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SIXTEENTH AMENDMENT

INCOME TAX

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INCOME TAX

SIXTEENTH AMENDMENT

The 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.

INCOME TAX

History and Purpose of the Amendment

The ratification of this Amendment was the direct consequence of the Court's decision in 1895 in *Pollock v. Farmers' Loan & Trust Co.*,[1] whereby the attempt of Congress the previous year to tax incomes uniformly throughout the United States[2] was held by a divided court to be unconstitutional. A tax on incomes derived from property,[3] the Court declared, was a "direct tax" which Congress under the terms of Article I, § 2, and § 9, could impose only by the rule of apportionment according to population, although scarcely fifteen years prior the Justices had unanimously sustained[4] the collection of a similar tax during the Civil War,[5] the only other occasion preceding the Sixteenth Amendment in which Congress had ventured to utilize this method of raising revenue.[6]

During the interim between the *Pollock* decision in 1895 and the ratification of the Sixteenth Amendment in 1913, the Court gave evidence of a greater awareness of the dangerous consequences to national solvency which that holding threatened, and partially circumvented the threat, either by taking refuge in redefinitions of "direct tax" or, and more especially, by emphasizing, virtually to the exclusion of the former, the history of excise taxation. Thus, in a series of cases, notably *Nicol v. Ames*,[7]

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[1] 157 U.S. 429 (1895); 158 U.S. 601 (1895).

[2] Ch. 349, § 27, 28 Stat. 509, 553.

[3] The Court conceded that taxes on incomes from "professions, trades, employments, or vocations" levied by this act were excise taxes and therefore valid. The entire statute, however, was voided on the ground that Congress never intended to permit the entire "burden of the tax to be borne by professions, trades, employments, or vocations" after real estate and personal property had been exempted, 158 U.S. at 635.

[4] Springer v. United States, 102 U.S. 586 (1881).

[5] Ch. 173, § 116, 13 Stat. 223, 281 (1864).

[6] For an account of the *Pollock* decision, *see* supra, pp. 352–56.

[7] 173 U.S. 509 (1899).

Knowlton v. Moore,[8] and *Patton v. Brady,*[9] the Court held the following taxes to have been levied merely upon one of the "incidents of ownership" and hence to be excises: a tax which involved affixing revenue stamps to memoranda evidencing the sale of merchandise on commodity exchanges, an inheritance tax, and a war revenue tax upon tobacco on which the hitherto imposed excise tax had already been paid and which was held by the manufacturer for resale.

Because of such endeavors the Court thus found it possible to sustain a corporate income tax as an excise "measured by income" on the privilege of doing business in corporate form.[10] The adoption of the Sixteenth Amendment, however, put an end to speculation whether the Court, unaided by constitutional amendment, would persist along these lines of construction until it had reversed its holding in the *Pollock* case. Indeed, in its initial appraisal[11] of the Amendment it classified income taxes as being inherently "indirect." "[T]he command of the amendment that all income taxes shall not be subject to apportionment by a consideration of the sources from which the taxed income may be derived, forbids the application to such taxes of the rule applied in the *Pollock* case by which alone such taxes were removed from the great class of excises, duties, and imports subject to the rule of uniformity and were placed under the other or direct class."[12] "[T]he Sixteenth Amendment conferred no new power of taxation but simply prohibited the previous complete and plenary power of income taxation possessed by Congress from the beginning from being taken out of the category of indirect taxation to which it inherently belonged."[13]

Income Subject to Taxation

Building upon definitions formulated in cases construing the Corporation Tax Act of 1909,[14] the Court initially described income as the "gain derived from capital, from labor, or from both combined," inclusive of the "profit gained through a sale or conversion of capital assets";[15] in the following array of factual situations it

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[8] 178 U.S. 41 (1900).

[9] 184 U.S. 608 (1902).

[10] Flint v. Stone Tracy Co., 220 U.S. 107 (1911).

[11] Brushaber v. Union Pac. R.R., 240 U.S. 1 (1916); Stanton v. Baltic Mining Co., 240 U.S. 103 (1916); Tyee Realty Co. v. Anderson, 240 U.S. 115 (1916).

