A TREATISE

ON THE LAW OF

INCOME TAXATION

UNDER FEDERAL AND STATE LAWS

BY

HENRY CAMPBELL BLACK

AUTHOR OF BLACK'S LAW DICTIONARY AND OF TREATISES ON JUDGMENTS, BANKRUPTCY, CONSTITUTIONAL LAW, INTERPRETATION OF LAWS, JUDICIAL PRECEDENTS, ETC.

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PREFACE

INCOME taxation as a source of public revenue has been in successful operation in Great Britain for more than a century, and today constitutes an important feature of the economic policy of most of the countries of continental Europe. In the United States it has been resorted to, experimentally or to meet special public needs, at various times in our history. But of late years it has so grown in favor with publicists and legislative bodies that it appears likely to become a permanent institution in many jurisdictions, and eventually to supersede all forms of taxation of personal property, as witness the Oklahoma statute of 1908, the elaborate and comprehensive enactment in Wisconsin in 1911, and, most important of all, the act of Congress of 1913. The economic phases of the subject have received much attention, but hitherto no American writer has discussed in detail its legal aspects or the application of the rules of law to the solution of the problems which inevitably arise in the administration of an income tax, and the few English text-books afford little or no assistance to the American lawyer. It has therefore seemed opportune to the present writer to prepare a systematic and comprehensive treatise on the law of Income Taxation, under both the federal statute and the laws of the various states, and the volume now offered to the public is the fruit of his endeavors in that behalf. The applicable authorities have been diligently collected, and it will be found that the text is supported by an exhaustive citation of the extant decisions, both of the federal and state courts, as well as by references to many English, Scotch, Canadian, and other decisions, with numerous rulings and decisions of the officers of the Treasury Department of the United States, opinions of Attorneys General, and other authorities, now for the first time collected in one volume. An appendix contains the full text of the act of Congress of 1913 and of the present income

tax laws of Wisconsin, Virginia, North Carolina, South Carolina, Oklahoma, and Hawaii, as well as the text of the federal income tax acts of 1862 to 1870, that of 1894, and the corporation excise tax law of 1909. These statutes are of the greatest importance for purposes of comparison and construction, being all in a sense in pari materia, and it has been thought well to give the reader an opportunity of studying them at large and in detail.

The following pages include a detailed discussion of the nature of income taxes in general, the constitutional and statutory provisions applicable thereto, the various constitutional objections to their validity and the decisions of the courts thereon, the rules for the construction of income tax laws, the various questions which arise in the practical determination of what constitutes taxable income, and concerning the persons and corporations subject to the tax, also the matter of exemptions and exceptions, deductions and allowances, the depreciation of property and equipment, and the amortization of bonds, and further, as to the time, form, and manner of making income tax returns, publicity of returns, penalties for delinquency, the assessment of the tax and appeals therefrom, the rate of taxation and its amount, the manner and process of collecting the income tax, including the new and important feature of collection "at the source," and the refunding and recovery of taxes illegally exacted.

It is hoped that the book will be found valuable not only to individual taxpayers and their legal advisers, but also to the financial officers of corporations, to local representatives of foreign companies and business houses, to American companies and firms doing business abroad, and to banks, bankers, and trust companies collecting foreign interest or dividends, all of whom have a direct interest in the taxation of incomes, and who, at least under the present federal statute, are in some measure charged with details in the administration of the law itself.

HENRY CAMPBELL BLACK.

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INCOME TAXATION

CHAPTER I

NATURE OF INCOME TAXES

§ 1. Definitions and General Considerations

An income tax is distinguished from other forms of taxation in this respect, that it is not levied upon property, nor upon the operations of trade and business or the subjects employed therein, nor upon the practice of a profession or the pursuit of a trade or calling, but upon the acquisitions of the taxpayer arising from one or more of these sources or from all combined, annually or at other stated intervals, and generally, but not necessarily, only upon the excess of such acquisitions over a certain minimum sum. It is not a tax upon accumulated wealth, but upon its periodical accretions. It is not a tax upon personal exertion for gain, whether combined with the employment of capital or not, but upon the fruits thereof. An income tax is in effect a tax upon earnings, taking that term in its broadest sense, and irrespective of the question whether the person whose income is taxed has actively earned it or has merely profited by loaning his capital for active employment by another.[1] The definition of

[1] "There is no tax which, in its essence, is more just and equitable than an income tax, if the statute imposing it allows only such exemptions as are demanded by public considerations and are consist-

an income tax as one which relates to the product or income from property or from business pursuits,[2] is sufficient for the purposes of a practical description, but is not scientifically accurate, since the term "income" may include acquisitions from other sources than those mentioned. For instance, money coming to one by gift or bequest is undoubtedly "income," though it is in the discretion of the taxing power to include it within the incidence of the tax or to exempt it. In the sense that it is imposed upon a limited and selected subject of taxation, an income tax may also be regarded as a special tax, rather than a general tax. Thus, in South Carolina, a general taxing act enacted in 1905 required the county auditors and treasurers to collect the taxes levied under its provisions, and forbade them to collect any other tax except such "special tax" as might be authorized under an act or joint resolution of the legislature. It was contended that this operated as a repeal of the income tax law of 1897. But the courts held otherwise, declaring that the income tax was a "special tax" within the meaning of the general statute.[3]

§ 2. Property Taxes Distinguished

A tax on incomes is not a tax on property, and a tax on property does not embrace incomes. Hence a municipal corporation which has authority by its charter to levy taxes for its own purposes on all "taxable property" does not possess

ent with the recognized principles of the equality of all persons before the law, and, while providing for its collection in ways that do not unnecessarily irritate and annoy the taxpayer, reaches the earnings of the entire property of the country, except governmental property and agencies, and compels those, whether individuals or corporations, who receive such earnings, to contribute therefrom a reasonable amount for the support of the common government of all." Dissenting opinion of Harlan, J., in Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108.

[2] Levi v. City of Louisville, 97 Ky. 394, 30 S. W. 973, 28 L. R. A. 480.

[3] Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 21 Am. & Eng. Ann. Cas. 193, 27 L. R. A. (N. S.) 864.

the authority to lay a tax on incomes.[4] For the same reason a tax laid on income is different from a tax laid on the property out of which the income arises, and although a statute may tax land at a different rate from that imposed on incomes, it is not therefore in conflict with a constitutional provision requiring that taxation on all species of property shall be uniform. As remarked by the Supreme Court of Georgia: "Gross earnings and interest coming in from any source, labor, capital, investment of any sort, or money loaned, are not property in the sense of the constitution, but are merely income. Certainly the gross earnings of a laboring man are nothing but his income. So it would seem the earnings of a salaried officer are income, and so the income from capital employed in a bank or railroad or manufacture would seem to be income only. The net income after the expenses are paid becomes property, when invested, or if it be money lying in a bank or locked up at home. The fact is, property is a tree, income is the fruit; labor is a tree, income the fruit; capital a tree, income the fruit. The fruit, if not consumed as fast as it ripens, will germinate from the seed which it incloses, and will produce other trees, and grow into more property; but so long as it is fruit merely, and plucked to eat and consumed in the eating, it is no tree and will produce itself no fruit." [5]

§ 3. Excise, Franchise, License and Occupation Taxes Distinguished

License and occupation taxes, which are payable in respect to the privilege of engaging in or carrying on a particular business or vocation, are not income taxes, notwithstanding the fact that the amount of tax payable by any individual may be measured by the amount of business which he transacts or his earnings therefrom. And conversely,

[4] City of Dubuque v. Northwestern Life Ins. Co., 29 Iowa, 9.
[5] Waring v. City of Savannah, 60 Ga. 93.

although a person's entire income may be derived from a particular pursuit or trade, a tax on the income as such is not a license or privilege tax. Thus, a tax on sales of a particular commodity, or a tax on the dealer measured by the amount of his sales, is not an income tax.[6] So, in Virginia, it appeared that a city ordinance provided that lawyers and others should be divided into six classes, and that those in each class should pay a certain sum as a tax. The committee on finance was to place each attorney in the class to which he properly belonged, looking to all the circumstances. After the committee had completed their classification, public notice was to be given, and any lawyer dissatisfied with his classification was to appear before the committee and have it corrected if erroneous. It was held that this was not an income tax, and the ordinance was valid.[7] Hence it appears that a person carrying on a certain business, as, for instance, a dealer in intoxicating liquors, may be subjected to a license tax for the privilege of pursuing that avocation, to a state or municipal tax for general purposes upon his stock in trade, and to a tax upon the income derived from his business, and yet, as all these taxes relate to different subjects and do not overlap or conflict, their imposition affords no legal ground for complaint.

Excise taxes include license fees and also some other forms of taxation, and these also are theoretically distinguishable from income taxes, although the practical difference is very slight in cases where the excise is measured by the income. And indeed it has sometimes been thought that an income tax should be classed as an excise tax, within the meaning of the federal Constitution. In the decision which overthrew the federal income tax law of 1894, one of the judges remarked: "Excises are a species of tax consisting gen-

[6] Commonwealth v. Brown, 91 Va. 762, 21 S. E. 357, 28 L. R. A. 110.

[7] Ould v. City of Richmond, 23 Gratt. (Va.) 464, 14 Am. Rep. 139.

erally of duties laid upon the manufacture, sale, or consumption of commodities within the country, or upon certain callings or occupations, often taking the form of exactions for licenses to pursue them. The taxes created by the law under consideration, as applied to savings banks, insurance companies, whether of fire, life, or marine, to building or other associations, or to the conduct of any other kind of business, are excise taxes, and fall within the requirement, so far as they are laid by Congress, that they must be uniform throughout the United States." [8]

But a franchise tax upon corporations is not an income tax, though it may be called an excise tax. And this is so whether the tax is laid by the state under whose laws the corporation is organized, and is exacted annually for the privilege of continuing its corporate existence, or is imposed by a different state for the privilege of doing business within its limits, or is imposed by an outside power, such as the United States, upon the franchise of transacting business in a corporate capacity. For this reason the tax on corporations imposed by the act of Congress of August 5, 1909, being laid specifically upon the carrying on or doing of business in a corporate or quasi corporate capacity, was adjudged not to be an income tax, although the amount of the tax in each instance was measured by the net annual income of the corporation, but an excise tax, and therefore not a direct tax, and therefore not invalid because not apportioned among the several states according to population.[9] Practically it makes but little difference to a corporation whether it is taxed upon its income or upon the value of its corporate privileges as measured by its income. But the theoretical distinction is valid, and its actual importance

[8] Per Field, J., concurring, in Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759.

[9] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

is shown by the fact that it was this distinction alone which ultimately saved the act of Congress of 1909 from the fate which befell that of 1894.

§ 4. Tax on Gross Receipts

In numerous states at the present time, various kinds of corporations and particularly railroad companies are not taxed directly upon their real and personal property, but upon their gross receipts. Whether or not a tax of this kind is to be regarded as an income tax is an unsettled question. It has been held in Louisiana that the term "income tax" includes a tax upon the gross receipts of a corporation or business.[10] But there is a contrary decision in Texas.[11] Certainly such a tax is not a general income tax, being restricted to corporations as distinguished from individuals, or even to certain classes of corporations. And it may clearly be regarded in the light of an excise tax, the subject of taxation being the transaction of business in a corporate capacity, and the receipts of the company serving only to measure the tax. Or perhaps, having regard to the use of this form of taxation as the sole means of assessing corporations, it may be considerd as in reality a tax on their property holdings, rather than an income tax, the amount being measured not so much by the market value of the property as by its profitableness, and its degree of profitableness being ascertained from the amount of the gross earnings.

§ 5. Income Tax as Direct Tax

In general usage, and according to the terminology of political economy, a direct tax is one demanded of the person who is expected to pay it and bear the expense of it without recoupment, while an indirect tax is demanded from one person in the expectation that he will indemnify him-

[10] Parker v. North British Ins. Co., 42 La. Ann. 428, 7 South. 599

[11] Galveston, H. & S. A. Ry. Co. v. Davidson (Tex. Civ. App.) 93 S. W. 436.

self at the expense of others.[12] When the question of the difference between direct and indirect taxes first came before the Supreme Court of the United States, in connection with the constitutional provision that "representatives and direct taxes shall be apportioned among the several states," it was held that the term "direct," as here used, was to be taken in a narrower sense than that above indicated; and it was ruled that only two classes of taxes could be considered as coming under this designation, namely, taxes on land and capitation taxes.[13] But these decisions have been overruled, and it is now held that income taxes, whether levied on the issues and profits of real estate or on the gains and interest from personal property, are also direct taxes within the meaning of the constitution.[14] The celebrated case in which this decision was made was twice before the Supreme Court, and in the course of the opinion filed on the second hearing it was said: "Our previous decision was confined to the consideration of the validity of the tax on the income from real estate, and on the income from municipal bonds. The question thus limited was whether such taxation was direct or not in the meaning of the Constitution; and the court went no further, as to the tax on the income from real estate, than to hold that it fell within the same class as the source whence the income was derived,—that is, that a tax upon the realty and a tax upon the receipts therefrom were alike direct; while, as to the income from municipal bonds, that could not be taxed because of want of power to tax the source, and no reference was made to the nature of the

[12] Brewers' Ass'n v. Attorney General [1897] App. Cas. 231; Black, Constitutional Law (3d edn.) p. 209.

[13] Springer v. United States, 102 U. S. 586, 26 L. Ed. 253; Pacific Ins. Co. v. Soule, 7 Wall. 433, 19 L. Ed. 95; Hylton v. United States, 3 Dall. 171, 1 L. Ed. 556.

[14] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759. And see Emery, Bird, Thayer Realty Co. v. United States, 198 Fed. 242.

tax, as being direct or indirect. 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." [15] For this reason, and by this decision, the income tax law of 1894 was pronounced unconstitutional. Since that time the Sixteenth Amendment to the Constitution has been adopted. But that amendment does not purport to declare that an income tax shall not be a direct tax. It only dispenses with the necessity of apportionment among the several states, so far as concerns a tax on incomes from whatever source derived. The decision of the Supreme Court above referred to has never been overruled, and it remains an authoritative declaration that a tax upon incomes is as much a direct tax as one laid upon land or personal property.

[15] Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108.

CHAPTER II

CONSTITUTIONAL AND STATUTORY PROVISIONS

§ 6. Provisions of United States Constitution

As originally adopted the Constitution of the United States contained the following provisions with reference to national taxation: "Representatives and direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective numbers" (Art. 1, § 2.) "The Congress shall have power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States" (Art. 1, § 8.) "No capitation or other direct tax shall be laid unless in proportion to the census or enumeration herein before directed to be taken." (Art. 1, § 9.) During the period of the Civil War and for some time thereafter, that is, between the years 1861 and 1870, successive acts of Congress imposed general taxation upon incomes derived from all sources, for the support of the federal government, without any attempt at apportionment among the states. But it was held by the courts that an income tax is not a direct tax and therefore does not require such apportionment, while the question of the "uniformity" of such acts under the constitutional provision above quoted does not appear to have been raised. But a similar statute enacted in 1894 was adjudged unconstitutional, in so far as it applied to incomes derived from the renting of real property or from the investment of personal property, for lack of apportionment, the

court now holding it to be a direct tax, and invalid so far as it applied to income derived from state or municipal bonds, on the ground that Congress had no rightful power to tax those subjects.[1] In so deciding, the Supreme Court advanced the suggestion that if the "ultimate sovereignty" desired to intrust to Congress a general power to tax incomes, it could be done by an amendment to the Constitution. Thereafter a constitutional amendment was proposed by act of Congress, submitted to the legislatures of the several states, ratified by the necessary majority, and proclaimed in 1913 as the Sixteenth Amendment. It is as follows: "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."

Is this amendment a grant of power or only the removal of a constitutional restriction? From the use of the words "from whatever source derived" it might be argued that it was the intention to bring within the taxing power of Congress certain subjects not previously included, such as income derived from the bonded debt of states or municipalities and the salaries of state officers. But this would appear to be a strained construction, because the lack of authority in the federal government to tax the subjects mentioned does not arise from any explicit provision of the Constitution, but from the relation between the states and the Union and the necessity of giving to each an entire immunity from possibly destructive taxation on the part of the other. That this was also the understanding of Congress in enacting the law of 1913 is shown by the fact that it expressly excludes "interest upon the obligations of a state or any political subdivision thereof," and also "the compensation of all officers and employees of a state or any political subdivision thereof."

On the other hand, the decision of the court in the Pollock

[1] Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108.

case was confined to the question of the constitutionality of the tax in so far as it bore upon income derived from real estate and from invested personal property. It was not decided that a tax upon income derived from business operations or from the practice of a trade or profession or the receipt of a salary was a direct tax, and this was explained by Mr. Justice Harlan, in his dissenting opinion, as equivalent to a declaration that no apportionment among the states would be necessary in so far as a tax upon incomes might be laid upon those subjects alone. It never was doubted that Congress possessed the power to tax incomes in so far as it could be done without infringing upon the rightful sovereignty of the states. The only question was as to the necessity of apportionment. On this question, the Supreme Court ruled that a tax on income derived from certain specified sources would require apportionment, while a tax on income derived from certain other sources would not. Now the Sixteenth Amendment, which was prompted by the decision in the Pollock case, and which need not have been proposed and adopted if it had not been for that decision, declares that there shall be no necessity of apportionment among the several states, nor any regard to the census or enumeration, for the purposes of a federal tax on incomes "from whatever source derived." It does not, therefore, enlarge the power of taxation previously possessed by Congress, but merely repeals certain parts of the existing Constitution which imposed a limitation upon the levying of one form of direct taxation, namely, an income tax.

§ 7. Provisions of State Constitutions

While it is probable that an express grant of authority in the constitution is not necessary to empower the legislature of a state to enact a general system of income taxation,[2] yet the imposition of an income tax is expressly authorized by

[2] See Glasgow v. Rowse, 43 Mo. 479.

the constitutions of several of the states.[3] But in some cases the power of the legislature is carefully restricted in this regard, especially with a view to avoiding double taxation or a burdensome accumulation of taxes, as in North Carolina, where the constitution provides that "the general assembly may tax trades, professions, franchises, and incomes, provided that no income shall be taxed when the property from which the income is derived is taxed."[4] In Wisconsin, the state which now possesses the most complete and detailed system of income taxation, it was at first doubted whether the original provision of the constitution was sufficiently broad to permit the levying of this kind of a tax. It was merely expressed as follows: "The rule of taxation shall be uniform, and taxes shall be levied upon such property as the legislature shall prescribe." This had been held as not expressly forbidding excise taxation, and therefore as admitting of a collateral inheritance tax,[5] but when a tax on incomes was proposed, the legislature (in 1905 and 1907) passed a resolution recommending an amendment to the section of the constitution above quoted by the addition of the following words: "Taxes may also be imposed on incomes, privileges, and occupations, which taxes may be graduated, and progressive and reasonable exemptions may be provided." This change was ratified by the people of the state at a general election held in 1908, and three years later (1911) the legislature enacted a statute laying a tax upon incomes and intended eventually to supersede all forms of personal property taxation.[6]

[3] See, for instance, Const. Cal., art. 13, § 11; Const. Tenn., art. 2, § 28; Const. Texas, art. 8, § 1; Const. Wis., art. 8, § 1.

