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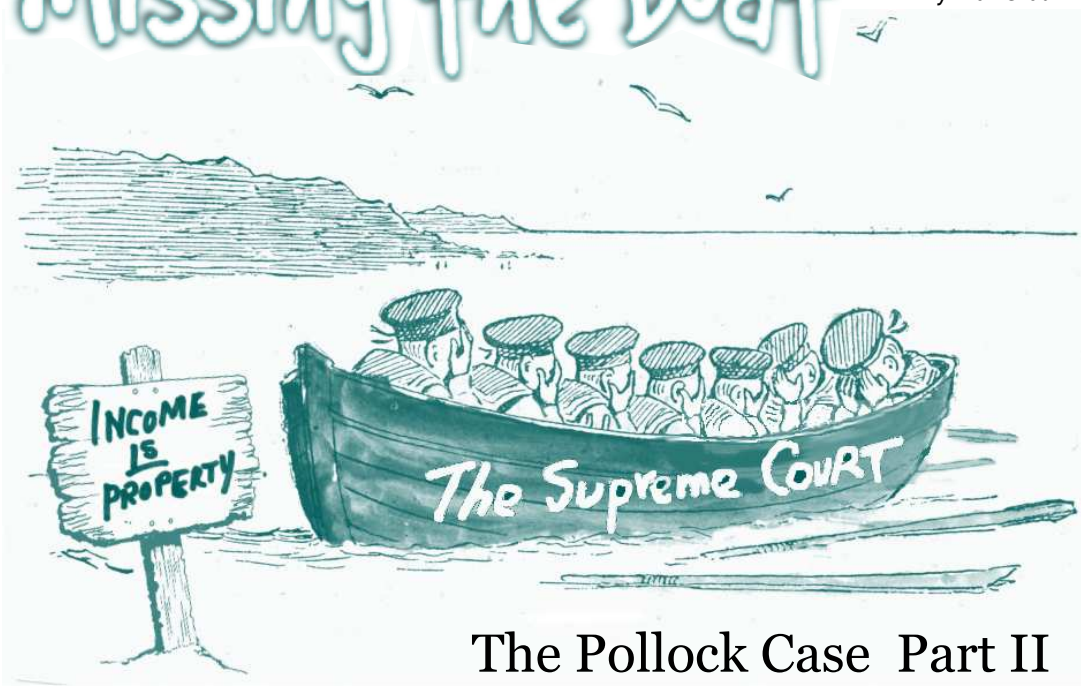
Missing the Boat

By Dick Greb



The Pollock Case Part II

Back in the August 2021 edition of the *Liberty Tree*, I began a discussion of a Supreme Court case from the end of the 19th century that is regularly ballyhooed by the tax honesty crowd. That case, of course, is *Pollock v. Farmers' Loan & Trust Company*. The full case was actually comprised of two separate decisions: the initial hearing was decided on April 8, 1895 (157 U.S. 429); and the rehearing was decided on May 20, 1895 (158 U.S. 601). The principle reason for its popularity is that it struck down the income tax imposed by sections 27 through 37 of the Act of Congress entitled "An Act to Reduce Taxation, to Provide Revenue for the Government, and for other purposes," enacted on August 27, 1894.[1] Unfortunately, that popularity is based for the most part on misunderstanding the *Pollock* decision. My purpose in pursuing this current series is to attempt to remedy that situation.

In the inaugural installment of the series I briefly showed the reasoning behind Justice Fuller's decision to invalidate the entire income tax scheme from the much larger tax act of 1894. However, in the initial hearing, only two points were decided. One was the taxability of interest received from municipal bonds. Such interest was held to be beyond the taxing power of the United States, because it impinged on the ability of the individual states to raise money for their operations. That is, by reducing the amount ultimately realized by the investors buying the bonds, states would be forced to increase the amount of interest they offered to pay, so as to compensate for the loss due to the tax. This increased cost is an impermissible burden on the states' operations. Note that this is an issue of taxability, not of method. Such interest simply cannot be taxed, neither directly nor indirectly. And the reciprocal is also true. The states cannot tax the interest on federal bonds, for the same reasons.