[12] Brushaber v. Union Pac. R.R., 240 U.S. 1, 18–19 (1916).

[13] Stanton v. Baltic Mining Co., 240 U.S. 103, 112 (1916).

[14] Stratton's Independence v. Howbert, 231 U.S. 399 (1913); Doyle v. Mitchell Bros. Co., 247 U.S. 179 (1918).

[15] Eisner v. Macomber, 252 U.S. 189 (1920); Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926).

subsequently applied this definition to achieve results that have been productive of extended controversy.

Corporate Dividends: When Taxable.—Rendered in conformity with the belief that all income "in the ordinary sense of the word" became taxable under the Sixteenth Amendment, the earliest decisions of the Court on the taxability of corporate dividends occasioned little comment. Emphasizing that in all such cases the stockholder is to be viewed as "a different entity from the corporation," the Court in *Lynch v. Hornby*,[16] held that a cash dividend equal to 24 percent of the par value of the outstanding stock and made possible largely by the conversion into money of assets earned prior to the adoption of the Amendment, was income taxable to the stockholder for the year in which he received it, notwithstanding that such an extraordinary payment might appear "to be a mere realization in possession of an inchoate and contingent interest . . . [of] the stockholder . . . in a surplus of corporate assets previously existing." In *Peabody v. Eisner*,[17] decided on the same day and deemed to have been controlled by the preceding case, the Court ruled that a dividend paid in the stock of another corporation, although representing earnings that had accrued before ratification of the Amendment, was also taxable to the shareholder as income. The dividend was likened to a distribution in specie.

Two years later the Court decided *Eisner v. Macomber*,[18] and the controversy which that decision precipitated still endures. Departing from the interpretation placed upon the Sixteenth Amendment in the earlier cases, i.e., that the purpose of the Amendment was to correct the "error" committed in the Pollock case and to restore income taxation to "the category of indirect taxation to which it inherently belonged," Justice Pitney, who delivered the opinion in the *Eisner* case, indicated that the sole purpose of the Sixteenth Amendment was merely to "remove the necessity which otherwise might exist for an apportionment among the States of taxes laid on

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[16] 247 U.S. 339, 344 (1918). On the other hand, in Lynch v. Turrish, 247 U.S. 221 (1918), the single and final dividend distributed upon liquidation of the entire assets of a corporation, although equaling twice the par value of the capital stock, was declared to represent only the intrinsic value of the latter earned prior to the effective date of the Amendment, and hence was not taxable as income to the shareholder in the year in which actually received. Similarly, in Southern Pacific Co. v. Lowe, 247 U.S. 330 (1918), dividends paid out of surplus accumulated before the effective date of the Amendment by a railway company whose entire capital stock was owned by another railway company and whose physical assets were leased to and used by the latter was declared to be a nontaxable bookkeeping transaction between virtually identical corporations.

[17] 247 U.S. 347 (1918).

[18] 252 U.S. 189, 206–08 (1920).

income." He thereupon undertook to demonstrate how what was not income, but an increment of capital when received, could later be transmitted into income upon sale or conversion and could be taxed as such without the necessity of apportionment. In short, the term "income" acquired to some indefinite extent a restrictive significance.

Specifically, the Justice held that a stock dividend was capital when received by a stockholder of the issuing corporation and did not become taxable without apportionment, that is, as "income," until sold or converted, and then only to the extent that a gain was realized upon the proportion of the original investment which such stock represented. "A stock dividend," Justice Pitney maintained, "far from being a realization of profits to the stockholder, . . . tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution . . . not only does a stock dividend really take nothing from . . . the corporation and add nothing to that of the shareholder, but . . . the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is richer because of an increase of his capital, at the same time shows [that] he has not realized or received any income in" what is no more than a "bookkeeping transaction." But conceding that a stock dividend represented a gain, the Justice concluded that the only gain taxable as "income" under the Amendment was "a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived,' that is, received or drawn by the recipient [the taxpayer] for his separate use, benefit, and disposal; . . . ." Only the latter in his opinion, answered the description of income "derived" from property, whereas "a gain accruing to a capital, not a growth or an increment of value in the investment" did not.[19] Although steadfastly refusing to depart from the principle[20] which it asserted in *Eisner v. Macomber*, the Court