[4] Const. N. Car., art. 5, § 3.

[5] Nunnemacher v. State, 129 Wis. 190, 108 N. W. 627, 9 L. R. A. (N. S.) 121.

[6] Const. Wis., art. 8, § 1. And see State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

§ 8. History of Income Tax Laws

In England, the first income tax law was proposed by Pitt, and was enacted by act of Parliament, January 9, 1799 [7] since which time, with occasional short lapses, income taxation has always formed a chief source of revenue in the United Kingdom. But the acts which have remained in force, with some modifications and minor changes, to the present time, and which have had a most important influence, by way of suggestion and precedent, upon the frame-work of all income tax laws in the United States, are the statutes of 1842 and 1853.[8]

In America, many states have at different times experimented with taxes of this kind, enacting, repealing, and sometimes re-enacting them, but few have continuously availed themselves of this source of revenue until comparatively recent times. Even as early as the colonial period statutes were here and there in force which did practically and substantially tax certain classes of incomes, though not by that name. Again, in the years between 1840 and 1850, laws of this character were sporadically enacted, as also in the following decade, when income tax laws were put in force in Alabama, Louisiana, and Missouri (among others), which are not now in force. But for all practical purposes the interest of the student of law and economics will center upon two foci, namely, the period of the Civil War and what may be called the period of present-day activity in income tax legislation, the latter beginning about 1894.

The first attempt of Congress to levy a tax of this kind was made in 1861, when it was sorely pressed with the burden of providing revenue to carry on the pending war. This act levied a tax upon practically all sources and kinds of income, but at varying rates, viz., three per cent upon incomes generally, one and one-half per cent upon interest on treasury notes and United States bonds, and five per cent on the in-

[7] Stat. 39 Geo. III, c. 13, 18 Stat. at L., p. 29.
[8] Stat. 5 & 6 Vict., c. 35; Stat. 16 & 17 Vict., c. 34.

comes of American citizens residing abroad. Annual incomes below $800 were exempted. The tax was to be levied and collected for only one year, that is, on the income of 1861, and no elaborate system for its collection was provided, administrative details being left to the regulation of the officers of the treasury department. In the following year, 1862, this act was re-enacted, but with very important changes. The exemption was now fixed at $600, and the tax was at the rate of three per cent on incomes between that minimum and the sum of $10,000, and five per cent on all incomes exceeding the latter amount, as also upon the incomes (irrespective of amount) of American citizens living abroad, except those in the service of the government. Salaries of persons in the employ of the United States, including senators and representatives in Congress, were exempted, and provision was also made for the deduction from taxable income of other taxes paid by the subject and also dividends received from corporations subject to tax. The statute was to be in force until and including the year 1866 and no longer, and taxable persons were required to make returns of their income. In the next year (1863) this act was amended by permitting the taxpayer to deduct from his taxable income rent paid for the dwelling house in which he resided. The income tax law of 1864, as amended in 1865, materially increased the burden of taxation, the exemption remaining as before, but the duty being now fixed at five per cent on incomes up to $5,000, and ten per cent on the excess over that sum. Several new features were now introduced, as, for instance, a partial attempt at "collection at the source" by taxing dividends declared by certain kinds of corporations and then permitting the stockholder to deduct the same from his estimate of income, and a like provision as to persons paid by the government. Now for the first time also we meet the provision that only one deduction of $600 shall be allowed from the aggregate incomes of the members of a family. Salaries paid to persons in the em-

ployment of the United States, including the members of Congress, were now subjected to the tax, as also premiums on gold. But the rental value of a homestead owned and occupied by the taxpayer was not to be included. Special provisions were made for estimating the income and the allowable deductions of farmers and stock-raisers. The life of the act was limited to the year 1870. It was amended in details in 1866 and 1867. Again in 1870 a statute was passed, to be in force only for that year and the one following, which imposed a flat tax of two and one-half per cent on income from all sources. These sources were elaborately defined and described, and it may be remarked that they were made to include interest accrued within the year but unpaid, if collectible, a stockholder's proportionate share of the undivided profits of the corporation, interest on United States securities and premiums on gold, the salaries of federal officers including members of Congress, and profits realized within the year from sales of real estate purchased within two years previous. The exemptions or deductions included the sum of $2,000 of income and also pensions under the laws of the United States, taxes paid, losses sustained and bad debts written off within the year, "but excluding all estimated depreciation of values," interest paid, and rent and the expenses of business. Consuls of foreign countries were exempted from the payment of the tax, so far as concerned their official emoluments and income from their property in foreign countries, but only in case their governments reciprocated. It is a significant fact that, during all this period, there was no attempt to tax corporations as such, except that the acts of 1862, 1864, and 1870 laid a tax on the dividends declared, and interest paid, by banks, trust companies, savings institutions, insurance companies, and railroads and other transportation companies.

The period of modern activity in income tax legislation was inaugurated by the enactment of the federal income tax

act of 1894. This statute was intended to expire by its own limitation in 1900, but in the year following its passage it was adjudged unconstitutional and therefore was not enforced. Allowing an exemption of $4,000, it imposed a tax of two per cent on all income above that amount, from whatever source derived, and a like tax upon the net earnings of all corporations doing business within the United States (not including partnerships), except corporations for charitable, religious, or educational purposes, fraternal benefit societies, mutual insurance companies, and certain kinds of building and loan associations and savings banks. It made some provision for collection of the tax at the source, and covered carefully the administrative features of such a tax, in regard to returns, the method of collection, the imposition and recovery of penalties, and conditions upon the publicity of the returns. But in other respects it did not differ very materially from the last and most elaborate of the earlier acts, that of 1870. The corporation excise tax law of 1909 imposed a tax of one per cent upon the entire net income (over and above $5,000) received in each year by "every corporation, joint stock company or association organized for profit and having a capital stock represented by shares, and every insurance company," whether organized under state or territorial or federal laws, or organized under the laws of a foreign country and engaged in business in any state and territory of the United States. In its main features, this statute very closely resembled that act of 1894, in so far as the latter was applicable to corporations. But the tax laid by the act of 1909 was specifically denominated a "special excise tax," and was declared to be imposed "with respect to the carrying on or doing business by such corporation." This was in reality an income tax very thinly disguised, and restricted to corporations. But the theoretical distinction between a tax on income and a tax on the privilege of doing business in a corporate capacity, as measured by income, afforded suffi-

cient ground for the courts to hold that it was not a direct tax and therefore not in conflict with the constitution.[9] Finally, as concerns the activity in this direction of the United States government, the tariff act of 1913 contained a section imposing a tax upon the incomes of both individuals and corporations. This statute will not now be discussed in detail, as its provisions will form a principal subject for consideration in the following pages.

The act of 1913, it should be remarked, supersedes and repeals the corporation excise tax law of 1909. But in order that corporations may not escape taxation for any part of the year 1913, that year is divided into two portions, as to one of which the excise tax is to be assessed and collected, and as to the other the income tax. The act provides that "an excise tax upon the doing of business, equivalent to one per centum upon their entire net income, shall be levied, assessed, and collected upon corporations, joint stock companies or associations, and insurance companies, of the character described in section 38 of the act of August 5, 1909, for the period from January first to February twenty-eighth, 1913, both dates inclusive, which said tax shall be computed upon one-sixth of the entire net income of said corporations, joint stock companies or associations, and insurance companies, for said year." And the provisions of the act of 1909, "relative to the collection of the tax therein imposed, shall remain in force for the collection of the excise tax herein provided." As to the remainder of the year, the imposition of the income tax upon any corporation subject to its terms is effected by a requirement that "said tax shall be imposed upon its entire net income accruing during that portion of said year (1913) from March first to December thirty-first, both dates inclusive, to be ascertained by taking five-sixths of its entire net income for said calendar year." But for the year 1913 "it

[9] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

shall not be necessary to make more than one return and assessment for all the taxes imposed herein upon said corporations, joint stock companies or associations, and insurance companies, either by way of income or excise, which return and assessment shall be made at the times and in the manner provided in this act. But the repeal of existing laws or modifications thereof embraced in this act shall not affect any act done, or any right accruing or accrued, or any suit or proceeding had or commenced in any civil case before the said repeal or modification; but all rights and liabilities under said laws shall continue and may be enforced in the same manner as if said repeal or modifications had not been made. Any offenses committed and all penalties or forfeitures or liabilities incurred prior to the passage of this act under any statute embraced in or changed, modified, or repealed by this act may be prosecuted or punished in the same manner and with the same effect as if this act had not been passed."

As regards the legislation of the states in the more recent period, it may be mentioned that an income tax law, not very complete or detailed, was enacted in North Carolina in 1907, a somewhat similar act by South Carolina in 1902, an act closely resembling that of North Carolina by Oklahoma in 1907, a short statute, but intended to include all kinds of income, by Virginia in 1903 and amended in 1908, a comprehensive statute, modeled on the various acts of Congress, by the territory of Hawaii in 1901, and a very long and detailed income tax law by Wisconsin in 1911. In addition to these, there are special and restricted income tax provisions in force in Massachusetts and Tennessee, brought down from earlier legislation in those states and included in their later codes or revisions.

§ 9. Income Tax Laws in Force

From the foregoing historical review it will be seen that income tax laws are now in force not only for the United

States generally, by the legislation of Congress, but also in and for the following states and territories: Wisconsin, Virginia, North Carolina, South Carolina, Massachusetts, Tennessee, Oklahoma, and Hawaii. The text of all these statutes, including the acts of Congress passed between 1861 and 1870 and the act of 1894 and the corporation tax law of 1909, as well as the federal income tax law of 1913, will be found printed in full in the appendix to this volume.

But it is not alone in America that taxation of incomes has been resorted to as a rich source of governmental revenue. On the contrary,—in some cases only from recent times, but in others for more than a century—the income tax has been, and is still, employed in England and several of her colonies, in Norway, Sweden, and Denmark, in Prussia, Austria, and Italy, and in fact in practically all the great civilized nations of the world, with the exception of France. As observed by the court in Wisconsin, in considering the validity of the statute of that state: "It may be well to note that income taxation is no new and untried experiment in the field of taxation. It has been in use in various forms, and generally with the progressive feature, by many of the civilized governments of the world for decades, which in some instances run into centuries. It has been used at various times by nearly or quite twenty of our own states, and is now in use in several of them. It was used for a brief period by the government of the United States, and is now in successful operation in practically all of the great nations of the civilized world, except the United States." [10] As to the last sentence, it should be remembered that this was written in 1912, and the exception then noted has now ceased to exist.

[10] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

§ 10. Economic Aspects of Income Taxation

Although we are here concerned rather with the legal aspects of the income tax laws than with their economic justification, it may be well to add what has been said on this subject by one or two authorities. As to this method of raising revenue, "the fundamental idea upon which its champions rest their argument in its favor is that taxation should logically be imposed according to ability to pay, rather than upon the mere possession of property, which for various reasons may produce no revenue to the owner. It is argued that there should be as nearly as practicable equality of sacrifice among the various taxpayers, and that a tax levied at an uniform or proportional rate can rarely, if ever, produce equality of sacrifice; that one per cent of a small income, which just suffices to support its owner, is a far larger relative contribution to the public treasury than one per cent of an income so large that it cannot be exhausted by the owner, except by means of lavish and extravagant expenditures."[11] "In theory an income tax is an ideal one. Much property is necessarily carried by citizens of a state that is unproductive, and hence yields but little income out of which taxes may be paid; while, on the other hand, if the state only demands a part of the income actually earned, it works no hardship on its citizens. If each man paid taxes according to his income, those who have most would pay most, and those who have least would pay least."[12]

[11] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

[12] Report of Minnesota State Tax Commission, 1910.

CHAPTER III

CONSTITUTIONAL VALIDITY OF INCOME TAX LAWS

§ 11. Requirement of Due Process of Law

As applied to the levy, assessment, and collection of taxes, the constitutional requirement of due process of law does not mean that either the validity of the tax or the liability of the particular person or property should be adjudicated by a court of justice. Nor does it mean that personal notice should be given to the taxpayer of each or any step in the proceedings. It is enough if he is informed of the amount for which he is to be charged, and is afforded an opportunity to contest the legality of the tax, the question of his liability to it, or the amount of his assessment, before some board or tribunal empowered to give him all the relief which justice may demand, though it be a board of administrative officers in the

first instance, with a final appeal to the courts.[1] As this method of procedure has commonly been prescribed by the income tax laws, their constitutional validity has been upheld as against the contention that they deprived the citizen of his property without due process of law.[2] In one of the cases dealing with this question it was said: "The claim that the act deprives the plaintiff of his property without due process of law, and denies him the equal protection of the laws, raises questions under the federal constitution, upon which the decisions of the Supreme Court of the United States are authoritative and controlling. In solving these questions we must therefore be guided by the decisions of that court. In the Kentucky Railroad Tax Cases, 115 U. S. 321, 6 Sup. Ct. 57, 29 L. Ed. 414, the court considered a statute of the state of Kentucky, which involved both these constitutional guaranties. Upon the question of what is due process of law, in the matter of levying and collecting taxes, the court, by Mr. Justice Matthews, said: 'It has been repeatedly decided by this court that the proceedings to raise the public revenue by levying and collecting taxes are not necessarily judicial, and that due process of law, as applied to that subject, does not imply or require the right to such notice and hearing as are considered to be essential to the validity of the proceedings and judgments of judicial tribunals. Notice by statute is generally the only notice given, and that has been held sufficient. "In judging what is due process of law," said Mr. Justice Bradley in Davidson v. New Orleans, 96 U. S. 97, 24 L. Ed. 616, "respect must be had to the cause and object of the taking, whether under the taxing power, the power of eminent domain, or the power of assessment for local improvements, or none of these; and if found to be suitable or admissible in

[1] Black, Const. Law (3d edn.) p. 580.

[2] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389; Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 21 Am. & Eng. Ann. Cas. 193, 27 L. R. A. (N. S.) 864.

the special case, it will be adjudged to be due process of law, but if found to be arbitrary, oppressive, and unjust, it may be declared to be not due process of law." In its application to proceedings for the levy and collection of taxes, it was said in McMillen v. Anderson, 95 U. S. 37, 42, 24 L. Ed. 335, that it "is not, and never has been, considered necessary to the validity of a tax that the party charged should have been present, or had an opportunity to be present, in some tribunal, when he was assessed." This language, it is true, was used in the decision of a case in reference to a license tax, where all the circumstances of its assessment were declared by statute, and nothing was intrusted to the discretion of public officers; but in the State Railroad Tax Cases, 92 U. S. 575, 610, 23 L. Ed. 663, where the ascertainment of the taxable value of railroads was the duty of a board, as in the present case, whose assessment was challenged for the reason that the proceedings were not due process of law, and for want of notice and a hearing, it was said by Mr. Justice Miller, delivering the opinion of the court: "This board has its time of sitting fixed by law. Its sessions are not secret. No obstruction exists to the appearance of any one before it to assert a right or redress a wrong, and, in the business of assessing taxes, this is all that can be reasonably asked." ' " [3]

§ 12. Requirement of Equality and Uniformity

"Property," as the term is used in reference to taxation, means the corpus of an estate or investment, as distinguished from the annual gain or revenue from it. Hence a man's income is not "property" within the meaning of a constitutional requirement that taxes shall be laid equally and uniformly upon all property within the state.[4] For this rea-

[3] Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 21 Am. & Eng. Ann. Cas. 193, 27 L. R. A. (N. S.) 864, citing also Cass Farm Co. v. Detroit, 181 U. S. 396, 21 Sup. Ct. 644, 45 L. Ed. 914.

[4] Waring v. Savannah, 60 Ga. 93; Glasgow v. Rowse, 43 Mo. 479.

son, no valid objection to an income tax on constitutional grounds can be based on the fact that it may exempt certain classes of persons or corporations while taxing others, or that it may be graduated or progressive, bearing with increasing severity upon the citizen in proportion as his income increases. Whatever force such objections might possess as applied to a general property tax, a tax on incomes is not included in the constitutional requirement.[5] And where the provision of the constitution is broader,—as, that "taxation shall be equal and uniform,"—still it is said, in relation to income taxes, that this requirement is satisfied by such regulations as will secure an equal rate and just valuation, without reference to the method of valuation, and in order to be uniform a tax need not be imposed and assessed upon all property by the same agency or officers.[6] So, as regards the provision of the federal constitution that taxes imposed by act of Congress shall be "uniform throughout the United States," it is said that the uniformity here required is a geographical uniformity, which does not require the equal application of the tax to all persons or corporations who may come within its operation, and hence taxing a business when carried on by a corporation, and exempting a similar business when carried on by a partnership or by a private individual, as was done by the corporation excise tax law of 1909, does not invalidate the tax.[7]

§ 13. Equal Protection of the Laws

Income tax laws have commonly contained provisions classifying the subjects of taxation, discriminating between individuals and corporations, or between residents and non-

[5] Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 21 Am. & Eng. Ann. Cas. 193, 27 L. R. A. (N. S.) 864.

[6] Commonwealth v. Brown, 91 Va. 762, 21 S. E. 357, 28 L. R. A. 110.