The other point decided, however, was a matter of method. The argument was never whether the feds could tax the income from real estate — that was a given, only whether such taxation must be by direct or indirect means. Of course, the government — which always prefers the mode less burdensome (to them) — went the indirect route, and Pollock's challenge was that it could only be done by the direct mode. After running through the facts of the case, Justice Fuller laid out the issue at hand.

> The first question to be considered is whether a tax on the rents or income of real estate is a direct tax within the meaning of the constitution. *Ordinarily, all taxes paid primarily by persons who can shift the burden upon some one else, or who are under no legal compulsion to pay them, are considered indirect taxes; but a tax upon property holders in respect of their estates, whether real or personal, or of the income yielded by such estates, and the payment of which cannot be avoided, are direct taxes.* Nevertheless, it may be admitted that, although this definition of direct taxes is prima facie correct, and to be applied in the consideration of the question before us, yet the constitution may

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1. 28 Stat. at L. 509, 553.

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bear a different meaning, and that such different meaning must be recognized.[2]

Taxes on real property are direct

You can see from this passage that Fuller recognized that the *prima facie* (on its face) correct distinction between direct and indirect taxes was the one espoused by James Madison, what I've referred to as the economic view. This in spite of the *Hylton* coup a century earlier, when the Federalists sought to eliminate that economic view as the determining factor. Fuller leaves open the possibility that the constitutional meaning may differ from the economic view, but then goes on to present more examples in agreement with it. In the course of this recital, quite a few of his examples clearly show that taxes on income would be direct, including a reference to Alexander Hamilton's argument in *Hylton*:

> The general line of observation was obviously influenced by Mr. Hamilton's brief for the government, in which he said: 'The following are presumed to be the only direct taxes: Capitation or poll taxes, taxes on lands and buildings, general assessments, whether ***on the whole property of individuals***, ***or on their whole real or personal estate***. All else must, of necessity, be considered as indirect taxes.'
>
> Mr. Hamilton also argued: 'If the meaning of the word 'excise' is to be sought in a British statute, it will be found to include the duty on carriages, which is there considered as an 'excise.' * * * An argument results from this, though not perhaps a conclusive one, yet, where so important a distinction in the constitution is to be realized, it is fair to seek the meaning of terms in the statutory language of that country from which our jurisprudence is derived.'
>
> ***If the question had related to an income tax, the reference would have been fatal, as such taxes have been always classed by the law of Great Britain as direct taxes.***[3]

Fuller also quotes from the debates in the House of Representatives on the carriage tax bill, where Rep. Theodore Sedgwick[4] "said that 'a capitation tax, and *taxes* on land and *on property and income generally, were direct charges*, as well in the immediate as ultimate sources of contribution."[5]

And finally, he quotes from Albert Gallatin's *Sketch of the Finances of the United States*, published in November, 1796:

> The most generally received opinion, however, is that, by direct taxes in the constitution, those are meant which are raised on the capital or revenue of the people; by indirect, such as are raised on their expense. ... [The use of the word 'capitation'] ***leaves little doubt that the framers of [the Constitution] by direct taxes, meant those paid directly from the falling immediately on the revenue; and by indirect, those which are paid indirectly out of the revenue by falling immediately upon the expense.***[6]

Each of the above quotes supports the position that a tax on income is direct. However, Fuller lets this slide as he works up to his main point:

> Be this as it may, it is conceded in all these cases, from that of *Hylton* to that of *Springer*, that taxes on land are direct taxes, and in none of them is it determined that taxes on rents or income derived from land are not taxes on land.[7]

He comes to this conclusion after running through a recital of earlier cases, apparently to counter the position of the dissenting judges who claimed the majority was overturning a century of previous precedents. Fuller showed that none of the prior cases dealt with this issue, and so there was no precedent to overturn. And he is correct in that assessment in the rather limited scope of income derived from land that was the focus in the original hearing.

Early in the majority opinion in the rehearing, Fuller broaches the wider scope to be discussed:

> We are now permitted to broaden the field of inquiry, and to determine to ***which of the two great classes a tax upon a person's entire income***, *whether derived from rents, or products, or otherwise, of real estate, or from bonds, stocks, or other forms of personal property,* ***belongs***; and ***we are unable to conclude*** that the enforced subtraction from the yield of all the owner's real or personal property, in the manner prescribed, is so different from a tax upon the property itself, ***that it is not a direct, but an indirect tax***, in the meaning of the Constitution.[8]

But, notice that although he makes reference to "a person's entire income," he qualifies it in the next phrase as being "derived from ... property." So, this decision extends the scope of the issue beyond the original 'income from real property' but only far enough to include 'income from personal property." And to my mind, this is the major shortcoming of the *Pollock* decisions. I'll pick up this thread a little later.