[19] Id. at 207, 211–12 (1920). This decision has been severely criticized, chiefly on the ground that gains accruing to capital over a period of years are not income and are not transformed into income by being dissevered from capital through sale or conversion. Critics have also experienced difficulty in understanding how a tax on income which has been severed from capital can continue to be labeled a "direct" tax on the capital from which the severance has thus been made. Finally, the contention has been made that in stressing the separate identities of a corporation and its stockholders, the Court overlooked the fact that when a surplus has been accumulated, the stockholders are thereby enriched, and that a stock dividend may therefore be appropriately viewed simply as a device whereby the corporation reinvests money earned in their behalf. *See also* Merchants' L. & T. Co. v. Smietanka, 255 U.S. 509 (1921).

[20] Reconsideration was refused in Helvering v. Griffths, 318 U.S. 371 (1943).

in subsequent decisions has, however, slightly narrowed the application thereof. Thus, the distribution, as a dividend, to stockholders of an existing corporation of the stock of a new corporation to which the former corporation, under a reorganization, had transferred all its assets, including a surplus of accumulated profits, was treated as taxable income. The fact that a comparison of the market value of the shares in the older corporation immediately before, with the aggregate market value of those shares plus the dividend shares immediately after, the dividend showed that the stockholders experienced no increase in aggregate wealth was declared not to be a proper test for determining whether taxable income had been received by these stockholders.[21] On the other hand, no taxable income was held to have been produced by the mere receipt by a stockholder of rights to subscribe for shares in a new issue of capital stock, the intrinsic value of which was assumed to be in excess of the issuing price. The right to subscribe was declared to be analogous to a stock divided, and "only so much of the proceeds obtained upon the sale of such rights as represents a realized profit over cost" to the stockholders was deemed to be taxable income.[22] Similarly, on grounds of consistency with *Eisner v. Macomber*, the Court has ruled that inasmuch as it gave the stockholder an interest different from that represented by his former holdings, a dividend in common stock to holders of preferred stock,[23] or a dividend

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[21] United States v. Phellis, 257 U.S. 156 (1921); Rockefeller v. United States, 257 U.S. 176 (1921). *See also* Cullinan v. Walker, 262 U.S. 134 (1923).

In Marr v. United States, 268 U.S. 536, 540–41 (1925), it was held that the increased market value of stock issued by a new corporation in exchange for stock of an older corporation, the assets of which it was organized to absorb, was subject to taxation as income to the holder, notwithstanding that the income represented profits of the older corporation and that the capital remained invested in the same general enterprise. Weiss v. Stearn, 265 U.S. 242 (1924), in which the additional value in new securities was held not taxable, was likened to Eisner v. Macomber, and distinguished from the aforementioned cases on the ground of preservation of corporate identity. Although the "new corporation had . . . been organized to take over the assets and business of the old . . . , the corporate identity was deemed to have been substantially maintained because the new corporation was organized under the laws of the same State with presumably the same powers as the old. There was also no change in the character of the securities issued," with the result that "the proportional interest of the stockholder after the distribution of the new securities was deemed to be exactly the same."

Under existing law, however, when a taxpayer exchanges all of the outstanding stock for a minor percentage of the total shares of a larger corporation, plus cash, the gain to be recognized in full is not limited to the cash but embraces the excess of the sum of the market value of the stock acquired plus the cash over the cost of the original stock plus the expenses of the sale. Turnbow v. Commissioner, 368 U.S. 337 (1961).

[22] Miles v. Safe Deposit Co., 259 U.S. 247 (1922).

[23] Koshland v. Helvering, 298 U.S. 441 (1936).

in preferred stock accepted by a holder of common stock[24] was income taxable under the Sixteenth Amendment.