[7] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

residents, exempting certain classes of companies or those engaged in certain pursuits, allowing deduction of some items and not of others, and altogether releasing from taxation incomes below a certain minimum and imposing a gradually increasing burden upon incomes above that sum. On account of these features they have always been urgently assailed as denying the "equal protection of the laws." But without avail. This provision, it is held, does not prevent such reasonable classifications and distinctions as those mentioned. Thus, in a decision sustaining the income tax law of the territory of Hawaii, it was said that the clause in the Fourteenth Amendment to which reference is made does not require taxes to be levied by a uniform method and at the same rate upon every class of property, but the manner of taxation with respect to each class is left to the legislative discretion.[8] Again: "The provision in the Fourteenth Amendment that no state shall deny to any person within its jurisdiction the equal protection of the laws was not intended to prevent a state from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all, such as churches, libraries, and the property of charitable institutions. It may impose different specific taxes upon different trades and professions, and may vary the rates of excise upon various products; it may tax real estate and personal property in a different manner; it may tax visible property only and not tax securities for payment of money; it may allow deductions for indebtedness or not allow them. All such regulations and those of like character, so long as they proceed within reasonable limits and general usage, are within the discretion of the state legislature, or the people of the state in framing their constitution. But clear and hostile discriminations against particular persons and classes, especially such as are of an unusual character, unknown to

[8] Peacock v. Pratt, 121 Fed. 722, 58 C. C. A. 48.

the practice of our government, might be obnoxious to the constitutional prohibition. It would, however, be impracticable and unwise to attempt to lay down any general rule or definition on the subject that would include all cases. They must be decided as they arise. We think that we are safe in saying that the Fourteenth Amendment was not intended to compel the states to adopt an iron rule of equal taxation. If that were its proper construction, it would not only supersede all those constitutional provisions and laws of some of the states whose object is to secure equality of taxation, and which are usually accompanied with qualifications deemed material, but it would render nugatory those discriminations which the best interests of society require, which are necessary for the encouragement of needed and useful industries, and the discouragement of intemperance and vice, and which every state, in one form or another, deems it expedient to adopt." [9] And again, "there is no general supervision on the part of the nation over state taxation, and in respect to the latter the state has, speaking generally, the freedom of a sovereign both as to the objects and methods. It was well said in the opinion of the circuit court in this case that there can at this time be no question, after the frequent and uniform expressions of the federal Supreme Court, that it was not designed by the Fourteenth Amendment to the constitution to prevent a state from changing its system of taxation in all proper and reasonable ways, nor to compel the states to adopt an ironclad rule of equality, to prevent the classification of property for purposes of taxation, or the imposition of different rates upon different classes. It is enough that there is no discrimination in favor of one as against another of the same class, and the method for the assessment and collection of the tax is not

[9] Bell's Gap R. R. Co. v. Pennsylvania, 134 U. S. 232, 10 Sup. Ct. 533, 33 L. Ed. 892.

inconsistent with natural justice." [10] Particularly with reference to the progressive or graduated features of a tax law (though the statute in question was an inheritance tax law and not an income tax law) the Supreme Court of the United States, sustaining the validity of the law, said: "What satisfies this equality has not been, and probably never can be, precisely defined. Generally it has been said that it only requires the same means and methods to be applied impartially to all the constituents of each class, so that the law shall operate equally and uniformly upon all persons in similar circumstances." [11] And the court in South Carolina remarks: "The right of the legislature of the state to make reasonable classifications of persons and property for public purposes has been so often affirmed by the courts that it can no longer be questioned. If the classification is not arbitrary,—that is, if it bears reasonable relation to the purposes to be effected,—and if the constituents of each class are all treated alike, under similar circumstances and conditions, the rule of equality is satisfied." [12] So the Supreme Court of Wisconsin declares: "The sum and substance of it is that the Fourteenth Amendment never was intended to lay upon the states an unbending rule of equal taxation. The states may make exemptions, levy different rates upon different classes, tax such property as they choose, and make such deductions as they choose, and so long as they obey their own constitutions and proceed within reasonable limits and general usage, there is no power to say them nay." [13]

[10] Michigan Cent. R. Co. v. Powers, 201 U. S. 245, 26 Sup. Ct. 459, 50 L. Ed. 744.

[11] Magoun v. Illinois Trust & Savings Bank, 170 U. S. 283, 18 Sup. Ct. 594, 42 L. Ed. 1037.

[12] Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 21 Am. & Eng. Ann. Cas. 193, 27 L. R. A. (N. S.) 864.

[13] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

The same principles apply to the validity of any income tax law enacted by Congress. Although the provision against laws denying the equal protection of the law applies only to the legislation of the states, it is probable that other clauses of the Constitution could be found which would stand in the way of any act of Congress containing arbitrary, invidious, or unreasonable discriminations against individuals or classes. But within reasonable limits, "we must not forget that the right to select the measure and objects of taxation devolves upon the Congress, and not upon the courts, and such selections are valid unless constitutional limitations are overstepped. It is no part of the function of a court to inquire into the reasonableness of the excise, either as respects the amount or the property upon which it is imposed." [14]

§ 14. Discrimination Between Corporations, Partnerships, and Individuals

The substantial difference between the rights, privileges, duties, and business methods of corporations and those of individuals engaged in business has been thought to afford a reasonable basis for placing them in different classes, for the purposes of taxation. Hence an income tax law cannot be adjudged invalid, as making unjust or illegal discriminations, because it imposes a different rate of taxation upon the income of corporations from that imposed on the income of individuals, or because it exempts the income of the individual below a certain sum, but does not grant a similar exemption to corporations.[15] As to the latter point, in particular, the theory is that an exemption of a minimum income is granted to the individual in lieu of a deduction for personal and

[14] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

[15] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147; Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389; Robertson v. Pratt, 13 Hawaii, 590.

family expenses, and that no rule of justice requires a similar allowance to corporations, which have no such expenses, a deduction of other necessary expenses being granted in both cases.[16] For similar reasons, there is a sufficient ground for classification between individuals and partnerships in the imposition of an income tax. And the Wisconsin statute was sustained by the Supreme Court of that state, against the contention that it made an unjust discrimination in allowing exemptions to individuals which were denied to partnerships. It was said: "A partnership ordinarily has certain distinct and well-known advantages in the transaction of business over the individual, arising from the fact that it allows a combination of capital, brains, and industry, and thus makes it possible to accomplish many things which an individual in the same business cannot accomplish. Further than this, however, there is another consideration. If the partner have individual income from other sources than the partnership business (as many do), his exemptions will be allowed to him out of the individual income, and thus, if he were also allowed exemptions from the partnership income, he would be allowed double exemptions. Altogether there seems to be ample reason for the classification." [17]

§ 15. Discrimination Between Residents and Non-Residents

Very serious objections have been urged against the various income tax laws, on account of the discriminations which they have ordinarily made as between residents and non-residents or citizens and aliens. It has been adjudged that the legislature may put foreign insurance companies in a class by themselves, and tax them at the rate of one per cent on their gross incomes, while other persons and corporations are taxed

[16] Robertson v. Pratt, 13 Hawaii, 590.

[17] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

two per cent on their net incomes and one per cent on their property.[18] But has a state any lawful power to tax the income, or any part of the income, of a non-resident, or the United States to tax the income of a person residing abroad, whether a citizen or an alien? If so, is it an unlawful discrimination to grant exemptions to residents and deny them to non-residents? Or to tax the entire income of the resident citizen, and to tax only so much of the income of the non-resident as is derived from sources within the state? And in the latter case, how is the validity of the law affected by the fact that part of the non-resident's taxed income may be derived from business or operations in the nature of interstate commerce? Further, is it essential to the validity of the statute that its administrative features, in regard to the assessment and collection of the tax, should be the same in the case of residents and non-residents?

It cannot be said that these questions have, as yet, been authoritatively settled by the courts. They were strongly urged upon the Supreme Court of Wisconsin in the case which tested and sustained the constitutionality of the income tax law of that state. But as they were not necessarily implicated in the case, and as the court held that, even conceding the invalidity of the particular features of the law which were objected to, that would not be sufficient ground for pronouncing it unconstitutional as a whole, no positive decision was rendered.[19] But the opinion of the court contains so full a statement of the questions referred to, and of the considerations which might affect their decision, as to require quotation at some length. Among other things, it was said: "It is argued that the provisions which deny to non-residents the exemptions which are allowed to residents, and which allow the board of review to increase the assessment of a non-resident without

[18] Robertson v. Pratt, 13 Hawaii, 590.

[19] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

notice, while requiring notice to be given to a resident, violate section 2 of article 4 of the federal Constitution, which provides that 'the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.' The question of the validity of the provision allowing exemptions to residents of the state and denying them to non-residents is raised, and receives some attention in the briefs, but was not mentioned in the oral arguments. We regard it as a question involved in considerable doubt, and one not necessary to be passed upon now. It cannot be imagined for a moment that the legislature would have failed to pass the act had it not contained this provision, and we prefer to wait until the question is presented in a concrete case, at which time there will be opportunity to fully consider it after comprehensive briefs and arguments. It seems that the Supreme Court of the United States decided, in Ward v. Maryland, 12 Wall. 418, 20 L. Ed. 449, that one of the privileges and immunities protected by the section quoted is the right to be exempt from any higher taxes or excises than are imposed by the state upon its own citizens. Other decisions relied on upon the same side are In re Stanford's Estate, 126 Cal. 112, 54 Pac. 259, 45 L. R. A. 788, and Sprague v. Fletcher, 69 Vt. 69, 37 Atl. 239, 37 L. R. A. 840, and the cases cited in the latter case. On the other side reliance is placed on the analogy of the laws providing for exemptions from execution seizure, which confine their benefits to residents, and upon Travelers' Insurance Co. v. Connecticut, 185 U. S. 364, 22 Sup. Ct. 673, 46 L. Ed. 949."

Again, in the same opinion, referring to certain sections of the income tax law, it was said: "The first of these sections provides, in substance, that a resident shall be taxed upon all of his income arising from rentals, stocks, bonds, securities, or evidences of debt, whether the same be derived from sources within or without the state, but that the non-resident shall only be taxed upon income derived from sources within the state or

within its jurisdiction, but that any person doing business both within and without the state shall, as respects that part of his income not derived from rentals, stock, bonds, and securities, be taxed only on that proportion thereof which is derived from business transacted and property located within the state, to be determined in the manner specified in subdivision 'e' of section 1770b, of the Statutes, as far as applicable. The general purpose of the section is quite evident, namely, to tax a resident upon his whole income, and a non-resident only upon his income plainly derived from sources within the territorial jurisdiction of the state, and to provide that, where either person is engaged in a business interstate in its character, he shall only be taxed on that portion of the income derived from business transacted and property located within the state, according to the rule prescribed in section 1770b for determining that proportion of capital stock of a foreign corporation doing business in this state, which must be reported to the Secretary of State. The rule so imported into the statute is an arbitrary rule, and need not be stated at length in the view we now take of our duty with regard to this contention. Two fundamental objections are made to this section: First, that the state cannot tax the incomes of non-residents, no matter from what source derived; and second, that the attempt to tax a part of the profits derived from an interstate business, under the rule adopted, must necessarily result in a taxation of the receipts of interstate commerce, and hence a regulation thereof, which is in violation of that clause of the federal Constitution which gives to Congress the power to regulate commerce between the states. We shall decide neither of these questions now. If the section be open to either or both of these objections, or any others, we cannot regard that fact as fatal to the act. The legislature evidently intended to avoid both of the objections made. They had a difficult and delicate subject to deal with. Had they been authoritatively informed that they could not constitutionally tax a non-resident's income at all, and could

not divide the income derived partially from state and partially from interstate business, we have no idea that they would on that account have abandoned their purpose to pass the law. Again, if they provided an improper rule for the division (conceding that a division can be made at all), there seems no reason why the rule may not be rejected and the proper rule, which will carry out the fundamental purpose of the provision, be used. In any event, we are fully satisfied that the rejection of any or all of the provisions objected to in this section cannot reasonably be held to invalidate the whole act."

And again, it was remarked: "A strong argument is made attacking the validity of section 1087, m, 22, which provides in substance that the income of a resident derived from different political subdivisions of the state shall be combined for the purpose of determining the exemptions and the rate, while the income of a non-resident is to be separately assessed and taxed in each of the municipalities from which it is derived. A table is submitted showing that under this rule if A., a resident, derived $1,000 from each of 13 different towns or cities, he will be required to pay a tax of $367, because his income is aggregated, and consequently becomes in large part subject to the higher rates, while if B., a non-resident, receives the same income from the same sources, he will only pay the smallest rate, i. e., one per cent of each $1,000, amounting to only $130. This, it is said, is unjust discrimination against the residents of the state, and deprives them of the privileges and immunities which are granted to the citizens of other states, in violation of the federal Constitution. This presents the question whether such a discrimination can be made between residents and non-residents, only this time the discrimination seems to be against the resident and in favor of the non-resident. This question, also, we deem one not necessary to be decided now, and we intimate no opinion upon it. It does not seem that the case will frequently arise, but if it does, it can

be then treated. We do not regard it as in any respect important in considering the validity of the act as a whole."

§ 16. Federal Taxation of Corporations Created by States

When the constitutionality of the federal corporation tax law of 1909 was attacked before the Supreme Court of the United States, the objection was very strongly urged that, for the federal government to impose a tax on corporations which received their franchises from the states was beyond its rightful authority, inasmuch as it was imposing a burden upon the right of the several states to create corporations, which might be pushed to such an extreme as to destroy that right, and hence an invasion of their prerogatives, and the crippling of a power rightfully belonging to them as separate governments. The act of 1909 purported to lay a tax on the privilege of engaging in or carrying on business in a corporate capacity, the amount of the tax to be measured by the net income of the corporation. The act of 1913 taxes the income of corporations directly and by name. But the same argument, if it had prevailed against the one statute, would be equally potent as against the other. Hence it becomes important to consider the decision of the Supreme Court in which this argument was tested and rejected.[20] The court said: "It is next contended that the attempted taxation is void because it levies a tax upon the exclusive right of a state to grant corporate franchises, because it taxes franchises which are the creation of the state in its sovereign right and authority. This proposition is rested upon the implied limitation upon the powers of national and state governments to take action which encroaches upon or cripples the exercise of the exclusive power of sovereignty in the other. It has been held in a number of cases that the state cannot tax franchises created by the United States or the

[20] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

agencies or corporations which are created for the purpose of carrying out governmental functions of the United States. An examination of these cases will show that in each case where the tax was held invalid, the decision rested upon the proposition that the corporation was created to carry into effect powers conferred upon the federal government in its sovereign capacity, and the attempted taxation was an interference with the effectual exercise of such powers.[21] * * * We must therefore enter upon the inquiry as to implied limitations upon the exercise of the federal authority to tax because of the sovereignty of the states over matters within their exclusive jurisdiction, having in view the nature and extent of the power specifically conferred upon Congress by the Constitution of the United States. We must remember, too, that the revenues of the United States must be obtained in the same territory, from the same people, and excise taxes must be collected from the same activities, as are also reached by the states in order to support their local government. While the tax in this case, as we have construed the statute, is imposed upon the exercise of the privilege of doing business in a corporate capacity, as such business is done under the authority of state franchises, it becomes necessary to consider in this connection the right of the federal government to tax the activities of private corporations which arise from the exercise of franchises granted by the state in creating and conferring powers upon such corporations. We think it is the result of the cases heretofore decided in this court that such business activities, though exercised because of state-created franchises, are not beyond the taxing power of the United States. Taxes upon rights exercised under grants of state franchises were

[21] Citing McCulloch v. Maryland, 4 Wheat. 316, 4 L. Ed. 579; Osborn v. Bank of United States, 9 Wheat. 738, 6 L. Ed. 204; Union Pac. R. Co. v. Peniston, 18 Wall. 5, 21 L. Ed. 787; California v. Central Pac. R. Co., 127 U. S. 1, 8 Sup. Ct. 1073, 32 L. Ed. 150.

sustained by this court.[22] * * * The cases unite in exempting from federal taxation the means and instrumentalities employed in carrying on the governmental operations of the state. The exercise of such rights as the establishment of a judiciary, the employment of officers to execute and administer the laws, and similar governmental functions, cannot be taxed by the federal government.[23] But this limitation has never been extended to the exclusion of the activities of a merely private business from the federal taxing power, although the power to exercise them is derived from an act of incorporation by one of the states. We therefore reach the conclusion that the mere fact that the business taxed is done in pursuance of authority granted by a state in the creation of private corporations does not exempt it from the exercise of federal authority to levy excise taxes upon such privileges. * * * Nor is the special objection tenable, made in some of the cases, that the corporations act as trustees, guardians, etc., under the authority of the laws or courts of the state. Such trustees are not the agents of the state government in a sense which exempts them from taxation because executing the necessary governmental powers of the state. The trustees receive their compensation from the interests served, and not from the public revenues of the state."

§ 17. Taxation of Income from Non-Taxable Property

In passing upon the constitutionality of the United States income tax law of 1894, the Supreme Court held that, in so far as the act levied a tax upon the income of persons or corporations derived from the bonds of municipal corporations, it was

[22] Citing Michigan Cent. R. Co. v. Collector, 100 U. S. 595, 25 L. Ed. 647; United States v. Erie R. Co., 106 U. S. 327, 1 Sup. Ct. 223, 27 L. Ed. 151; Spreckels Sugar Ref. Co. v. McClain, 192 U. S. 397, 24 Sup. Ct. 376, 48 L. Ed. 496.

[23] Citing Collector v. Day, 11 Wall. 113, 20 L. Ed. 122; United States v. Baltimore & O. R. Co., 17 Wall. 322, 21 L. Ed. 597; Ambrosini v. United States, 187 U. S. 1, 23 Sup. Ct. 1, 47 L. Ed. 49.

invalid, because such a tax is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the constitution.[24] A similar question arose under the corporation excise tax law of 1909, but it was held by the same court that the latter statute was not invalid because the income of a corporation subject to the tax might consist in part, or even entirely, of interest on municipal bonds, the ground of the distinction being that the act of 1909 did not impose a tax on the income so derived, but on the franchise or privilege of doing business in a corporate capacity, the income being merely used as the measure of the amount of the tax in the particular case.[25] The act of 1913 has reverted to the principle of taxing incomes directly, but it meets the point in question by excluding from taxable income "interest upon the obligations of a state or any political subdivision thereof." It had also been held in an earlier case that the act of Congress of 1864, imposing an income tax, and containing a provision for taxing the interest paid by railroads and some other corporations on their bonded debt, requiring them to pay the tax and deduct the amount thereof from their periodical payments to the holders of the bonds, could not be applied in the case of a municipal corporation owning such bonds, since the municipalities created by the states are entirely beyond the taxing power of the federal government.[26] But whether a state may indirectly affect the borrowing power of another state or its municipalities, by taxing its own citizens upon so much of their income as is derived from the bonded or other debt of such other state or its municipalities, is a different question altogether. But at least it has been decided that there is noth-

[24] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759.