Taxes on personal property are direct

The progression Fuller established in the first hearing was: taxes on land are indisputably direct; income

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2. 157 US 429, 558 (1895); hereafter '1st'.
3. 1st, at 572.
4. Sedgwick was Representative for Massachusetts's 2nd congressional district as a Federalist from 1793 to 1795.
5. 1st, at 568.
6. 1st, at 570.
7. 1st, at 579.
8. US 601, 618 (1895); hereafter '2nd'.

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from land gives land its value; therefore, taxes on income from land are likewise direct. He then opens up the issue of personal property:

> We admit that it may not unreasonably be said that logically, if taxes on the rents, issues, and profits of real estate are equivalent to taxes on real estate, and are therefore direct taxes, taxes on the income of personal property as such are equivalent to taxes on such property, and therefore direct taxes.[9]

However, in that first hearing, the justices were evenly split on that question, and so it was argued again in the rehearing. Even so, there is little actual discussion related solely to the question of personal property. Rather, Fuller simply makes the jump from realty to personalty, as seen in the following passage:

> Whatever the speculative views of political economists or revenue reformers may be, can it be properly held that the Constitution, taken in its plain and obvious sense, and with due regard to the circumstances attending the formation of the government, authorizes a general unapportioned tax on the products of the farm and the rents of real estate, although imposed merely because of ownership and with no possible means of escape from payment, as belonging to a totally different class from that which includes the property from whence the income proceeds?
>
> There can be but one answer, unless the constitutional restriction is to be treated as utterly illusory and futile, and the object of the framers defeated. We find it impossible to hold that a fundamental requisition, deemed so important as to be enforced by two provisions, one affirmative and one negative, can be refined away by forced distinctions between that which gives value to property, and the property itself.
>
> ***Nor can we perceive any ground why the same reasoning does not apply to capital in personalty held for the purpose of income or ordinarily yielding income, and to the income therefrom.***[10]

So, the logic goes, since the value of invested personal property consists of the income derived from it, then it is no different from real property in that respect, and thus a tax on that income must be considered direct as well. This is correct also, but yet again, it avoids the larger context of income in general.

Taxes on income are direct

This is the elephant in the room that never gets properly decided. However, it's not because it was never addressed. In fact, Fuller's majority opinion in the rehearing discusses income in the general context much more than it discusses income from personal property. He makes extensive references to the Constitutional convention, the founding fathers' views and to the *Hylton* decision. He also refers to the treatment of income taxes under the laws of the several states, and under English law, since, as noted above, "it is fair to seek the meaning of terms in the statutory language of that country from which our jurisprudence is derived." With respect to such English law, Fuller says:

> ***In England, we do not understand that an income tax has ever been regarded as other than a direct tax.*** ... [A]lthough there was a partial income tax in 1758, there was no general income tax until Pitt's of 1799. Nevertheless, the income taxes levied by these modern acts, Pitt's, Addington's, Petty's, Peal's, and by existing laws, are all classified as direct taxes; and ***so far as the income tax we are considering is concerned, that view is concurred in by the cyclopedists, the lexicographers, and the political economists, and generally by the classification of European governments wherever an income tax obtains***.[11]

As for *Hylton*, Fuller extensively discusses the opinions of the various justices, but ignores their dicta to correctly come to the only issue actually decided (albeit an erroneous decision, as shown in my series on the case):

> What was decided in the *Hylton* case then was that a tax on carriages was an excise, and, therefore, an indirect tax.[12]

In other words, Fuller acknowledges that their century-old dicta cannot govern the question then before him.

In discussing the Constitutional provisions, Fuller recognized a couple of the issues I examined at length in the *Hylton* series; the protection manifested in tying direct taxes to voting strength; and the *inherent* inequalities of apportionment of direct taxes. However, unlike the justices in *Hylton* — who claimed such inequality was evidence that the tax could not have been meant to be considered direct — he correctly understood that the inequalities were intended by the founders.