Corporate Earnings: When Taxable.—On at least two occasions the Court has rejected as untenable the contention that a tax on undistributed corporate profits is essentially a penalty rather than a tax or that it is a direct tax on capital and hence is not exempt from the requirement of apportionment. Inasmuch as the exaction was permissible as a tax, its validity was held not to be impaired by its penal objective, namely, "to force corporations to distribute earnings in order to create a basis for taxation against the stockholders." As to the added contention that, because liabilty was assessed upon a mere purpose to evade imposition of surtaxes against stockholders, the tax was a direct tax on a state of mind, the Court replied that while "the existence of the defined purpose was a condition precedent to the imposition of the tax liability, . . . [did] not prevent it from being a true income tax within the meaning of the Sixteenth Amendment."[25] Subsequently, in *Helvering v. Northwest Steel Mills,*[26] this appraisal of the constitutionality of the undistributed profits tax was buttressed by the following observation: "It is true that the surtax is imposed upon the annual income only if it is not distributed, but this does not serve to make it anything other than a true tax on income within the meaning of the Sixteenth Amendment. Nor is it true . . . that because there might be an impairment of the capital stock, the tax on the current annual profit would be the equivalent of a tax upon capital. Whether there was an impairment of the capital stock or not, the tax . . . was imposed on profits earned during . . .—a tax year—and therefore on profits constituting income within the meaning of the Sixteenth Amendment."[27]

Likening a cooperative to a corporation, federal courts have also declared to be taxable income the net earnings of a farmers' cooperative, a portion of which was used to pay dividends on capital stock without reference to patronage. The argument that such

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[24] Helvering v. Gowran, 302 U.S. 238 (1937).

[25] Helvering v. National Grocery Co., 304 U.S. 282, 288–89 (1938). In Helvering v. Mitchell, 303 U.S. 391 (1938), the defendant contended the collection of fifty per cent of any deficiency in addition to the deficiency alleged to have resulted from a fraudulent intent to evade the income tax amounted to the imposition of a criminal penalty. The Court, however, described the additional sum as a civil and not a criminal sanction, and one whch could be constitutionally employed to safeguard the Government against loss of revenue. In contrast, the exaction upheld in Helvering v. National Grocery Co., though conceded to possess the attributes of a civil sanction, was declared to be sustainable as a tax.

[26] 311 U.S. 46 (1940). *See also* Crane-Johnson Co. v. Helvering, 311 U.S. 54 (1940).

[27] 311 U.S. 53.

earnings were in reality accumulated savings of its patrons which the cooperative held as their bailee was rejected as unsound for the reason that "while those who might be entitled to patronage dividends have . . . an interest in such earnings, such interest never ripens into an individual ownership . . . until and if a patronage dividend be declared." Had such net earnings been apportioned to all of the patrons during the year, "there might be . . . a more serious question as to whether such earnings constituted 'income' [of the cooperative] within the Amendment."[28] Similarly, the power of Congress to tax the income of an unincorporated joint stock association has been held to be unaffected by the fact that under state law the association is not a legal entity and cannot hold title to property, or by the fact that the shareholders are liable for its debts as partners.[29]

Whether subsidies paid to corporations in money or in the form of grants of land or other physical property constitute taxable income has also concerned the Court. In *Edwards v. Cuba Railroad*,[30] it ruled that subsidies of lands, equipment, and money paid by Cuba for the construction of a railroad were not taxable income but were to be viewed as having been received by the railroad as a reimbursement for capital expenditures in completing such project. On the other hand, sums paid out by the Federal Government to fulfill its guarantee of minimum operating revenue to railroads during the six months following relinquishment of their control by that government were found to be taxable income. Such payments were distinguished from those excluded from computation of income in the preceding case in that the former were neither bonuses, nor gifts, nor subsidies, "that is, contributions to capital."[31] Other corporate receipts deemed to be taxable as income include the following: (1) "insiders profits" realized by a director and stockholder of a corporation from transaction in its stock, which, as required by the Securities and Exchange Act,[32] are paid over to the corporation;[33] (2) money received as exemplary damages for fraud or as the punitive two-thirds portion of a treble damage antitrust recovery;[34] and (3) compensation awarded for the fair rental value of trucking facilities operated by the taxpayer under control and possession of the Government during World War II, for in the last

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[28] Farmers Union Co-op v. Commissioner, 90 F.2d 488, 491, 492 (8th Cir. 1937).