[25] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

[26] United States v. Baltimore & O. R. Co., 17 Wall. 322, 21 L. Ed. 597.

ing in the Constitution of the United States to prevent such taxation.[27] It seems clear, however, that a state cannot lawfully tax either its own citizens or non-residents upon their income derived from its own bonds, when such bonds were not taxable at the time of their issuance, for this would impair the obligation of the contract implied in the issue and sale of the bonds, and more especially would this be true where the legislature of the state had covenanted that the bonds should be free from taxation.[28] It must also follow from the principle of the necessary independence of the federal and state governments that the income tax law of any state cannot include interest on the bonds or other public securities of the United States. And state laws of this kind generally make an express exception as to income derived from United States securities, at least where such securities are declared to be tax-exempt by act of Congress. But it has been held that the possible impairment of the borrowing power of the government, as the remote effect of a state statute imposing a tax upon the transfer of a decedent's property, when the statute is applied to property consisting of United States bonds, is not sufficient to render the statute unconstitutional.[29] It should also be remarked, in this connection, that a state tax upon the gross receipts or the net income of corporations or individuals cannot validly be made to operate as a restraint upon or interference with interstate commerce, and hence, in the case of carriers and other companies engaged in interstate as well as domestic business, only the receipts from domestic commerce can be taxed by the state.[30]

[27] Bonaparte v. Tax Court, 104 U. S. 592, 26 L. Ed. 845.

[28] Houston & T. C. R. Co. v. Texas, 177 U. S. 66, 20 Sup. Ct. 545, 44 L. Ed. 673; State Tax on Foreign-Held Bonds, 15 Wall. 300, 21 L. Ed. 179; Antoni v. Greenhow, 107 U. S. 769, 2 Sup. Ct. 91, 27 L. Ed. 468.

[29] Plummer v. Cole, 178 U. S. 115, 20 Sup. Ct. 829, 44 L. Ed. 998.

[30] Philadelphia & S. S. S. Co. v. Pennsylvania, 122 U. S. 326, 7 Sup. Ct. 1118, 30 L. Ed. 1200; Leloup v. Port of Mobile, 127 U. S.

§ 18. Taxing Salaries of Federal and State Officers

The federal income tax law of 1913 exempts "the compensation of all officers and employees of a state or any political subdivision thereof, except when such compensation is paid by the United States Government." It would not be competent for Congress to lay a tax upon the salary of an officer of a state, and this by necessary implication from the constitution and the mutual relation of the federal and state governments, neither being authorized to tax the means or agencies employed by the other in carrying out its governmental functions; and hence it was held that a tax assessed, under the federal income tax law of 1864, upon the salary of a state judge was wrongfully imposed, and if paid under protest could be recovered back.[31] And in a similar case it was held to be immaterial that the judge's salary was fixed by the authorities of a county and payable out of the treasury of a city.[32] So, one's compensation as state's attorney is not liable to the federal income tax, nor can such compensation be applied to the satisfaction of the monetary exemption; it must be omitted altogether from the computation of his income, and the taxpayer must have his exemption out of his income from other sources.[33] And for similar reasons, it has been held that a stamp tax imposed by the United States upon a bond required by a state from an officer, as a prerequisite to the exercise of the duties of his office, is, in necessary legal effect, a tax upon the officer's right to qualify, and upon the exercise by the state of its governmental functions, and therefore invalid, and the fact that the tax is required to be paid before the officer has qualified is not material.[34] Conversely, a state income tax cannot be made to apply to the salary of any officer of the United

640, 8 Sup. Ct. 1380, 32 L. Ed. 311; State v. United States Fidelity & Guaranty Co., 93 Md. 314, 48 Atl. 918.

[31] The Collector v. Day, 11 Wall. 113, 20 L. Ed. 122.

[32] Freedman v. Sigel, 10 Blatchf. 327, Fed. Cas. No. 5,080.

[33] United States v. Ritchie, Fed. Cas. No. 16,168.

[34] Bettman v. Warwick, 108 Fed. 46, 47 C. C. A. 185.

States government.[35] "It is considered as settled that the state has no power to tax an officer of the United States, or vice versa, because the power to tax includes the power to destroy, and if a state were allowed to tax a United States officer one dollar, it might tax him to the full amount of his salary, and thus arrest all the measures of the government. And so the United States cannot tax a state officer for the same reason." [36] The only state income tax law now in force which explicitly recognizes this limitation is that of Wisconsin, which allows a deduction from taxable income of "salaries or other compensation received from the United States by officials thereof." [37] But a similar exception must be read by necessary implication into the laws of any other state where the question might arise. Therefore all federal officers, such as postmasters, internal revenue officers, district attorneys, officers of the land department, and United States judges resident within the state, must be understood to be exempt from the state income tax, in so far as relates to their salary or compensation from the United States, though, if such officers have an income derived from other sources, it is subject to the tax, as there is nothing in their official character to exempt their private means from state taxation. And it should be observed that the licensing of a merchant under the United States revenue laws does not render him an "officer" of the federal government, nor withdraw him from the taxing power of the state.[38] And although the salary of an officer in the United States army cannot be taxed by a state or municipality, yet his personal property, such as household furniture, is not exempt from such taxation,[39] and of course the same principle would apply to his investments or the income derived

[35] Purnell v. Page, 133 N. C. 125, 45 S. E. 534.

[36] King v. Hunter, 65 N. C. 603, 613.

[37] Wisconsin Income Tax Law, 1911, § 1087m, 4, f. See this statute in full in the Appendix.

[38] State v. Bell, 61 N. C. 76.

[39] Finley v. City of Philadelphia, 32 Pa. St. 381.

therefrom. And it has been held in Massachusetts that money which one has on deposit in a bank is not exempt from taxation because it was derived from his salary as a federal officer, for it loses its identity as salary when it has been paid to him and come into his possession.[40]

As to the incidence of federal taxation upon federal officers, it should be observed that there are some whose salary, while it is to be fixed and appropriated by Congress, is safeguarded from change during their tenure of office by the constitution itself. As to the President, he is to "receive a compensation which shall neither be increased nor diminished during the period for which he shall have been elected." (Const. U. S., art. 2, § 1.) And as to the federal judges, they shall "receive a compensation which shall not be diminished during their continuance in office." (Const. U. S., art. 3, § 1.) The income tax laws enacted by Congress during the period of the Civil War contained no such exception. But the justices of the Supreme Court, through Chief Justice Taney, addressed a communication to the Secretary of the Treasury declaring their conviction that their salaries were not legally subject to the tax. Thereupon the Attorney General, to whom the communication had been referred, gave an elaborate opinion, advising the Secretary of the Treasury that the income tax could not lawfully be assessed upon and collected from the salaries of those judicial officers of the United States who were in office at the time of the enactment of the statute imposing the tax.[41] No attempt was made thereafter to assess the tax upon the salaries of the judges. But in the income tax law of 1894, Congress again failed to make an exception in this particular, and the statute was held unconstitutional and void in so far as it attempted to tax the salaries of the judges of the United States courts.[42] But the act of 1913 meets this point by pro-

[40] Dyer v. City of Melrose, 197 Mass. 99, 83 N. E. 6.

[41] 13 Op. Atty. Gen. 161.

[42] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759, per Field, J., concurring.

viding that "in computing net income under this section there shall be excluded * * the compensation of the present President of the United States during the term for which he has been elected, and of the judges of the supreme and inferior courts of the United States now in office," the evident intention being that the next President of the United States, and all federal judges appointed after the enactment of the statute, shall be subject to the income tax in respect to their salaries.[43]

But as to all the other officers and employés of the United States (including the members of Congress themselves) whose salary or compensation may be fixed and changed in the absolute discretion of Congress, there is no constitutional objection to the incidence of the income tax upon such salaries. Such was the decision made under the act of 1862 in regard to collecting the income tax from the salary of an officer in the

[43] An interesting question might here be raised as to the effect of this provision on the power of Congress hereafter to repeal the income tax law or to change the rate of taxation under it. For if the imposition of the income tax upon the salary of the President would "diminish" it, within the meaning of the constitution (and that is the only possible legal reason for excepting the present incumbent), then the repeal of the act would as certainly "increase" the compensation of any future President to whose salary it had attached at the beginning of his term, which is equally forbidden by the constitution. And if a President shall be elected while the present statute is in force, any change in the rate of taxation, effected by amendment of the act, would either increase or diminish his compensation, as the case might be. And the same considerations apply to taxing the federal judges, except that their salaries may be increased, but not diminished, during their continuance in office. It would therefore appear to follow, as a perfectly logical conclusion, though an almost absurd result, that if a future Congress should desire to increase the rate of income taxation, it would have to make an explicit exception as to the President and the federal judges, who would then continue to be taxed at a different rate from other citizens; and if it were desired to repeal the act, the President alone must be required to continue paying the tax until the expiration of his term of office. Of course these complexities could have been avoided by the simple means of absolutely excepting these officers from the operation of the statute.

United States army,[44] and the rule is equally applicable to all others save those mentioned in the preceding paragraph.

We have next to consider the application of a state income tax law to the salaries of the state officers. Here also the principle applies that if the constitution of the state protects such salaries from change during the incumbency of the particular officer, it prevents their being taxed as income. Thus in North Carolina, "it is provided in the constitution that the salaries of the most important officers shall not be altered during their term of office, and this is understood to exempt their salaries from taxation, because to tax is to diminish, or it may be to destroy." [45] Hence if the local constitution provides that the salaries of the judges of the state shall not be diminished during their continuance in office, such salaries are exempt from the income tax.[46] "It may be that the restriction in this article [of the constitution] upon the power of the legislature refers principally to the diminution of the salaries of the judges by a law fixing it at a less amount than that established at the epoch of their entrance into office. The object, however, of this article was to secure the independence of the judiciary. If the legislature can tax the salaries, it would be deprived of its plenary effect." [47] The only decision to the contrary was made in an early case in Pennsylvania, which, however much it may be respected at home, is not entitled to much persuasive effect elsewhere, in view of its opposition to the general current of authority.[48] But unless

[44] Galm v. United States, 39 Ct. Cl. 55.

[45] King v. Hunter, 65 N. C. 603; In re Taxation of Salaries of Judges, 131 N. C. 692, 42 S. E. 970.

[46] Purnell v. Page, 133 N. C. 125, 45 S. E. 534; In re Taxation of Salaries of Judges, 131 N. C. 692, 42 S. E. 970; Robertson v. Pratt, 13 Hawaii, 590.

[47] City of New Orleans v. Lea, 14 La. Ann. 197.

[48] Northumberland v. Chapman, 2 Rawle (Pa.) 73. In this case it was said by Chief Justice Gibson: "As the constitution, like every other instrument, is to have a reasonable interpretation, the prohibition in question is to be restrained to laws which have such a reduc-

thus restrained by some explicit provision of the state constitution, it is within the lawful power of the state legislature to make an income tax law apply to the salaries of the various officers of the state and of its municipalities,[49] as is done in Wisconsin in all cases where such taxation would not be "repugnant to the constitution." It should be remembered that public office is not a "contract," within the sense of the constitutional prohibition against laws impairing the obligation of contracts. And hence no contract is violated by the imposition of an income tax upon the salary of an officer who was in office and whose compensation was fixed by law, at the time the income tax law came into effect; for his right to the compensation grows out of the rendition of services, and not out of any contract between the government and the officer that the services shall be rendered and the compensation paid.[50]

Finally, an income tax law is not to be pronounced uncon-

tion for their object, and not for their consequence. On any other principle of construction, a tax could not be constitutionally assessed on property purchased with money drawn from a judge's salary, which would, in reason, have as fair a claim to exemption as the salary itself. If we once get away from the plain inartificial import of the prohibition, it is not easy to tell at what stage of refinement we shall stop. The object of the legislature was to apportion the public burden according to the ratio of property, and to produce in detail a result approaching as near as possible to that of an income tax, a measure of assessment more equable in the abstract than any other that could be proposed. Now there is no reason to exempt a judge from contribution which is not just as applicable to any other officer who presents no tangible surface but his office to the revenue laws, nor was the object of the prohibition to place him in this respect on higher ground. The legislature could not constitutionally retrench a part of a judge's salary under the pretext of assessing a tax on it; but, for the bona fide purpose of contribution, a reasonable portion of it, like any other part of his property, may be applied to the public exigencies."

[49] In re Taxation of Salaries of Judges, 131 N. C. 692, 42 S. E. 970.

[50] See Butler v. Pennsylvania, 10 How. 402, 13 L. Ed. 472; Smith v. City of New York, 37 N. Y. 518; Conner v. City of New York, 5 N. Y. 285.

stitutional and void in its entirety simply because it lays a tax upon the salaries of certain officers who are constitutionally exempt from such taxation, or fails to make an explicit exception in their favor. The protection of the constitution because of such an illegal provision can be invoked only by one against whom it is sought to be enforced; and even in such a case, if the law in affirmative terms lays the tax on such an exempt income, that portion of it can be exscinded without destroying the rest, while, if it merely omits to make the necessary exception, it can be construed as not applying in the particular case.[51]

§ 19. Exemption of Incomes Below a Fixed Sum

It has been held by a great many authorities that a statute imposing taxes on inheritances, legacies, and successions is not unconstitutional because it exempts from its operation estates or inheritances below a certain minimum value,[52] provided only that the exemption is not so excessive as to be entirely unreasonable.[53] On the same principle, an income tax law is not unconstitutional because it wholly exempts from

[51] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147; Peacock v. Pratt, 121 Fed. 772, 58 C. C. A. 48; Robertson v. Pratt, 13 Hawaii, 590.

[52] Knowlton v. Moore, 178 U. S. 60, 20 Sup. Ct. 755, 44 L. Ed. 977; Magoun v. Illinois Trust & Sav. Bank, 170 U. S. 283, 18 Sup. Ct. 594, 42 L. Ed. 1037; Colton v. Montpelier, 71 Vt. 413, 45 Atl. 1039; In re Hickok's Estate, 78 Vt. 259, 62 Atl. 724; In re Wilmerding's Estate, 117 Cal. 281, 49 Pac. 181; State v. Vance, 97 Minn. 532, 106 N. W. 98; State v. Bazille, 97 Minn. 11, 106 N. W. 93; Black v. State, 113 Wis. 205, 89 N. W. 522; State v. Guilbert, 70 Ohio St. 299, 71 N. E. 636; Gelsthorpe v. Furnell, 20 Mont. 299, 51 Pac. 267; State v. Alston, 94 Tenn. 674, 30 S. W. 750, 28 L. R. A. 78; In re Mixter's Estate, 10 Pa. Co. Ct. R. 409.

[53] Minot v. Winthrop, 162 Mass. 113, 38 N. E. 512, 26 L. R. A. 259, in which case it was held that an excise tax on inheritances was not so clearly unreasonable, by reason of exempting estates under $10,000, as to render it unconstitutional. But see State v. Ferris, 9 Ohio Cir. Ct. R. 298, holding void an inheritance tax law which exempted property to the amount of $20,000.

taxation all incomes below a certain annual amount, and the question where the tax shall begin, or where the exemption shall end, is one exclusively for the decision of the legislature.[54] Such a tax law, making a reasonable exemption, is not in violation of a constitutional provision that taxes shall be equal and uniform.[55] And if it is at all within the power of a court to adjudge that the exemption granted is so excessive as to invalidate the statute, at least no such decision has ever yet been rendered. On the contrary, the decisions have sustained the income tax laws in this particular. That of Hawaii, exempting incomes to the amount of $1,000, was sustained as against the objection that the allowance was excessive.[56] That of Wisconsin was similarly held valid, although it exempts life insurance to the amount of $10,000, in favor of one legally dependent on the deceased. The court called this a "striking exemption," but said: "While this is somewhat large, we cannot say that it is unreasonable." [57] The income tax act of Congress of 1894 was sustained (by an inferior court) as against objection that the exemption allowed, $4,000, was unreasonably great.[58] The corporation excise tax law of 1909 was assailed on the ground that it exempted incomes of less than $5,000, but the Supreme Court of the United States answered this objection with a mere reference to certain of its earlier decisions concerning similar exemptions in inheritance tax law.[59]

Through no decision on this precise point was rendered in the case before the United States Supreme Court involving the validity of the act of Congress of 1894, yet some of the

[54] Moore v. Miller, 5 App. D. C. 413; New Orleans v. Fourchy, 30 La. Ann. 910.

[55] New Orleans v. Fourchy, 30 La. Ann. 910.

[56] Robertson v. Pratt, 13 Hawaii, 590.

[57] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

[58] Moore v. Miller, 5 App. D. C. 413.

