not underlying wealth. The Sixteenth Amendment's text did not seek to undo Article I, Section 9's limit on direct taxation. Thus, the Sixteenth Amendment created a limited exception to the apportionment requirement, by reversing the holding of *Pollock* without accepting the theory of the *Pollock* dissenters – that direct taxes described only a tax on real property. The Sixteenth Amendment used the language of its time to tax only income and realized gains, but not property, wealth, or unrealized gains. The supporters of the Sixteenth Amendment were well aware of Henry George's 1880 *Progress and Poverty*, which proposed a radical single tax on all property so as to redistribute wealth and break up monopoly power. Brownlee, *supra*, at 78-79. But it had no influence here.

The historical debates over the motivations of behind the Sixteenth Amendment saw some 20th Century historians promote a class-based interpretation. These historians saw the amendment as the victory of the rural and industrial classes against a wealthy urban elite, of liberals over conservatives, workers and farmers over plutocrats, and the South and Midwest over the East. *See generally* Sidney Ratner, *Taxation and Democracy in America* (1967). More recent writers explain the Sixteenth Amendment as Congress's attempt to limit more radical redistributive taxes or to distract from more regressive tariffs and consumption excises. Robert Stanley, *Dimensions of Law in the Service of Order: Origins of the Federal Income Tax, 1861-1913*, at 16-17 (1993). Other scholars trace support for the income tax to states that wanted spending on the military or veterans' programs that benefited their regions. Bennett D. Baack & Edward John Ray, *Special Interests and the Adoption of the Income Tax in the United States*, 45 J. Econ. Hist. 607, 619–20, 624 (1985). Some supporters wanted to reduce income inequalities, Brownlee, *supra*, at 90-91, or to equalize the tax treatment of the proceeds from stocks and bonds with salaries and wages, which would allow for the taxation of the wealthiest. John D. Buenker, *The Ratification of the Federal Income Tax Amendment*, 1 Cato Journal 183 (1981) or to target the well to do in the Northeast. Robin L. Einhorn, *Look Away Dixieland: The South and the Federal Income Tax*, 108 Nw. U. L. Rev. 773 (2014).

But the key point is this. Not one of these historical studies finds that *anyone* of importance for the drafting or ratification of the Sixteenth Amendment understood it to permit the taxation of wealth or to upset the *Pollock*'s Court distinction between property and rents, personal property and income. Debates occurred on marginal issues. Charles Evans Hughes, for example, focused his attack on whether the federal government should have the ability to tax the interest on state and local bonds. Buenker, *supra,* at 190-91. Senators William Borah and Elihu Root responded that the new amendment would only reverse the result of the *Pollock* decision without fundamentally altering the structure of the federal taxing power. Kyvig, *supra*, at 194. Representing the Sixteenth Amendment not just as authorizing an income tax, but also subjecting to taxation increases in property and asset values could well have doomed its ratification. Today, some argue that *Pollock* was so obviously mistaken that the Sixteenth Amendment was unnecessary, unless it made possible revolutionary new forms of taxation, such as one on wealth. *See* Calvin H. Johnson, *Purging Out Pollock: The Constitutionality of Federal Wealth or Sales Taxes*, 97 Tax Notes 1723, 1734 (2002); Bruce Ackerman, *Taxes and the Constitution*, 99 Colum. L. Rev. 1, 3 (1999). Such arguments are belied by the ratification history of the Sixteenth Amendment itself.

CONCLUSION

For the foregoing reasons, this Court should reverse the decision below of the U.S. Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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