[29] Burk-Waggoner Ass'n v. Hopkins, 269 U.S. 110 (1925).

[30] 268 U.S. 628 (1925).

[31] Texas & Pacific Ry. Co. v. United States, 286, U.S. 285, 289 (1932); Continental Tie & L. Co. v. United States, 286 U.S. 290 (1932).

[32] 15 U.S.C. § 78p.

[33] General American Investors Co. v. Commissioner, 348 U.S. 434 (1955).

[34] Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955).

instance the Government never acquired title to the property and had not damaged it beyond ordinary wear.[35]

Gains: When Taxable.—When through forfeiture of a lease in 1933, a landlord became possessed of a new building erected on his land by the outgoing tenant, the resulting gain to the former was taxable to him in that year. Although "economic gain is not always taxable as income, it is settled that the realization of gain need not be in cash derived from the sale of an asset. . . . The fact that the gain is a portion of the value of the property received by the . . . [landlord] does not negative its realization. . . . [Nor is it necessary] to recognition of taxable gain that . . . [the landlord] should be able to sever the improvement begetting the gain from his original capital." Hence, the taxpayer was incorrect in contending that the Amendment "does not permit the taxation of such [a] gain without apportionment amongst the states.[36] Consistent with this holding the Court has also ruled that when an apartment house was acquired by bequest subject to an unassumed mortgage and several years thereafter was sold for a price slightly in excess of the mortgage, the basis for determining the gain from that sale was the difference between the selling price, undiminished by the amount of the mortgage, and the value of the property at the time of the acquisition, less deductions for depreciation during the years the building was held by the taxpayer. The latter's contention that the Revenue Act, as thus applied, taxed something which was not revenue was declared to be unfounded.[37]

As against the argument of a donee that a gift of stock became a capital asset when received and that therefore, when disposed of, no part of that value could be treated as taxable income to said donee, the Court has declared that it was within the power of Congress to require a donee of stock, who sells it at a profit, to pay income tax on the difference between the selling price and the value when the donor acquired it.[38] Moreover, "the receipt in cash or property . . . not [being] the only characteristic of realization of

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[35] Commissioner v. Gillette Motor Co., 364 U.S. 130 (1960).

[36] Helvering v. Brumn, 309 U.S. 461, 468–69 (1940).

[37] Crane v. Commissioner, 331 U.S. 1, 15–16 (1947).

[38] The donor could not, "by mere gift, enable another to hold this stock free from . . . [the] right . . . [of] the sovereign to take part of any increase in its value when separated through sale or conversion and reduced to possession." Taft v. Bowers, 278 U.S. 470, 482, 484 (1929). However, when a husband, as part of a divorce settlement, transfers his own corporate stock to his wife, he is deemed to have exchanged the stock for the release of his wife's inchoate, marital rights, the value of which are presumed to be equal to the current, market value of the stock, and, accordingly, he incurs a taxable gain measured by the difference between the initial purchase price of the stock and said market value upon transfer. United States v. Davis, 370 U.S. 65 (1962).

income to a taxpayer on the cash receipt basis," it follows that one who is normally taxable only on the receipt of interest payments cannot escape taxation thereon by giving away his right to such income in advance of payment. When "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." Hence an owner of bonds, reporting on the cash receipts basis, who clipped interest coupons therefrom before their due date and gave them to his son, was held to have realized taxable income in the amount of said coupons, notwithstanding that his son had collected them upon maturity later in the year.[39]

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[39] Helvering v. Horst, 311 U.S. 112, 115–16 (1940).