[59] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

separate opinions filed in that case contain valuable discussions both of the general question of exempting small incomes and of the limits of the authority of the courts in deciding upon the reasonableness of the exemption. Thus, in one of the opinions it was said: "A tax which is wanting in uniformity among members of the same class is or may be invalid. But this does not deprive the legislature of the power to make exemptions, provided such exemptions rest upon some principle, and are not purely arbitrary, or created solely for the purpose of favoring some person or body of persons. Thus in every civilized country there is an exemption of small incomes, which it would be manifest cruelty to tax, and, the power to make such exemptions once granted, the amount is within the discretion of the legislature, and so long as that power is not wantonly abused, the courts are bound to respect it. In this law there is an exemption of $4,000, which indicates a purpose on the part of Congress that the burden of this tax should fall on the wealthy, or at least upon the well-to-do. If men who have an income or property beyond their pressing needs are not the ones to pay taxes, it is difficult to say who are; in other words, enlightened taxation is imposed upon property and not upon persons. Poll taxes, formerly a considerable source of revenue, are now practically obsolete. The exemption of $4,000 is designed, undoubtedly, to cover the actual living expenses of the large majority of families, and the fact that it is not applied to corporations is explained by the fact that corporations have no corresponding expenses. The expenses of earning their profits are of course deducted in the same manner as the corresponding expenses of a private individual are deductible from the earnings of his business. The moment the profits of a corporation are paid over to the stockholders, the exemption of $4,000 attaches to them in the hands of each stockholder." [60] And in another opinion in

[60] Dissenting opinion of Brown, J., in Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108.

the same case it was said: "In this connection, and as a ground for annulling the provisions taxing incomes, counsel for the appellant refers to the exemption of incomes that do not exceed $4,000. It is said that such an exemption is too large in amount. That may be conceded. But the court cannot for that reason alone declare the exemption to be invalid. Every one, I take it, will concede that Congress, in taxing incomes, may rightfully allow an exemption to some amount. This was done in the income tax laws of 1861 and in subsequent laws and was never questioned. Such exemptions rest upon grounds of public policy, of which Congress must judge, and of which this court cannot rightfully judge; and that determination cannot be interfered with by the judicial branch of the government, unless the exemption is of such a character and is so unreasonably large as to authorize the court to say that Congress, under the pretence merely of legislating for the general good, has put upon a few persons burdens that, by every principle of justice and under every sound view of taxation, ought to have been placed upon all or upon the great mass of the people. If the exemption had been placed at $1,500, or even $2,000, few, I think, would have contended that Congress, in so doing, had exceeded its powers. In view of the increased cost of living at this day, as compared with other times, the difference between either of those amounts and $4,000 is not so great as to justify the courts in striking down all of the income tax provisions. The basis upon which such exemptions rest is that the general welfare requires that, in taxing incomes, such exemptions should be made as will fairly cover the annual expenses of the average family, and thus prevent the members of such families becoming a charge upon the public. The statute allows corporations, when making returns of their net profits or income, to deduct actual operating or business expenses. Upon like grounds, as I suppose, Congress exempted incomes under $4,000." [61] In an-

[61] Dissenting opinion of Harlan, J., in Pollock v. Farmers' Loan & Trust Co., supra.

other case, in construing a territorial income tax law, the court observed: "It is contended that the exemption of incomes to the extent of $1,000 is an illegal discrimination. The power of state legislatures to grant reasonable exemptions from taxation is undisputed. It has been upheld on grounds of enlightened public policy—a public policy which seeks to exclude from taxation the living expenses of the average family, and thus to enable the poor man to escape becoming a public burden. It rests upon the theory that the exemption results in ultimate benefit to the taxpayer, which compensates him for the additional burden of taxation which he is thereby called upon to bear. It does not apply to corporations, for the reason that they have no corresponding expense. But the exemption must be reasonable and impartial, and must be extended to all who are similarly situated. It is urged that the exemption in question is unreasonable. If the power to make exemptions be once conceded, the amount of the exemption is largely within the discretion of the legislature—a discretion which is not subject to review in the courts unless it be clearly shown to have been abused." [62]

§ 20. Exemption of Classes of Individuals or Corporations

It is a conceded principle of taxation, applicable to income taxes as well as to any others, that there is no constitutional objection to an exemption in favor of those corporations or institutions which serve important public purposes or confer benefits upon the public at large, such as religious, educational, and charitable organizations. Also it is clear that any corporation which bears its due share of the public burden, under a special form of taxation, may lawfully be exempted from the payment of any or all other taxes. Thus, the exemption of insurance companies from an income tax law does not render it invalid as to other corporations which are made subject to the law, where the exemption is made expressly on

[62] Peacock v. Pratt, 121 Fed. 772, 58 C. C. A. 48.

the ground that such companies are required by another law to pay a tax on the premiums received.[63] But beyond these elementary principles, the subject is not free from doubt. It would be obviously contrary to sound principles of constitutional law to push the power of exemption so far as to make the burden of the tax in reality fall upon a selected class of individuals or corporations. On this point the Supreme Court of Louisiana has said: "It is not necessary for us to decide whether or not, under the constitution, the legislature has power to levy an income tax. It suffices to say that, if the legislature has such power, it would be an indispensable condition of its exercise that the tax should embrace the incomes of all persons not exempted, and whatever power of classification the legislature might possess as to the subject-matter of taxation, that power could under no pretext be stretched so as to embrace the right to single out a particular class of taxpayers and to require them to pay such a tax, while exempting all others." [64] No such sweeping exemptions have been attempted in recent income tax laws. But they commonly contain exemptions in favor of labor organizations, agricultural societies, savings banks, mutual building and loan associations, mutual insurance companies, fraternal orders and benefit societies (or some of the foregoing), as well as charitable and educational institutions. The validity of such exemptions has been severely criticized. Thus, in one of the opinions filed in the Pollock case, it was said: "Exemptions from the operation of a tax always create inequalities. Those not exempted must, in the end, bear an additional burden or pay more than their share. A law containing arbitrary exemptions can in no just sense be termed uniform. In my judgment, Congress has rightfully no power, at the expense of others, owning property of the like character, to sustain pri-

[63] Peacock v. Pratt, 121 Fed. 772, 58 C. C. A. 48.

[64] Parker v. North British & M. Ins. Co., 42 La. Ann. 428, 7 South. 599.

vate trading corporations, such as building and loan associations, savings banks, and mutual life, fire, marine, and accident insurance companies, formed under the laws of the various states, which advance no national purpose or public interest, and exist solely for the pecuniary profit of their members." [65] But in a more recent case the Supreme Court of the United States has apparently given its approval to the validity of just such exemptions as those mentioned. In refusing to hold unconstitutional the corporation tax law of 1909, on the ground that it taxed a business when carried on by a corporation, and exempted a similar business when carried on by a partnership or a private individual, it said: "In levying excise taxes the most ample authority has been recognized from the beginning to select some and omit other possible subjects of taxation, to select one calling and omit another, to tax one class of property and to forbear to tax another." And later in the same opinion it was said: "As to the objection that certain organizations,—labor, agricultural, and horticultural,—fraternal and benevolent societies, loan and building associations, and those for religious, charitable, or educational purposes, are excepted from the operation of the law, we find nothing in it to invalidate the tax. As we have had frequent occasion to say, the decisions of this court from an early date to the present time have emphasized the right of Congress to select the objects of excise taxation, and within this power to tax some and leave others untaxed must be included the right to make exemptions such as are found in this act." [66]

§ 21. Allowance of Deduction for Other Taxes Paid

The Wisconsin income tax law contains a provision that "any person who shall have paid a tax upon his personal prop-

[65] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759, per Field, J., concurring.

[66] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

erty during any year shall be permitted to present the receipt therefor to, and have the same accepted by, the tax collector to its full amount in the payment of taxes due upon the income of such person during said year." [67] When the constitutionality of the statute was under consideration by the Supreme Court of the state, an objection against its validity was urged on the ground that this provision created an unjust and unlawful discrimination between taxpayers all equally subject to the law, since one taxpayer might be required to pay the whole of the income tax assessed against him, while another, having an exactly equal income, could have the tax thereon very materially reduced by taking advantage of this provision. But the court held that the objection was without force and overruled it.[68]

§ 22. Double Taxation

Vigorous objections to the validity of income tax laws have been based on the ground that they impose, or at least result in, double taxation. And it cannot be denied that this is usually the case. "It may safely be said that the payment of an income tax almost necessarily involves, in some indirect and limited sense, the payment of a double tax. For income, oftener than otherwise, in some way, either directly or indirectly, is derived from or grows out of property subject to taxation." [69] But though double taxation is vicious and unjust in principle, and no statute will be so construed as to impose double taxes if it can reasonably be avoided,[70] yet a statute which produces this result cannot be adjudged invalid on economic principles, nor unless it conflicts with some explicit provision of the constitution. This important point is discussed, in relation to in-

[67] Wisconsin Income Tax Law, 1911, § 1087m, 26.

[68] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

[69] Lott v. Hubbard, 44 Ala. 593.

[70] Black, Const. Law (3d edn.) p. 464.

come taxation, by the court in South Carolina, in the following terms: "The next objection to the act is that it results in double taxation. The contention is that plaintiff's income was derived from dividends received upon his stock in corporations chartered and doing business under the laws of the state, and as these corporations had paid taxes on their property, and also on their franchises, a tax on plaintiff's income is double taxation. There is much room for discussion and difference of opinion as to what really amounts to double taxation. But the weight of authority and reason sustains the taxation of shares of stock in a corporation to the holder thereof, notwithstanding the corporation has paid taxes on its property and also on its franchises. The rents and profits derived from real estate, and the products of the farm, may be taxed, though the land from which they are derived has also been taxed. The profits of a business may be taxed though the property in the business, bought on credit, has been taxed to the owner, and the debt he owes therefor has been taxed to the creditor, and the property covered by mortgage may be taxed to the owner, and the mortgage thereon to the mortgagee. These may be instances of double taxation in one sense, yet they are not within the rule of uniformity and equality prescribed by the constitution, which forbids the taxation twice of the same property for the same purpose, while other property, under similar circumstances and conditions, is taxed only once. There is no constitutional inhibition against such taxation; and in the absence of constitutional restriction, the power of the legislature to tax is limited only by its own discretion and its responsibility to its constituents. It has been said the power to tax is an inherent right of sovereignty, necessary to its existence, and limited only by its necessities. We make out no conclusive case against a tax when we show that it reaches twice the same property for the same purpose. This may have been intended, and, in many cases, at least is

admissible." [71] The general weight of authority undoubtedly does sustain the principle that a tax may be levied on income derived from property, in the shape of rent or otherwise, although the property yielding the income is also subjected to taxation, and that this does not violate the rule against double taxation, because the two interests or species of property are distinct and severable.[72] It must be admitted, however, that this doctrine does not pass entirely unchallenged.[73] And in at least one state this very result has been guarded against by a clause in the constitution which provides that "the general assembly may tax trades, professions, franchises, and incomes, provided that no income shall be taxed when the property from which the income is derived is taxed." [74] On the other hand the constitution of another state having an income tax law (Wisconsin) expressly makes a distinction between "property" and "income" and authorizes the taxation of both. And the Supreme Court of that state, in sustaining the income tax, has remarked: "It is claimed with much earnestness and ability that the act violates the provisions of the fourteenth amendment to the federal Constitution. One of the contentions under this head is that the progressive features of the act are discriminatory, if not absolutely confiscatory. Another contention is that the act provides for double taxation, and for both reasons it is claimed

[71] Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 27 L. R. A. (N. S.) 864, 21 Am. & Eng. Ann. Cas. 193.

[72] Comstock v. Grand Rapids, 54 Mich. 641, 20 N. W. 623; Woodruff v. Oswego Starch Factory, 177 N. Y. 23, 22 N. E. 994; Chisholm v. Shields, 21 Ohio Cir. Ct. R. 231; Memphis v. Ensley, 6 Baxt. (Tenn.) 553, 32 Am. Rep. 532.

[73] "We are of the opinion that it was not the intention of the legislature to tax real property under the name of land, slaves, etc., and then to tax under the term of incomes the profits realized from such land, slaves, etc. It would be double taxation first to tax property to the extent allowed by law, and then to tax the profits derived from such property." City of New Orleans v. Fassman, 14 La. Ann. 865. And see Kennard v. Manchester (N. H.) 36 Atl. 553.

[74] Const. N. Car., art. 5, § 3.

that it denies to citizens the equal protection of the laws. It is said in support of this contention that the United States Supreme Court in the Pollock case [75] has held that taxation of income derived from land is in fact taxation of the land itself, hence that the act provides for double taxation, first of the land in specie, and next of the income therefrom. It seems that this claim may be very easily met. The question in the Pollock case was whether the taxation of rentals of land was direct taxation within the meaning of that term as used in the Constitution of the United States, and it was held to be the same, in substance, as a tax on the land itself, and hence a direct tax. This may be admitted for the purposes of the case, but it does not appear to in any way decide the question here at issue, or even to be very persuasive. The question there was of the power of Congress, under that clause of the federal Constitution which forbids any direct federal tax except one levied in proportion to the population. The question here is primarily of the power of the legislature of Wisconsin, under its constitution, to levy an income tax in addition to a real estate tax, and secondarily whether such tax denies to anyone the equal protection of the laws. The inapplicability of the rule in the Pollock case to the case here presented seems so plain as to require little comment. There can be no doubt of the proposition that income taxation of a progressive character, in addition to taxation of property, is directly authorized by the constitution of Wisconsin as amended in 1908. Words could hardly be plainer to express that idea than the words used. From them it clearly appears that taxation of property and taxation of incomes are recognized as two separate and distinct things in the state constitution. Both may be levied, and lawfully levied, because the constitution says so. However philosophical the argument may be that taxation of rents received from property

[75] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759.

is in effect taxation of the property itself, the people of Wisconsin have said that 'property' means one thing and 'income' means another; in other words, that income taxation is not property taxation, as the words are used in the constitution of Wisconsin." [76]

On the same principle, a tax laid upon the receipts or income arising from the conduct of a particular business, such as that of a banker or broker, is not invalid because the law of the state also requires persons engaging in such business to take out a license and pay a fee therefor, nor is the imposition of the tax on the income an unconstitutional invasion of the right or privilege granted by the license.[77] And so a merchant's income from his business is taxable under the law, although he is taxed also on his stock in trade.[78]

Questions of a somewhat different order may arise when it is considered that the income tax laws of two different states, or of a state and the United States, may bear upon the same person in respect to the same income. But it seems that no constitutional objection can be based on the fact that two or more independent sovereignties subject the same property (subject to the jurisdiction of both or all) to taxation for their own separate purposes. Thus, it is held that a state is none the less entitled to tax the transfer of an estate by will or inheritance because some part of the property may be in another state and be taxable there under the same kind of a statute, or because the estate has already paid an inheritance tax to the United States.[79] So, the tax imposed by the federal income tax law of 1864, upon all dividends declared to stockholders "as part of the earnings, income, or

[76] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

[77] Drexel v. Commonwealth, 46 Pa. St. 31; Burch v. Savannah, 42 Ga. 596.

[78] Wilcox v. County Com'rs of Middlesex, 103 Mass. 544.

[79] Appeal of Hopkins, 77 Conn. 644, 60 Atl. 657; Matter of Daly, 100 App. Div. 373, 91 N. Y. Supp. 858.

gain of any bank," was held to be assessable against the bank for the whole amount of dividends so declared, notwithstanding the fact that it had paid a sum to the state of New York, under a statute of that state imposing a tax against the stockholders upon the value of their shares, and requiring the bank to retain the amount thereof from the dividends due them, until it was made to appear that their tax was paid.[80] And that taxation of the same property by different governments is neither unlawful nor uncommon may further be shown by the following remarks of an English judge, made in an income tax case: "There could be double taxation if the legislature distinctly enacted it, but upon general words of taxation, and when you have to interpret a taxing act, you cannot so interpret it as to tax the subject twice over to the same tax. But it all depends upon its being the same tax, and as the Attorney General has said, there is nothing to prevent either one legislature, or two legislatures if they have jurisdiction over the subject-matter, imposing different taxes upon the same subject-matter. Double taxation in one sense is common enough in the case of these companies which have their head establishments in one country and their business in another, although no doubt there is always a sort of grievance felt in reference to it." [81] But although a cumulation of taxes in this way may be constitutionally defensible, undoubtedly it sometimes results in very heavy burdens. Under the laws as they stand at present, for example, a person engaging in a certain line of business (as, for instance, a tobacconist) might be required to pay, first, a license tax or fee to the United States, second, a license tax or fee to the municipality where he does business, third, a tax on the building in which his business is carried on, if he happens to own it, fourth, a tax on his stock in trade as personal property, fifth,

[80] Central Nat. Bank v. United States, 137 U. S. 355, 11 Sup. Ct. 126, 34 L. Ed. 703.

[81] Stevens v. Durban-Roodepoort Gold Min. Co., 5 Tax Cas. 402.

an income tax to the United States, sixth, a tax on the same income to the state.

§ 23. Taxing Aggregate Income of Family

Modern income tax laws have commonly provided that only one deduction of the amount allowed by statute as exempt shall be made from the aggregate income of all the members of any family. And the practical construction has been that this required the head of the family, in making his return for taxation, to add the income of his wife and minor children, if any, to his own. This has been objected to on constitutional grounds as making an unjust and unlawful discrimination. But the courts have not taken that view. Thus, in Wisconsin, it was said: "Objection is also made to the provision that the income of a wife living with her husband shall be added to the income of the husband, and the income of children under eighteen years of age living with their parent or parents shall be added to that of the parent or parents. This is another case of classification, and it is only justifiable in case there is some substantial difference of situation which suggests the advisability of difference of treatment. We think there clearly is such a difference, in this: That experience has demonstrated that otherwise there will be many opportunities for fraud and evasion of the law, which the close relationship of husband and wife or parent and child make possible, if not easy. The temptation to make colorable shifts and transfers of property in order to secure double or even triple exemptions, if there were not some provision of this kind in the law, would unquestionably be very great. There is no such temptation or opportunity in the case of the single man, or the man and wife who are living separately." [82]

[82] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

§ 24. Validity of Graduated or Progressive Tax

The constitutions of both Wisconsin and South Carolina contain provisions authorizing the graduation or progressive increase of the income tax, and in both those states the validity of this feature of the law has been sustained.[83] In Wisconsin, it was also objected that such an arrangement of the tax was in conflict with the provision of the fourteenth amendment to the federal constitution securing to all citizens the equal protection of the laws; but the court ruled otherwise.[84] Moreover, in some of the states, the inheritance tax laws are also progressive, and in at least one it has been decided that there is no constitutional objection to them on that ground,[85] thus furnishing at least an argument from analogy to support the similar feature of the income tax law. The only contrary decision was rendered in Hawaii, where the court decided against the constitutional validity of a graded income tax (enacted in 1896, and much resembling the federal income tax law of 1894) on the ground of its being in conflict with a provision of the constitution that each citizen "shall be obliged to contribute his proportion or share" of the expenses of government. The law in question exempted all incomes below $2,000, allowed an exemption of $2,000 on all incomes below $4,000, and taxed all incomes above $4,000 without exemption. It was held that this was not proportional taxation, but unjust discrimination.[86]

In regard to the United States law, where the ground of objection, if any there be, must be found in the federal con-

[83] Const. Wis., art. 8, § 1, as amended in 1908; Const. S. Car., art. 10, § 1; Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 27 L. R. A. (N. S.) 864, 21 Am. & Eng. Ann. Cas. 193.

[84] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

[85] Drew v. Tifft, 79 Minn. 175, 81 N. W. 830, 47 L. R. A. 525, 79 Am. St. Rep. 446; State v. Bazille, 97 Minn. 11, 106 N. W. 93.

[86] Campbell v. Shaw, 11 Hawaii, 112.

stitution and not elsewhere, it may be remarked that the income tax laws of 1862 and 1864 were both graduated, in the sense that they imposed a heavier tax upon incomes above a certain figure than on incomes below it. But apparently their validity on this account was never drawn in question. The Supreme Court of the United States, however, has held that no constitutional objection to a graduated inheritance tax law can be drawn from the provision of the constitution that taxes shall be "uniform throughout the United States." For the uniformity in taxation required by this clause is not an intrinsic but a geographical uniformity, and the phrase is synonymous with the expression "to operate generally throughout the United States." [87] Probably, therefore, a similar decision may be expected in regard to the validity of the super-tax imposed by the present income tax law.