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9. 1st, at 579.
10. 2nd, at 627.
11. 2nd, at 630.
12. 2nd, at 627.

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> ***If***, in the changes of wealth and population in particular states, ***apportionment produced inequality, it was an inequality stipulated for, just as the equal representation of the states, however small, in the Senate, was stipulated for.*** …
>
> The founders anticipated that the expenditures of the states, their counties, cities and towns would chiefly be met by ***direct taxation on accumulated property***, while they expected that those of the Federal government would be for the most part met by indirect taxes. And ***in order that the power of direct taxation by the general government should not be exercised, except on necessity***; and, when the necessity arose, should be so exercised as to leave the states at liberty to discharge their respective obligations, ***and should not be so exercised, unfairly and discriminatingly, as to particular states or otherwise, by a mere majority vote, possibly of those whose constituents were intentionally not subjected to any part of the burden, the qualified grant was made.***[13]

He had made the same point in the first hearing as well:

> Nothing can be clearer than that ***what the constitution intended to guard against was the exercise by the general government of the power of directly taxing persons and property within any state through a majority made up from the other states.*** It is true that ***the effect of requiring direct taxes to be apportioned*** among the states in proportion to their population ***is necessarily that the amount of taxes on the individual taxpayer in a state having the taxable subject-matter to a larger extent in proportion to its population than another state has, would be less than in such other state; but this inequality must be held to have been contemplated, and was manifestly designed to operate to restrain the exercise of the power of direct taxation*** to extraordinary emergencies, and to prevent an attack upon accumulated property by mere force of numbers.[14]

Fuller acknowledged that, "[a]t the time the Constitution was framed and adopted, under the systems of direct taxation of many of the states, taxes were laid on incomes from professions, business, or employments, as well as from 'offices and places of profit.'"[15] Yet, despite that acknowledgment, and the fact not one actual citation or quote was ever offered to oppose the argument that income taxes in general were direct (the *Springer* case[16] is never even mentioned in the rehearing!), the court ultimately refused to carry the decision to its natural and proper conclusion.

> We have considered the Act only in respect of the tax on income derived from real estate, and from invested personal property, and have not commented on so much of it as bears on gains or profits from business, privileges, or employments, in view of the instances in which taxation on business, privileges, or employments, has assumed the guise of an excise tax and been sustained as such.[17]

Income is property!

What seems to be missing from the entire charade is the simple yet undeniable fact that *income is property!* One doesn't need to look behind the income — to the source — to find the property being burdened, because the income is property. It's personal property. And, if as quoted above, "taxes on the income of personal property as such are equivalent to taxes on such [personal] property, and therefore direct taxes," then how can that not also extend to the species of personal property classified as 'income'? Is it to be supposed that by giving a special name to it, that that peculiar species of property is somehow transmogrified into non-property? Of course not. Constitutional protections cannot be so easily blown to the wind; or at least they shouldn't be.

One final point on this issue of income as property is the idea — mentioned in the quote by Alexander Hamilton above — that in order for a tax on property to be direct, it must be on the "whole property" of a person. But, if that was the determining factor of whether such tax was direct or indirect, it would be so easy to evade Constitional restrictions, they would be meaningless. For example, Congress could create any arbitrary distinction to divide every person's property into two categories, and then simply tax each of the two categories by separate tax acts. Since neither tax would be on the 'whole' property, then both could be indirect, even though the cumulative effect of the two laws, taken together, would be a tax on the whole. Or, easier still, Congress could just deduct some amount from the whole — say $1,000, or maybe $100, or maybe just $1 — and tax all the rest. Since it taxed something less than the 'whole property,' it could likewise be indirect. Since such easily defeated protections are no protection at all, these examples show that this 'whole property' scheme is unworkable.

The bottom line is that the black-robed liberty thieves came close, but still missed the boat in shooting down the 1894 income tax provision on the limited grounds that they chose. Stay tuned for further installments.

13. 2nd, at 621.
14. 1st, at 582.
15. 2nd, at 632.
16. *Springer v. United States*, 102 U.S. 586 (1880).
17. 2nd, at 635.