With a frequency that for obvious reasons is progressively diminishing, the Court also has been called upon to resolve questions as to whether gains, realized after 1913, on transactions consummated prior to ratification of the Sixteenth Amendment are taxable, and if so, how such tax is to be determined. The Court's answer generally has been that if the gain to the person whose income is under consideration became such subsequently to the date at which the amendment went into effect, namely, March 1, 1913, and is a real, and not merely an apparent, gain, said gain is taxable. Thus, one who purchased stock in 1912 for $500 could not limit his taxable gain to the difference, $695, the value of the stock on March 1, 1913 and $13,931, the price obtained on the sale thereof, in 1916; but was obliged to pay tax on the entire gain, that is the difference between the original purchase price and the proceeds of the sale, Goodrich v. Edwards, 255 U.S. 527 (1921). Conversely, one who acquired stock in 1912 for $291,600 and who sold the same in 1916 for only $269,346, incurred a loss and could not be taxed at all, notwithstanding the fact that on March 1, 1913, his stock had depreciated to $148,635. Walsh v. Brewster, 255 U.S. 536 (1921). On the other hand, although the difference between the amount of life insurance premiums paid as of 1908, and the amount distributed in 1919, when the insured received the amount of his policy plus cash dividends apportioned thereto since 1908, constituted a gain, that portion of the latter which accrued between 1908 and 1913 was deemed to be an accretion of capital and hence not taxable. Lucas v. Alexander, 279 U.S. 473 (1929).

However, a litigant who, in 1915, reduced to judgment a suit pending on February 26, 1913, for an accounting under a patent infringement, was unable to have treated as capital, and excluded from the taxable income produced by such settlement, that portion of his claim which had accrued prior to March 1, 1913. Income within the meaning of the Amendment was interpreted to be the fruit that is born of capital, not the potency of fruition. All that the taxpayer possessed in 1913 was a contingent chose in action which was inchoate, uncertain, and contested. United States v. Safety Car Heating Co., 297 U.S. 88 (1936).

Similarly, purchasers of coal lands subject to mining leases executed before adoption of the Amendment could not successfully contend that royalties received during 1920–1926 were payments for capital assets sold before March 1, 1913, and hence not taxable. Such an exemption, these purchasers argued, would have been in harmony with applicable local law whereunder title to coal passes immediately to the lessee on execution of such leases. To the Court, on the other hand, such leases were not to be viewed "as a 'sale' of the mineral content of the soil" inasmuch as minerals "may or may not be present in the leased premises, and may or may not be found [therein]. . . . If found, their abstraction . . . is a time consuming operation and the payments made by the lessee . . . do not normally become payable as the result of a single transaction. . . ." The result for tax purposes would have been the same even had the lease provided that title to the minerals would pass

Income from Illicit Transactions.—In *United States v. Sullivan*,[40] the Court, held that gains derived from illicit traffic were taxable income under the act of 1921.[41] Said Justice Holmes for the unanimous Court: "We see no reason . . . why the fact that a business is unlawful should exempt it from paying the taxes that if lawful it would have to pay."[42] Consistent therewith, although not without dissent, the Court ruled that Congress has the power to tax as income moneys received by an extortioner,[43] and, more recently, that embezzled money is taxable income of an embezzler in the year of embezzlement. "When the taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, 'he has received income . . . , even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.' "[44]

Deductions and Exemptions.—Notwithstanding the authorization contained in the Sixteenth Amendment to tax income "from whatever source derived," Congress has been held not to be precluded thereby from granting exemptions.[45] Thus, the fact that "under the Revenue Acts of 1913, 1916, 1917, and 1918, stock fire insurance companies were taxed . . . upon gains realized from the sale . . . of property accruing subsequent to March 1, 1913," but were not so taxed by the Revenue Acts of 1921, 1924, and 1926, did not prevent Congress, under the terms of the Revenue Act of 1928, from taxing all the gain attributable to increase in value after March 1, 1913, which such a company realized from a sale of property in 1928. The constitutional power of Congress to tax a gain being well established, Congress was declared competent to choose "the moment of its realization and the amount realized"; and "its failure to impose a tax upon the increase in value in the earlier years . . . [could not] preclude it from taxing the gain in the year when realized . . . ."[46] Congress is equally well equipped with the "power to condition, limit, or deny deductions from gross in-

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only "on severance by the lessee." Bankers Coal Co. v. Burnet, 287 U.S. 308 (1932); Burnet v. Harmel, 287 U.S. 103, 106–107, 111 (1932).