§ 25. Retrospective Operation of Statute

On general principles and irrespective of explicit constitutional limitations, a statute imposing an income tax may subject to taxation the income of the citizen for the whole of the current year in which the statute is passed, that is, not only so much of the income as accrued from the date of the enactment of the law to the end of the year, but also that portion which accrued or was earned from the beginning of the year to the date of the law. For the year's income is treated and considered as one entire thing, not as made up of several portions or items. And hence, although the statute might be called retrospective in its operation upon a part of the first year's income, it is not retrospective in such a sense as to render it unconstitutional.[88] "It is clearly perfectly constitutional as well as expedient, in levying a tax upon

[87] Knowlton v. Moore, 178 U. S. 41, 20 Sup. Ct. 747, 44 L. Ed. 969.
[88] State v. Bell, 61 N. C. 76; State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

profits or income, to take as the measure of taxation the profits or income of a preceding year. To tax is legal, and to assume as a standard the transactions immediately prior is certainly not unreasonable, particularly when we find it always adopted in exactly similar cases." [89] "The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, cannot be doubted; much less can it be doubted that it can impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed." [90] So the Wisconsin statute was held not to be invalid because it included, as part of the income to be taxed in the year of its enactment, profits derived from the sale of property purchased at any time within three years previously.[91]

But the case is different in regard to the federal income tax. Until the adoption and promulgation of the Sixteenth Amendment, Congress had no rightful power to tax incomes, unless on condition that the tax should be apportioned among the several states. Hence if the present statute had attempted to tax the whole of the citizen's income for the year 1913, it would have included some gains and profits which, at the time they were acquired, and when alone they could be described as "income," were not subject to the taxing power of Congress, except on the condition mentioned. Hence it is provided that "for the year ending December thirty-first, 1913, said tax shall be computed on the net income accruing from March first to December thirty-first, 1913, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions herein provided for."

[89] Drexel v. Commonwealth, 46 Pa. St. 31.

[90] Stockdale v. Insurance Companies, 20 Wall. 323, 22 L. Ed. 348.

[91] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

§ 26. Objections as to Title, Purpose, and Mode of Enactment of Statute

The constitution of South Carolina provides that no tax shall be levied except in pursuance of a law which shall distinctly state the object of the same, to which object the tax shall be applied. When the income tax law of that state was adopted, in 1897, its validity was assailed on the ground that it did not comply with this constitutional provision. But as the title of the statute was "An act to raise revenue for the support of the state government by the levy and collection of a tax on income," the court had no difficulty whatever in holding that it did distinctly state the object to which the tax was to be applied.[92] In the same case it was further held that this statute was not in violation of another provision of the state constitution to the effect that the General Assembly shall provide for an annual tax sufficient to defray the estimated expenses of the state for a year. It was argued that the income tax law attempted to provide for taxation for more than one year, regardless of the estimated expenses of the state for the years in which it should be collected. But the court held otherwise, saying that the tax is levied annually, and is applied to the expenses of the state in the year in which it is collected, and the courts are bound to assume that the legislature, in estimating the annual expenses of the state, takes into consideration all the sources of income to the state, including the income tax, and fixes the general levy accordingly.

In regard to the federal corporation tax law of 1909, it appeared that the bill, introduced in and passed by the House of Representatives, was a general bill for the collection of revenue, including, as one of its features, a plan of inheritance taxation, and that this part was stricken out by the Senate and the corporation tax substituted. And it was argued that

[92] Alderman v. Wells, 85 S. C. 507, 67 S. E. 781, 27 L. R. A. (N. S.) 864, 21 Am. & Eng. Ann. Cas. 193.

this rendered the act invalid, since the Constitution provides that all bills for the raising of revenue shall originate in the House of Representatives. But the court held otherwise, in view of the further provision of the Constitution that the Senate may propose or concur with amendments to revenue bills, as well as other bills.[93]

§ 27. Objections to Administrative Provisions of Act

Statutes providing for the taxation of incomes have often been subjected to severe criticism on the ground that they confide too much authority and discretion to executive and administrative officers, in regard to the settlement of matters of detail, to the construction of the machinery necessary for the operation of the law, and to the making of rules and regulations for its enforcement. But it may now be regarded as a settled principle of constitutional law that, although a legislative body cannot delegate its power to make laws, yet, having enacted statutes, it may invest executive officers or boards or commissions created for the purpose with authority to make rules and regulations for the practical administration of such statutes in matters of detail and to enforce the same, and also to determine the existence of the facts or conditions on which the application of the law depends. And "there is a marked and increasing tendency to leave more and more of what may be called the detail of legislation to such officers and commissions, the legislature settling the general policy and outline of the laws on a given subject, and confiding to administrative agencies the work of erecting the machinery necessary for their practical operation and their application in particular cases." [94] For this reason it

[93] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

[94] Black, Const. Law (3d edn.) pp. 96, 97, and cases there cited. See, particularly, Union Bridge Co. v. United States, 204 U. S. 364, 27 Sup. Ct. 367, 51 L. Ed. 523; Field v. Clark, 143 U. S. 649, 12 Sup. Ct. 495, 36 L. Ed. 294; Coopersville Co-operative Creamery Co. v. Lemon, 163 Fed. 145, 89 C. C. A. 595; In re Huttman, 70 Fed. 699.

is thought that no valid objection to the federal income tax law can be based upon the authority which it intrusts to the Commissioner of Internal Revenue, with respect to prescribing forms and making rules and regulations on various matters of administration, more especially as it does not go nearly so far in this regard as some of the earlier acts of Congress on the same subject, which were never successfully challenged on this ground. For similar reasons, the Wisconsin statute was upheld against the objection that it unconstitutionally authorized the state tax commission to appoint the income tax assessors. The court held that this was not invalid either as a delegation of legislative power to the commission or as violating the constitutional guaranties of local self-government.[95]

Objection is also made to those provisions commonly found in income tax laws which require the citizen to disclose the sources and amount of his income in sworn returns, which, under certain conditions, are open to the inspection of the public, or which require him to open his books and papers to the examination of the revenue officers or submit to interrogation concerning his business affairs. Such provisions, it is argued, amount to authorizing "unreasonable searches and seizures," and moreover, in view of the possible use of information thus obtained, they may compel the individual to furnish evidence against himself in a criminal proceeding. But no decision sustaining such objections as these has been found. On the contrary the courts hold that such provisions cannot be brought within the reasonable intendment of the constitutional guaranties referred to, that similar provisions are already very common in the tax laws of various states and have always been acquiesced in, or at least, not successfully attacked, and that, as to the matter of self-crimination, even if such a result could follow from the enforcement of any provision of an income tax law, it would be no ground

[95] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

for adjudging the whole statute unconstitutional, but only a matter to be pleaded by the individual in his own behalf when a criminal proceeding shall actually be brought against him and an attempt actually made to use against him evidence thus extorted.[96]

§ 28. Apportionment of Federal Income Tax

The United States income tax law of 1894 was adjudged unconstitutional on the ground that it was a "direct" tax within the meaning of the Constitution of the United States and yet was not "apportioned among the several states" as that instrument requires.[97] The corporation tax law of 1909 was also not apportioned among the states, but its validity was sustained by the Supreme Court, on the ground that it was not a direct tax upon the income of corporations, but an excise tax upon the conducting or carrying on of business in a corporate capacity, and that there is nothing in the Constitution requiring excise taxes to be apportioned according to population.[98] So far as regards the present income tax law, and any future law of the same character, the necessity of apportionment is dispensed with by the Sixteenth Amendment to the Constitution, which provides that "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."

[96] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389; Peacock v. Pratt, 121 Fed. 772; Co-operative Building & Loan Ass'n v. State, 156 Ind. 463, 60 N. E. 146.

[97] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759; s. c., 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108.

[98] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

CHAPTER IV

CONSTRUCTION OF STATUTES IMPOSING INCOME TAXES

§ 29. Rule of Strict Construction

It is a rule sanctioned by many authorities, and particularly with reference to the revenue laws of the United States, that a statute imposing taxes is to be construed strictly against the government and in favor of the taxpayer, and that no person and no property is to be included within its scope unless explicitly placed there by the clear language of the statute, and no heavier burdens imposed than the plain meaning of its terms will warrant.[1] Thus, it has been said: "It is an old and familiar rule of the English courts, applicable to all forms of taxation and particularly special taxes, that the sovereign is bound to express its intention to tax in clear and unambiguous language, and that a liberal construction be given to words of exception confining the operation of duty. * * * We have ourselves had repeated occasion to hold that the customs rev-

[1] American Net & Twine Co. v. Worthington, 141 U. S. 468, 12 Sup. Ct. 55, 35 L. Ed. 821; Benziger v. United States, 192 U. S. 38, 24 Sup. Ct. 189, 48 L. Ed. 331; Spreckels Sugar Co. v. McClain, 192 U. S. 397, 24 Sup. Ct. 376, 48 L. Ed. 496; Eidman v. Martinez, 184 U. S. 578, 22 Sup. Ct. 515, 46 L. Ed. 697; Parkview Building & Loan Ass'n v. Herold, 203 Fed. 876; Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199; Missouri, K. & T. Ry. Co. v. Meyer, 204 Fed. 140; United States v. Wigglesworth, 2 Story, 369, Fed. Cas. No. 16,690; Rice v. United States, 53 Fed. 910, 4 C. C. A. 104; United States v. Watts, 1 Bond, 580, Fed. Cas. No. 16,653; Powers v. Barney, 5 Blatchf. 202, Fed. Cas. No. 11,361; Vicksburg & M. R. Co. v. State, 62 Miss. 105; Matter of Will of Vassar, 127 N. Y. 1, 12, 27 N. E. 394. Compare John J. Sesnon Co. v. United States, 182 Fed. 573, 105 C. C. A. 111.

enue laws should be liberally interpreted in favor of the importer, and that the intent of Congress to impose or increase a tax upon imports should be expressed in clear and unambiguous language." [2] "It is a general rule, in the interpretation of all statutes levying taxes or duties upon subjects or citizens, not to extend their provisions by implication beyond the clear import of the language used, or to enlarge their operation so as to embrace matters not specifically pointed out, although standing upon a close analogy. In every case, therefore, of doubt, such statutes are construed most strongly against the government and in favor of the subjects or citizens, because burdens are not to be imposed, nor presumed to be imposed, beyond what the statute expressly and clearly imports." [3] "If the consideration thus given to the case still leaves the matter in doubt, there should be applied the well-settled rule that the citizen is exempt from taxation, unless the same is imposed by clear and unequivocal language, and that, if there is a fair doubt as to the construction of an act imposing taxation, the doubt should be resolved in favor of those upon whom the tax is sought to be laid." [4] And again, it is a "conceded principle that taxes must be imposed by law, and that the law should be construed favorably to the taxpayer and not extended by implication beyond its clear intent." [5] And so, "at the outset it may be remarked that a statute providing for the imposition of taxes is to be strictly construed, and all reasonable doubts in respect thereto resolved against the government and in favor of the citizen. This principle is so well established that the citation of any considerable number of authorities in its support is unnecessary." [6]

[2] Eidman v. Martinez, 184 U. S. 578, 22 Sup. Ct. 515, 46 L. Ed. 697.
[3] United States v. Wigglesworth, 2 Story, 369, Fed. Cas. No. 16,690.
[4] Parkview Building & Loan Ass'n v. Herold, 203 Fed. 876.
[5] Missouri, K. & T. Ry. Co. v. Meyer, 204 Fed. 140.
[6] Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199.

Applying these principles to the specific case of income taxation, the rule may be deduced that only those persons and corporations are subject to the payment of the income tax who are specially described in the statute authorizing it or clearly within the meaning of the general terms which it employs, and that if any substantial and reasonable doubt arises as to whether any particular fund or kind or class of gain or acquisition constitutes taxable "income" within the meaning of the law, it is to be resolved in favor of the taxpayer and not in favor of the government. And so the authorities hold.[7] Thus, in regard to the federal corporation tax law of 1909, it was said that this statute, "levying as it does a tax upon the citizen, must be strictly construed; it cannot be enlarged by construction to cover matters not clearly within its import. The question is not what Congress might have done or should have done, but what it actually did do. When this is ascertained, the duty of the court is accomplished." [8] And this view is further strengthened by the consideration that the same rule has come to be accepted and applied in the case of the laws taxing inheritances and successions, which furnish the nearest analogy to an income tax law. Such a statute, it is held, must be construed strictly against the state or the government and in favor of the taxpayer, and a doubt as to the taxability of a particular fund should be resolved in favor of the citizen.[9]

[7] Forman v. Board of Assessors, 35 La. Ann. 825; Lining v. Charleston, 1 McCord (S. C.) 345; Robson v. Regina, 4 Terr. Law Rep. (Canada) 80.

[8] Pennsylvania Steel Co. v. New York City Ry. Co., 198 Fed. 774, 117 C. C. A. 556.

[9] Eidman v. Martinez, 184 U. S. 578, 22 Sup. Ct. 515, 46 L. Ed. 697; In re Harbeck's Will, 161 N. Y. 211, 55 N. E. 850; In re Kimberly's Estate, 27 App. Div. 470, 50 N. Y. Supp. 586; People v. Koenig, 37 Colo. 283, 85 Pac. 1129; State v. Bazille, 97 Minn. 11, 106 N. W. 93.

§ 30. Statutes in Pari Materia

It is a fundamental rule in the interpretation of statutes that acts in pari materia are to be read and construed together. The reasons for this rule have been explained by the present writer in another volume, as follows: "All the enactments of the same legislature on the same general subject-matter are to be regarded as parts of one uniform system. Later statutes are considered as supplementary or complementary to the earlier enactments. In the course of the entire legislative dealing with the subject we are to discover the progressive development of a uniform and consistent design, or else the continued modification and adaptation of the original design to apply it to changing conditions or circumstances. In the passage of each act, the legislative body must be supposed to have had in mind and in contemplation the existing legislation on the same subject and to have shaped its new enactment with reference thereto. Hence the same principle which requires us to study the context for the meaning of a particular phrase or provision, and which directs us to compare all the several parts of the same statute, only takes on a broader scope when it bids us read together, and with reference to each other, all statutes in pari materia. Whatever is ambiguous or obscure in a given statute will be best explained by a consideration of analogous provisions in other acts relating to the same subject, or by a study of the general policy which pervades the whole system of legislation. Secondly, the rule derives support from the principle which requires that the interpretation of a statute shall be such, if possible, as to avoid any repugnancy or inconsistency between enactments of the same legislature. To achieve this result it is necessary to consider all previous acts relating to the same matters, and to construe the act in hand so as to avoid, as far as it may be possible, any conflict between them. Hence, for example, where the legislature has used a word in a statute in one sense and with one meaning, and subsequently uses the same word in

legislating on the same subject-matter, it will be understood as using the word in the same sense, unless there is something in the context or in the nature of things to indicate that it intended a different meaning thereby." [10] And it is said that the rule of construction by the aid of statutes in pari materia is especially applicable in the case of revenue laws, which, though made up of independent enactments, are regarded as one system, in which the construction of any separate act may be aided by the examination of other provisions which compose the system.[11] And it is not necessary to the application of this rule that the earlier act should still continue in force. Although it may have expired by its own limitation, or though it may have been expressly or impliedly repealed, still it is to be considered and read as explanatory of the later enactment.[12] It has been held, however, in one case, that where a personal tax law imposes a tax on a certain occupation, without defining it, it is doubtful whether the court, in construing it, can look to old and repealed tax laws, which define such occupation, to ascertain the legislative meaning.[13]

Now it has been held that all the successive acts of Congress from 1861 to 1867, imposing income taxes, are in pari materia, and are to be construed as one continuous enactment.[14] And of course this doctrine may be expanded so as to include the acts of Congress of 1894, 1909, and 1913. (It is chiefly for this reason that all these various enactments have been printed in full in the appendix to this volume, where they may be studied and compared at length.) And it follows that it will be a legitimate method of construing the present income tax law, in cases where its language in relation to a particular point or subject is obscure, confusing, or unintelligible, to

[10] Black, Interpretation of Laws (2d edn.) pp. 332–334.
[11] United States v. Collier, 3 Blatchf. 325, Fed. Cas. No. 14,833.
[12] King v. Loxdale, 1 Burr. 445; Southern Ry. Co. v. McNeill, 155 Fed. 756.
[13] Lockwood v. District of Columbia, 24 App. D. C. 569.
[14] United States v. Smith, 1 Sawy. 277, Fed. Cas. No. 16,341.

compare it with the corresponding provisions on the same point in the earlier acts, which may be more clear and precise, and to presume that Congress intended its words to be understood in the same sense as before, unless there is such a distinct change of language as to compel the inference that a change in legislation was certainly intended. So likewise, the income tax law of any given state is to be read and compared, not only with previous income tax laws, if any, but also with all the other revenue laws of the same state, each serving to illuminate and explain the others, in cases where their provisions touch or coincide, and where any substantial doubt arises from the ambiguity of the language employed.

§ 31. Associated Words and Phrases

It is another ancient and fundamental rule in the construction of statutes that the meaning of a doubtful word or phrase may be ascertained by reference to the meaning of other words or phrases with which it is associated, and that, where several things are referred to, they are presumed to be of the same class, when connected by a copulative conjunction, unless a contrary intent plainly appears.[15] For example, all the acts of Congress on the subject of income taxation, from 1862 to the present time, have associated together the words "gains," "profits," and "income" as descriptive of the subject taxed, and the same is true of the income tax laws of some of the states. These words may be traced far back in the history of English taxation. The original income tax law of that country, enacted in 1799, imposed a tax on "income" by that name, but the acts of 1842 and 1853 introduced the associated terms "profits and gains," whence they were apparently borrowed by Congress in framing the act of 1862, and have since persisted in use. Applying the rule above stated, we are justified in asserting the following principles as applicable to the interpretation of the phrase in question: If it is doubtful

[15] Black, Interpretation of Laws (2d edn.) p. 194.

whether or not a particular fund or acquisition is taxable as "income," under the statute, it is not taxable unless it is income in the nature of "gain" or "profit." If any item is clearly included in the description of "gains" yet it is not taxable unless it is a gain in the nature of "income" or "profit." And although the disputed item may be certainly a "profit," in one sense of the word, yet it is not taxable unless it be a profit accruing by way of "gain" or "income."

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CHAPTER V

WHAT CONSTITUTES TAXABLE INCOME

§ 32. General Definitions of "Income"

"Income" is defined as that gain which proceeds from labor, business, property, or capital of any kind, as, the produce of a farm, the rent of houses, the proceeds of professional business, the profits of commerce or of occupation, or the interest of money or stock in funds, etc.; revenue; salary; especially the annual receipts of a private person or a corporation from

property.[1] It means that which comes into or is received from any business or investment of capital, without reference to the outgoing expenditures; when applied to the affairs of individuals, the term expresses the same idea that "revenue" does when applied to the affairs of a nation or state.[2] The term "income," as used in a statute providing that no income derived from property subject to taxation shall be taxed, "means the income for the year and is the result of the year's business. It is the net result of many conbined influences—the use of the capital invested; the personal labor and services of the members of the firm, and the skill and ability with which they lay in, and from time to time renew, their stock; the carefulness and good judgment with which they sell and give credit; and the foresight and address with which they hold themselves prepared for the fluctuations and contingencies affecting the general commerce and business of the government. To express it in a more summary and comprehensive form, it is the creation of capital, industry, and skill." [3] Again, as this term is used in statutes relating to the nature and ownership of property, it includes the rents and profits of real estate, interest on money, dividends on stock, and other produce of personal property.[4] Particularly, when applied to a sum of money, or to money invested in public or corporate securities, income means interest.[5]

But an important distinction must be noted in the signification of this word, according as it is used in the ordinary busi-

[1] Mundy v. Van Hoose, 104 Ga. 625, 30 S. E. 782; Sowards v. Taylor, 42 Ill. App. 275; Remington v. Field, 16 R. I. 509, 17 Atl. 551; Thorn v. De Breteuil, 86 App. Div. 405, 83 N. Y. Supp. 849.

[2] Bates v. Porter, 74 Cal. 224, 15 Pac. 732; People v. Board of Sup'rs of Niagara County, 4 Hill (N. Y.) 20; Mundy v. Van Hoose, 104 Ga. 625, 30 S. E. 782.

[3] Wilcox v. Middlesex County, Com'rs, 103 Mass. 544.

[4] Rev. Codes N. Dak. 1899, § 3322; Civ. Code S. Dak. 1903, § 238; Civ. Code Cal. 1903, § 748.

[5] Sims' Appeal, 44 Pa. St. 345; Pearson v. Chace, 10 R. I. 455.

ness affairs of the community (or in statutes relating thereto) or in a tax statute. In the former case, it is understood to mean "net" income or profit; in the latter case, it is equivalent to "gross" income or "gross receipts," unless otherwise specified in the statute. Thus, it is said that the word "income," as used in commerce and trade, means the balance of gain over loss in the fiscal year or other period of computation, or it is the ultimate profit of a business or trade, ascertained by placing the sum total of gains over against the sum total of losses.[6] So, "the income of an estate means nothing more than the profit it will yield after deducting the charges of management, or the rent which may be obtained for the use of it. The rents and profits of an estate, the income, or the net income of it, are all equivalent expressions." [7] So, in a statute providing that a certain railroad company shall be required to make an annual payment from its income to the sinking fund, to aid in the construction of the road, the word "income" must be construed as meaning the amount of money remaining to the corporation on making up its annual account, after deducting from all its receipts the necessary expense of repairs and management, and also the amount of interest on the debt of the commonwealth which the corporation is bound to pay in behalf of the commonwealth.[8] So in a railroad mortgage providing that, until default, the mortgagor shall remain in possession and operate the road and take the tolls, rents, and income, and apply them to the payment of current expenses, the term "income" means what is left after paying the expenses of earning income.[9]

But on the other hand, in a statute imposing taxes, "income" means gross receipts, not net profits, unless it is so specified. Whenever the law means to tax the clear profits arising

[6] City of Kingston v. Canada Life Assur. Co., 19 Ontario, 453.
[7] Andrews v. Boyd, 5 Me. 199.
[8] Opinion of Justices, 5 Metc. (Mass.) 596.
[9] Poland v. Lamoille Valley R. Co., 52 Vt. 144, 177.

from the employment of capital or otherwise, the expression used is "net income" or "net annual income." [10] And especially the phrase "whole income" means the aggregate of all receipts without any deduction for expenses or losses, that is, it means gross receipts and not net profits.[11] But, as stated in an earlier section,[12] if this word is associated with the term "profits," as in the phrase "gains, profits, and income," it may take color from the more restricted term and be limited by it. That is to say, in the phrase quoted, the word "income" should not be taken in its most extensive signification, but as meaning income which is in the nature of a profit, in other words, net income. But it must be admitted that there is some authority to the contrary.[13]

Unless limited by the context, however, the word "income" is one of very broad and comprehensive meaning. Thus, in a constitutional provision that no municipal corporation shall become indebted in any one year for a greater amount than its income, unless with the consent of two-thirds of the voters, the word income means income derived from any and all sources, and not that derived from taxation alone.[14] But it cannot be too strongly insisted upon that the word "income," when properly used, is applicable only to receipts in cash. When a bond which was purchased at a discount reaches par in the market, the owner cannot properly be said to have made

[10] People v. Supervisors of New York, 18 Wend. (N. Y.) 605; Wells v. Shook, Fed. Cas. No. 17,406.

[11] Lawless v. Sullivan, 3 Can. Sup. Ct. 117.

[12] Supra, § 31.

[13] Morton's Ex'rs v. Morton's Ex'r, 112 Ky. 706, 66 S. W. 641, where it was held that, in a statute relating to dower in the "rents and profits" of a decedent's real estate, the phrase means gross rents, without deduction for taxes, insurance, or repairs, and that the use of the word "profits" cannot be deemed to be a limitation upon or qualification of the preceding word "rents" so as to restrict that word in meaning to "net rents."

[14] Lamar Water & Electric Light Co. v. City of Lamar, 128 Mo. 188, 26 S. W. 1025, 32 L. R. A. 157.

a profit; he is in a position where he can realize a profit if he sells the bond, but not otherwise. If he sells, then the sum gained may constitute a part of his income, but it cannot be so described while he continues to hold the security. So, the farmer's crop is not his income; it is the source from which his income will be derived when it is converted into cash. So, a sum which is due as interest on a note, but which remains uncollected at the end of the year, may be reckoned as a part of the year's income, as a matter of bookkeeping, but it is not properly described as income until it is received, that is, it is "income" when it comes in, but not while it remains outstanding. This rule may perhaps be relaxed so far as to admit an exception in the case of certain items which are received as the equivalent of money and which are readily convertible into cash. But the principle is, as ruled in an English case, that nothing is to be considered as income except what represents value in money, that is, either money or something that is equivalent to money because it can be converted into money and the proceeds expended in any way the recipient may please. In this case, speaking of the income tax of that country, it was said: "It is a tax on income in the proper sense of the word. It is a tax on what comes in, on actual receipts, not on what saves his pocket, but on what goes into his pocket." [15] Of course it is entirely within the power of a legislature having jurisdiction to lay an income tax to make the word "income" include items which are not at all proper to be described under that name. But then those items are taxed, not because they constitute income, but because the legislature has said that they shall be taxed. And on the other hand, when the word "income" is clearly defined in the act imposing the tax, it cannot be taken to include anything which is not within that definition.[16]

[15] Tenant v. Smith [1892] App. Cas. 150, 61 Law Jour. P. C. 11.

[16] City of New Orleans v. Hart, 14 La. Ann. 803; City of New Orleans v. Fassman, 14 La. Ann. 865.

We conclude therefore that, for the purpose of an income tax, a proper definition of the word "income" would be all that a man receives in cash during the year, except such sums as are merely capital or principal in a changed form, that is, excluding sums which are merely the proceeds of some other form of capital converted into cash.

§ 33. "Profits" and "Gains" Compared and Distinguished

"Profit" is the gain made on any business or investment when both the receipts and expenditures are taken into consideration.[17] It is the amount of acquisition beyond expenditure, the excess of value received for producing or selling over and above cost.[18] It represents the net gain made from an investment, or from the prosecution of any business, after the payment of all expenses incurred.[19] In the common acceptation of the term, "profit" is the benefit or advantage remaining after all costs, charges, and expenses have been deducted, because until then, and while anything remains uncertain, it is impossible to say whether or not there has been a profit.[20] Or, according to a fuller description given by the Supreme Court of California, the word "profits" signifies an excess of the value of returns over the value of advances; the excess of receipts over expenditures; that is, net earnings. In commerce it means the advance in the price of goods sold beyond the cost of purchase. In distinction from the wages of labor, it is well understood to imply the net return to the capital or stock employed after deducting all the expenses, including not

17 Providence Rubber Co. v. Goodyear, 9 Wall. 788, 19 L. Ed. 566; People v. San Francisco Sav. Union, 72 Cal. 199, 13 Pac. 498; Taylor v. Harwell, 65 Ala. 1; Mayer v. Nethersole, 71 App. Div. 383, 75 N. Y. Supp. 987.

18 Mundy v. Van Hoose, 104 Ga. 292, 30 S. E. 783; Curry v. Charles Warner Co., 2 Marv. (Del.) 98, 42 Atl. 425; Bates v. Porter, 74 Cal. 224, 15 Pac. 732; People v. Niagara County Sup'rs, 4 Hill (N. Y.) 20.

19 Goodhart v. Pennsylvania R. Co., 177 Pa. St. 1, 35 Atl. 191, 55 Am. St. Rep. 705.

20 Mackey v. Millar, 6 Phila. (Pa.) 527.

only the wages of those employed by the capitalist, but the wages of the capitalist himself for superintending the employment of his capital stock. Profits are divided by writers on political economy into gross and net; the former being the entire difference between the value of advances and the value of returns, and the latter so much of this difference as arises exclusively from the capital employed. Profits cannot consist of earnings never yet received.[21] So, the term "profits" as used in a statute imposing a tax of five per cent on all profits of railroad and canal companies, refers to the profits arising from the operation of the railroad or canal, but without deduction of interest paid to its bondholders or dividends paid to its stockholders, that is, the excess of receipts over expenses of operation.[22] But the surplus earnings of a corporation over and above all expenses are taxable as "profits," notwithstanding that it is required by law to appropriate all such surplus to a particular purpose (as, to a sinking fund) and to no other.[23]

It is said, and with truth, that this term is often used as synonymous with "income" and as meaning the same thing, and particularly where the two words are coupled in the same phrase.[24] And one court has remarked that, when they are thus joined together, there is no difference in the meaning of the words, and the use of them both is only due to a lawyer-like fondness for using several words where one would be sufficient.[25] But this is scarcely correct. There is a substantial difference in the meaning of the two words. And it is more accurate to say that, when they are joined together in the same phrase, the word "profits" is used to particularize and

21 People v. San Francisco Sav. Union, 72 Cal. 199, 13 Pac. 498.

22 Sioux City & P. R. Co. v. United States, 110 U. S. 205, 3 Sup. Ct. 565, 28 L. Ed. 120.

23 Mersey Docks & Harbour Board v. Lucas, 51 Law J. Q. B. 114, 1 Tax Cas. 385, affirmed, L. R. 8 App. Cas. 891.

24 Bates v. Porter, 74 Cal. 224, 15 Pac. 732; Burt v. Rattle, 31 Ohio St. 116, 130.

25 In re Clark, 62 Hun (N. Y.) 275, 17 N. Y. Supp. 93.

point out one kind of income, or income derived from a particular source; and it will generally be found that their joinder is easily explained from their correlation with other descriptive words in the same sentence, as, for example, where "gains" may be correlated with "sales or dealings in property," "income" with such words as "salaries" and earnings from "professions and vocations," and "profits" with "business, trade, and commerce." Besides, "income" is clearly a word of larger import than "profits." The former term may very properly include such items as the rent of houses, interest on investments, the earnings of a professional man, or the salary of an officer of a corporation, but none of these could with any propriety be called "profits." In effect, the latter term is more appropriately confined to gains resulting from the operations of trade or commerce, and especially from mercantile or manufacturing business or transportation. Moreover, it is important not to lose sight of the distinction that, while "income" means that which comes in or is received from any business or investment of capital, without reference to the outgoing expenditures, "profit" means the gain which is made upon any business or investment when both receipts and payments are taken into account.[26]

It is not quite so easy to account for the use of the word "gain" in conjunction with the two other terms which we have been considering. But it may probably be said that when a tax law employs the phrase "gains, profits, and income," to describe what is taxable, the term "gains" is inserted out of abundant caution, and intended to include an acquisition of the taxpayer which is not to be described as a "profit," and which might not be included in the term "income" if that word were taken in a narrow sense. Properly speaking, "gain" means that which is acquired or comes as a benefit,[27] and in a

[26] In re Murphy, 80 App. Div. 238, 80 N. Y. Supp. 530.
[27] Thorn v. De Breteuil, 86 App. Div. 405, 83 N. Y. Supp. 849.

statute laying an income tax it may mean money received within the year which is not the fruit of a business transaction nor of the labor or exertion of the individual, but something arising from fortuitous circumstances or conditions which he does not control. In this signification, the term would include money received as a legacy or money won on a wager.

§ 34. Change or Substitution of Capital Distinguished

Both in popular and legal parlance, "income" is distinguished from "capital" or "principal." Capital is the source of income. Income is the fruit of capital. Capital may be made very mobile and constantly changed from one form of investment to another. Each time that it returns to the owner it may or may not bring income with it. But it would be a misnomer to reckon the whole of each such return as "income" simply because it is so much money coming into the possession of the owner. Out of the fund so returning there must first be deducted, in case there has been no loss, a sum sufficient to replace the capital originally invested, and the balance, if any, will be income. Thus, when money is loaned on a promissory note for one year at interest, and the note is paid at maturity with the accumulated interest, the sum received must be apportioned between capital and interest. The receipt of so much of that sum as equals the face of the note is not a receipt of income; it is a replacement or substitution of capital; only the money received as interest constitutes income. So the income of a merchant does not include his gross receipts, but only so much thereof as represents the profits on his sales; the remainder is capital replaced. Again, a sum of money received from a railroad company in payment of damages for a part of a person's land taken by the railroad for its use, is not income; it is a substituted capital.[28] And the mere change or transfer of

[28] Gibson v. Cooke, 1 Metc. (Mass.) 75.

a fund held in trust, from the hands of one trustee into the hands of another or substituted trustee, does not make the whole fund in the hands of the last trustee "gains, profits, and income," within the meaning of the income tax law.[29] It is of course possible that the word "income" may be so stretched as to include even capital returned, if the context absolutely requires such a construction. In one case, on the construction of a statute authorizing certain commissioners to deposit the "income" of a certain fund, it was held that the word had the same meaning as "money" or "receipts," and that it was to be interpreted as embracing all receipts of money, whether of principal or interest, from the mortgages or other securities in which the fund had been previously invested.[30] But this construction was reached by reading the statute with reference to certain other statutes relating to the same subject-matter, and no such necessity would ordinarily apply in the interpretation of income tax laws, where, on the contrary, the rule of strict construction in favor of the taxpayer would require a careful distinction to be observed between capital and income.

§ 35. Rent of Land and Royalties

Rent paid by a tenant for the use and occupation of real estate is always considered as "income" of the lessor,[31] and this has been specified as one of the varieties of taxable income in practically all of the income tax laws which have hitherto been enacted. It should be noted, however, that the statute of Virginia excepts "ground rents or rents charge," which is entirely proper, since the annual payments under a ground lease are not so much to be regarded as rent, or a price paid for the use of the land, as in the nature

[29] Reynolds v. Williams, 4 Biss. 108, Fed. Cas. No. 11,734.

[30] State v. McCarty, 1 Wils. (Ind.) 205, 219.

[31] Perotz's Appeal, 102 Pa. St. 235, 256; Sohier v. Eldredge, 103 Mass. 345; Lindley's Appeal, 13 Wkly. Notes Cas. (Pa.) 65, 69.

of periodical installments of purchase money. In a will or a deed, the expression "yearly income" of real estate may mean the balance of what is received in the way of rent, after deducting taxes paid.[32] And the same result is effected under the income tax laws by the provisions allowing a deduction from the total income of taxes paid within the year and also an allowance either for depreciation of the property from which income is derived or for its reasonable repair. Where farming land is leased to be worked by a tenant on shares, the income which the lessor derives from it is his share or proportion of the produce, or rather, the sum which he realizes from the sale of his part of the produce.[33]

It is also held that rent reserved in a lease of land containing coal or other minerals, the mines to be worked by the lessee, is income of the lessor, although it is stipulated to be paid in the form of a royalty of so much for each ton of coal or other mineral extracted.[34] But this may depend on the intention of the parties as to making a lease proper or a sale, and this in turn may be presumed from the form of the contract which they make. For if the transaction takes the form of a sale of the coal (or other mineral) in place, the proceeds received will be a part of the corpus of the estate, that is, capital or principal, but not income.[35] Thus, a demise of all the coal under the surface of a specified piece of land is a sale of the coal, not a lease, and the sums due and paid by the lessee to the lessor as royalties are not rents, and therefore not income, but purchase money of real estate.[36]

[32] Inhabitants of Freeport v. Inhabitants of Sidney, 21 Me. 305.
[33] Thompson's Appeal, 100 Pa. St. 478.
[34] Eley's Appeal, 103 Pa. St. 300; Reynolds v. Hanna, 55 Fed. 783, 797; Wentz's Appeal, 106 Pa. St. 301; Bedford's Appeal, 126 Pa. St. 117, 17 Atl. 538; Shoemaker's Appeal, 106 Pa. St. 392; McClintock v. Dana, 106 Pa. St. 386; Hill v. Gregory [1912] 2 K. B. 61.
[35] Reynolds v. Hanna, 55 Fed. 783.
[36] Fairchild v. Fairchild (Pa.) 9 Atl. 255.