[40] 274 U.S. 259 (1927).

[41] 42 Stat. 227, 250, 268.

[42] 274 U.S. 259, 263. Profits from illegal undertakings being taxable as income, expenses in the form of salaries and rentals incurred by bookmakers are deductible. Commissioner v. Sullivan, 356 U.S. 27 (1958).

[43] Rutkin v. United States, 343 U.S. 130 (1952). Four Justices, Black, Reed, Frankfurter, and Douglas, dissented.

[44] James v. United States, 366 U.S. 213, 219 (1961) (overruling Commissioner v. Wilcox, 327 U.S. 404 (1946)).

[45] Brushaber v. Union Pac. R.R., 240 U.S. 1 (1916).

[46] MacLaughlin v. Alliance Ins. Co., 286 U.S. 244, 250 (1932).

comes in order to arrive at the net that it chooses to tax."[47] Accordingly, even though the rental value of a building used by its owner does not constitute income within the meaning of the Amendment,[48] Congress was competent to provide that an insurance company shall not be entitled to deductions for depreciation, maintenance, and property taxes on real estate owned and occupied by it unless it includes in its computation of gross income the rental value of the space thus used.[49]

Also, a taxpayer who erected a $3,000,000 office building on land, the unimproved worth of which was $660,000, and who subsequently purchased the lease on the latter for $2,100,000 is entitled to compute depreciation over the remaining useful life of the building on that portion of $1,440,000, representing the difference between the price and the unimproved value, as may be allocated to the building; but he cannot deduct the $1,440,000 as a business expense incurred in eliminating the cost of allegedly excessive rentals under the lease, nor can he treat that sum as a prepayment of rent to be amortized over the 21-year period that the lease was to run.[50]

Diminution of Loss.—Mere diminution of loss is neither gain, profit, nor income. Accordingly, one who in 1913 borrowed a sum of money to be repaid in German marks and who subsequently lost

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[47] Helvering v. Ind. L. Ins. Co., 292 U.S. 371, 381 (1934); Helvering v. Winmill, 305 U.S. 79, 84 (1938).

[48] A tax on the rental value of property so occupied is a direct tax on the land and must be apportioned. Helvering v. Ind. L. Ins. Co., 291 U.S. 371, 378–79 (1934).

[49] Id. at 381. Expenditures incurred in the prosecution of work under a contract for the purpose of earning profits are not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. Accordingly, a dredging contractor, recovering a judgment for breach of warranty of the character of the material to be dredged, must include the amount thereof in the gross income of the year in which it was received, rather than of the years during which the contract was performed, even though it merely represents a return of expenditures made in performing the contract and resulting in a loss. The gain or profit subject to tax under the Sixteenth Amendment is the excess of receipts over allowable deductions during the accounting period, without regard to whether or not such excess represents a profit ascertained on the basis of particular transactions of the taxpayer when they are brought to a conclusion. Burnet v. Sanford & Brooks Co., 282 U.S. 359 (1931).

The grant on denial of deductions is not based on the taxpayers' engagement in constitutionally protected activities, and, accordingly, no deduction is granted for sums expended in combating legislation, enactment of which would destroy taxpayer's business. Commarano v. United States, 358 U.S. 498 (1959).

Likewise, when tank truck owners, either intentionally for business reasons or unintentionally, violate state maximum weight laws, and incur fines, the latter are not deductible, for fines are penalties rather than tolls for the use of highways, and Congress is not to be viewed as having intended to encourage enterprises to violate state policy. Tank Truck Rentals v. Commissioner, 356 U.S. 30 (1958); Hoover Express Co. v. United States, 356 U.S. 38 (1958).

[50] Millinery Corp. v. Commissioner, 350 U.S. 456 (1956).

the money in a business transaction cannot be taxed on the curtailment of debt effected by using depreciated marks in 1921 to settle a liability of $798,144 for $113,688, the "saving" having been exceeded by a loss on the entire operation.[51]

[51] Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926).