§ 36. Rental Value of Residence

The Wisconsin income tax law of 1911 provides that the term "income" shall include the estimated rental value of residence property occupied by the owner thereof, and hence the taxpayer who owns the house in which he lives must include in his return of his income the annual rent which he could or would receive for the property if he chose to let it and reside elsewhere. This provision is in accord with the principles of income taxation in England and some other foreign countries, but was not known in American legislation until introduced by the Wisconsin statute. Indeed, the rental value of the taxpayer's residence, when owned by him, was expressly directed to be excluded from the computation of his income by the acts of Congress of 1864 and 1870. The validity of this clause in the Wisconsin law was assailed on the ground that, as such rental value is not income in any proper sense of the word, it could not be made income by the mere declaration of the legislature that it should be such. But the Supreme Court of the state saw nothing in this provision to invalidate the statute. "It is said," observed the court, "that this is not income, and that calling it income does not make it income. It may be conceded that things which are not in fact income cannot be made such by mere legislative fiat, yet it must also be conceded, we think, that income in its general sense need not necessarily be money. Clearly it must be money or that which is convertible into money." [37] But this is by no means a satisfactory way of meeting the objection. The court would have taken up much stronger ground if it had ruled that the rental value of an owner's residence is not income at all, but yet that it is subject to the tax because it is so declared in the statute and because it is a thing of value which the legislature has the power and authority to tax, whether or not it constitutes

[37] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

income. On economic grounds such a provision is more easily defensible. And on this point the court in Wisconsin, in the same connection, remarked: "The clause was doubtless inserted in an effort to equalize the situation of two men each possessed of a house of equal rental value, one of whom rents his house to a tenant, while the other occupies his house himself. Under the clause in question, the two men with like property are placed upon an equal footing, and in no other way apparently can that be done." [38] It is true the English and Scotch courts hold that the annual rental value of a house which a man owns and in which he lives, and which he could rent to another if he chose, is a part of his income for purposes of taxation.[39] But it is otherwise if the house is provided for him by others, to be occupied during his life, but without any power or authority on his part to let it to another.[40] And the advantage gained, or the saving effected, by having the right to occupy another person's house as a residence free of rent,—as in the case of a manager of a bank who has the right, so long as he continues in his office, to reside in the building owned by the bank and used for its banking purposes,—is not income in such sense as to be taxable.[41]

Under the income tax laws elsewhere than in Wisconsin, it is thought that this item could not be brought within the definition of "income" by any reasonable or permissible construction. Thus, it has been held (though not in connection with the subject of taxation) that neither the increased value which would accrue to lands of a charitable institution if they were used for other purposes than the charity, nor their use for the purposes of the charity without realizing an actual income, can be regarded as "annual income" within

[38] State v. Frear, supra.
[39] Corke v. Fry, 32 Scotch Law Rep. 341.
[40] McDougall v. Sutherland, 31 Scotch Law Rep. 630.
[41] Tennant v. Smith [1892] App. Cas. 150.

the meaning of a restriction in the charter of such an institution upon holding property which shall exceed a specified annual income. Annual income, it was said, means annual receipts, and is not the equivalent of annual value. And even if the value of the use could be regarded as annual income, it should be computed, not with reference to the market value, but to the annual value to the corporation for the special purpose to which the property was devoted.[42]

§ 37. Salaries and Earnings from Professions and Trades

A salary accruing to the taxpayer, whether payable annually or at shorter intervals, is taxable as a part of his income, and it is immaterial (except in so far as the statute makes express exceptions) whether he earns it in the capacity of a public officer or as an employé of a private corporation, or a partnership, or an individual.[43] Thus, the pay of an army officer on the retired list is "income" and taxable as such.[44] Nor does it make any difference that the amount of the salary is uncertain or varies from time to time, or that it depends on the extent of services actually rendered or the amount of business transacted, or that it may include commissions on sales. Whatever is received in the course of the year in the way of salary, wages, or compensation constitutes a part of that year's income. Thus, it is said in an English case that "income" includes all gains and profits derived from personal exertions, whether such gains and profits are fixed or fluctuating, certain or precarious, and whatever may be the principle or basis of calculation. Hence a locomotive engineer, who earns more than the statutory minimum, is taxable, although he is not paid a salary but so much for every mile he runs his engine.[45]

[42] Betts v. Betts, 4 Abb. New Cas. (N. Y.) 317.
[43] White v. Koehler (N. J.) 57 Atl. 124.
[44] In re Ward [1897] 1 Q. B. 266.
[45] Attorney General v. Ostrum [1904] App. Cas. 144.

So also the earnings of professional men, such as lawyers, physicians, surgeons, clergymen, engineers, architects, authors, and others, derived from their professional employment, constitute taxable income, if sufficient in amount to come within the terms of the statute, even though not specifically mentioned in it. And it is immaterial by what name such earnings may be called, or whether they take the form of a fixed periodical compensation or accrue in each instance in consideration of particular services rendered. And the same is true of the wages or earnings of mechanics and artisans, if sufficient in annual amount to come within the purview of the statute, as may easily be the case under some of the state laws. And in all ordinary cases, whatever accrues to the taxpayer as compensation for his personal exertion or endeavor will be taxable as income, no matter what may be the nature of the employment or pursuit which he follows, since the terms of the statutes are broad enough to cover almost every conceivable kind of activity. In an English case it was held that betting on horse races, when carried on systematically and annually and as the person's chief or only way of gaining money, is a "vocation" within the income tax law, and he must pay the tax on his winnings, if any.[46]

§ 38. Pensions, Gifts, Prizes, and Awards

Under the English law it is held that the pension of a retired judge or other public officer, though voted annually by the legislative authority, is taxable as income.[47] But a pension not granted by the government, but by a private individual or society, as a purely voluntary gift, and without any legal claim upon the donor, in recognition of meritorious past services or for other such reasons, is not a "profit or gain arising from any kind of property" or from "any profession, trade, employment, or vocation," and is therefore not

[46] Partridge v. Mallandaine, L. R. 18 Q. B. Div. 276.
[47] Ex parte Huggins, L. R. 21 Ch. Div. 85.

assessable as income of the recipient.[48] On the other hand, it was held that, where a corporation establishes a pension or benefit fund for its employés, requiring each of them to become a subscriber and to contribute a certain percentage of his salary, but contributions are returnable (except where forfeited for fraud or dishonesty) either by way of a superannuation benefit, or in a lump sum with interest in case of death or retirement, the full salaries of the employés accrue to them and are assessable for the income tax, and not merely the amount received after deducting such contributions.[49] On similar principles it is held that a gift of money, raised by voluntary subscriptions, and made annually to a minister of religion by his congregation, is assessable as income, because made to him as a minister and in respect to the discharge of his duties in that office, which is an "employment" within the meaning of the statute.[50] But where a curate receives from a religious society a grant in money, renewable annually at discretion and on certain conditions, and the grant is in recognition of faithful services as a clergyman, but not in respect of the particular curacy which he holds, it is held that it is not taxable as income.[51] So where a portion of a collection made in church was given by way of an "Easter offering" to the incumbent of the parish by reason of his office, but the gift would not have been made had not the recipient, besides being the incumbent, also been poor, it was held that the money was not given as an additional remuneration for services, but on account of personal poverty, and was therefore not taxable.[52]

Similar questions may arise in the administration of the income tax laws of this country. Suppose, for example, that

[48] Turner v. Cuxon, L. R. 22 Q. B. Div. 150.
[49] Hudson v. Gribble [1903] 1 K. B. 517, 4 Tax Cas. 522.
[50] In re Strong, 15 Scotch Law Rep. 704, 1 Tax Cas. 207.
[51] Turner v. Cuxon, L. R. 22 Q. B. Div. 150.
[52] Turton v. Cooper, 5 Tax. Cas. 138. But see Cooper v. Blakiston [1909] App. Cas. 104, 5 Tax Cas. 347.

one receives a gift of money from a relative, or draws a prize in a lottery or in any form of competition, or wins a bet on a race or at the gaming table, or (to take a worthier illustration) receives an award in money, not as payment for services but in recognition of meritorious conduct or achievement or discovery,—such as the Nobel prize—it is clear that he makes a "gain," though not a "profit," and that the sum received is "income" as distinguished from "principal" or "capital." The federal income tax law includes "the income from, but not the value of, property acquired by gift, bequest, devise, or descent." But aside from this specific exception, and as the problem might arise under other taxing laws, the question whether an acquisition of the kind supposed would be taxable as income must depend upon the construction of the statutes. They contain terms broad enough to cover all such cases, as, where the act of Congress in force declares that the tax shall be laid on "the entire net income received from all sources," and upon "gains or profits and income derived from any source whatever," and the Wisconsin statute, after enumerating certain items, taxes "all other income of any kind derived from any source whatever." If these expressions are to be construed as effective to the full extent of the language employed, they would undoubtedly include gifts, winnings, and pecuniary awards or prizes. But if, following the usual rule of statutory construction, the generality of these expressions is to be restricted by a comparison with the more specific terms used in the context, then they would include only gains or income from sources similar to, or comparable with, those already enumerated, such as salaries, professional earnings, mercantile business, invested capital, and so on. In this case, following the analogy of the English cases above cited, it seems that such acquisitions as those we have instanced would not be regarded as income.

The same remarks may apply to a judgment for money, the account of which is paid to the creditor within the taxing

year. If the cause of action were an injury to property or contract rights, it might be considered as, in some sense at least, a replacement of capital. If it were for services rendered, the amount of the judgment would clearly be "compensation," or even "salary" or "fees," though recovered by suit. But a judgment in an action of tort, as, for example, defamation of character or negligence causing personal injuries, would never be regarded as a part of one's income in the common acceptation of the term, and should not be brought within even the most extensive terms of the statute, since a broad and liberal construction in favor of the government is not the rule in such cases, but the reverse.

§ 39. Legacies and Inheritances

The income tax act of Congress of 1913 expressly excludes from the taxpayer's income "the value of property acquired by bequest, devise, or descent." The former act, that of 1894, on the other hand, included "money and the value of all personal property acquired by gift or inheritance." There was no exception as to legacies or property acquired by descent on which an inheritance tax had already been paid, though probably such inheritance tax itself might be deducted under the description of "taxes actually paid." The Wisconsin statute of 1911 allows a deduction of "inheritances, devises, and bequests received during the year upon which an inheritance tax shall have been paid to this state." It appears, therefore, that a resident of Wisconsin receiving a legacy from a non-resident, on which the inheritance tax had been paid in the state of the decedent's domicile, must include the amount thereof in his income for the year. The income tax law of Hawaii includes "money and the value of all personal property acquired by gift or inheritance," but with a proviso that there shall not be included in the income of any person or corporation "any bequest or inheritance otherwise taxed as such." In jurisdictions where the matter

is not thus provided for by statute, the question of taxing legacies or inheritances as income is not free from doubt, and the authorities cast but little light upon it. There is, however, an English case, in which it was ruled that a sum of money acquired as a legacy is not taxable under the denomination of "income." It was said by Chief Baron Kelly: "It would be something startling, and almost ludicrous, to contend that, when a fortune is left to an individual, if it happened to be in money, the whole fortune is to be taken as a year's income." [53] This was said arguendo, and is therefore strictly speaking obiter dictum, but the point was well brought out and elaborated, and the quotation clearly expresses the conviction of the court.

§ 40. Products of Agriculture or Stock-Raising

The profit derived by a farmer or stock-raiser from the sale of the products of the farm or ranch, that is, the amount received on such sales less the cost of production, constitutes income taxable under the statutes now in force. In one state, Virginia, this is specially provided for by the statute, which declares that "income" shall include "the amount of sales of live stock and meat of all kinds, less the value assessed thereon the previous year by the commissioner of the revenue," and "the amount of sales of wood, butter, cheese, hay, tobacco, grain, and other vegetable and agricultural productions during the preceding year, whether the same was grown during the preceding year or not, less all sums paid for taxes and for labor, fences, fertilizers, clover and other seed purchased and used upon the land upon which the vegetable and agricultural productions were grown or produced, and the rent of said land paid by said person, if he be not the owner thereof." [54] Though the other state statutes do

[53] Knowles v. McAdam, L. R. 3 Ex. Div. 23, 1 Tax Cas. 161.

[54] Acts Virginia 1903, c. 148, p. 155, as amended by Acts 1908, c. 10, p. 20. See this statute in full in the appendix to this volume.

not contain such explicit provisions as these, still their terms are broad enough to include the profits of agriculture and also to allow such offsets as those specified in the Virginia act, in computing the net return. Thus, the Wisconsin law, after enumerating certain sources of income, lays the tax on "all other income of any kind derived from any source whatever," and allows the deduction of "the ordinary and necessary expenses actually paid within the year in carrying on the profession, occupation, or business from which the income is derived." [55] As to the federal statutes, the income tax law of 1894 contained a specific provision on this subject, following the example of the income tax laws of the Civil War period. It directed that taxable income should include "the amount of sales of live stock, sugar, cotton, wool, butter, cheese, pork, beef, mutton, or other meats, hay, and grain, or other vegetable or other productions, being the growth or produce of the estate of such person, less the amount expended in the purchase or production of said stock or produce, and not including any part thereof consumed directly by the family." [56] The act of Congress now in force omits these particular provisions and reverts to the use of more general language. But it cannot be doubted that it applies to the subject under consideration, since it declares that "the net income of a taxable person shall include gains, profits, and income derived from * * * vocations, businesses, trade, commerce, or sales or dealings in property * * * or the transaction of any lawful business carried on for gain or profit."

It is to be noted that so much of the produce of a farm as is directly used and consumed by the farmer and his family is not to be reckoned as a part of his income, even though it

[55] Wisconsin Income Tax Law 1911, § 1087m, par. 2, clause 2f; Id., § 1087m, par. 4a. See this statute in full in the appendix to this volume.

[56] Act Cong. Aug. 27, 1894, § 28, 28 Stat. 509.

might have been sold, if not so used, and a profit derived from it.[57] Unsold and consumed in the use by the producer, it cannot possibly be brought within any definition of income, nor even regarded as the source of income. Nor need this rule be affected by the fact that the statute may expressly forbid the deduction of "personal, family, or living expenses," as this phrase obviously relates to money expended for such purposes.

In the next place, grain or other crops or live stock remaining in the producer's possession and unsold at the end of the year are not to be reckoned as a part of the year's income. This is to be inferred from the fact that those statutes which have dealt specifically with this matter have not directed that the term "income" should include the amount of crops raised, etc., or the value of such productions, but only the "amount of sales" thereof, after making the proper deductions. But aside from this consideration, the rule is deducible from the general principle that a law taxing income does not apply to any thing of value which, if sold, is capable of producing income, but which, remaining unsold, is to be regarded as principal or at most as a source of income. In other connections, it is true, the word has sometimes been stretched to this extent. Thus, on the construction of a statute providing that a guardian should improve the estate frugally, and apply the income to the maintenance of the ward, it was held that this use of the word "income" did not require the guardian to lease the real estate and so derive an income in cash from it, but that he might farm the land himself.[58] So, an early case in Maryland holds that, in a devise of real and personal estate and negroes in trust, the income to be applied for the benefit of a certain beneficiary, the word "in-

[57] Robertson v. Pratt, 13 Hawaii, 590; People v. Purdy, 58 Hun (N. Y.) 386, 12 N. Y. Supp. 307.

[58] Remington v. Field, 16 R. I. 509, 17 Atl. 551.

come" is broad enough to include the increase of the slaves.[59] But the rule of construction in regard to a tax law is not the same as that which applies in the case of a testamentary or other trust. Whatever latitude may be allowed in the latter case, to carry out the purpose of the trust, the rule for a statute imposing taxes is that the construction is strictly in favor of the taxpayer and nothing is included as taxable unless plainly and distinctly made so by the words of the act.[60]

§ 41. Produce of Mines and Oil and Gas Wells

The owners of mines producing coal, gold, silver, or other minerals, or of nitrate beds or other similar natural deposits, or of oil or natural gas wells, are assessable for the income tax upon the net profits realized by the sale of their products in each year.[61] The argument has sometimes been advanced that, as minerals in place constitute a part of the realty, and as the extraction of any given quantity leaves the investment of the owner worth just so much the less, the sale of mineral products should be regarded as a sale of capital assets, and not as income. Thus, in a case in Pennsylvania, an oil company, having all its capital invested in oil-producing property, and paying dividends entirely out of the products of its oil wells, resisted payment of an income tax assessed against it, claiming that it could have no taxable net income until the proceeds of its business had repaid all the capital invested, since, in view of the depletion of its sources of revenue, its dividends paid included not only earnings but also a portion of its capital returned in this way to the stockholders. But the court re-

[59] Holmes v. Mitchell, 4 Md. 532.

[60] Supra, § 29.

[61] See Alianza Co. v. Bell [1906] App. Cas. 18; Rhymney Iron Co. v. Fowler [1896] 2 Q. B. 79, 3 Tax Cas. 476; Knowles v. McAdam, L. R. 3 Ex. Div. 23, 1 Tax Cas. 161; Arizona Copper Co. v. Smiles, 29 Scotch Law Rep. 134, 3 Tax Cas. 149; Stevens v. Durban-Roodepoort Gold Min. Co., 5 Tax Cas. 402; United States v. Nipissing Mines Co., 202 Fed. 803; Commonwealth v. Ocean Oil Co., 59 Pa. St. 61. See, also, Treasury Decisions Nos. 1754 and 1755.

fused to accept this view, holding that all the income received by the company from its works, after deducting the operating expenses, was net income and taxable as such.[62] Moreover, this doctrine is well within the analogy and the reason of the well-known rule that in the case of mining companies, quarry companies, and the like, which have what is called a "wasting property," the payment of dividends to the stockholders out of the amount realized on the sale of their products is not regarded as an impairment of capital, nor are such companies required to create a sinking fund, out of earnings, before declaring dividends, to offset the gradual depletion of the property in which the capital is invested.[63] So it has been held that the income of a decedent's estate, as distinguished from the principal, includes the proceeds of the sale of oil produced after the testator's death, accruing as royalty under an oil lease of his lands made by him before his death in consideration of a royalty of part of the oil.[64] Further, the taxability of profits derived from the sale of minerals is recognized in the federal income tax law by the provision allowing a deduction "in the case of mines," for "depletion of ores and all other natural deposits on the basis of their actual original cost in cash or the

[62] Commonwealth v. Ocean Oil Co., 59 Pa. St. 61.

[63] People v. Roberts, 156 N. Y. 585; Excelsior Water & Mining Co. v. Pierce, 90 Cal. 131, 27 Pac. 44; Lee v. Neuchatel Asphalte Co., L. R. 41 Ch. Div. 1. In the case last cited it was said: "If a company is formed to acquire and work a property of a wasting nature, for example, a mine, a quarry, or a patent, the capital expended in acquiring the property may be regarded as sunk and gone, and if the company retains assets sufficient to pay its debts, it appears to me that there is nothing whatever in the act to prevent any excess of money obtained by working the property over the cost of working it from being divided amongst the shareholders; and this, in my opinion, is true although some portion of the property itself is sold, and in some sense the capital is thereby diminished. But it is, I think, a misapprehension to say that dividing the surplus after payment of expenses of the produce of your wasting property is a return of capital in any such sense as is forbidden by the act."

[64] In re Woodburn's Estate, 138 Pa. St. 606, 21 Atl. 16, 21 Am. St. Rep. 932.

equivalent of cash." Naturally there must also be deducted the cost of production, that is, of mining or extracting the ore, and the taxable net income of the owner will be the price received on the sale of his products less these deductions.

But here, as in the case of agricultural products discussed in the preceding section, the measure of taxable net income is not the amount or value of the products of the year's operation, but the net proceeds of sales, and hence there should not be included any ores or other products remaining unsold at the close of the year. And conversely, the year's income is not measured by the year's production. For irrespective of the time when the particular ores were brought to the surface, their proceeds are taxable as income of the year in which they are sold. Nor should the estimate of income be made to include any part of the products of mines or wells which is used by the owner in the heating, lighting, or operation of his own plant, or otherwise consumed in aid of production. There is one decision which apparently contravenes this last statement. Under a state statute imposing a percentage tax on the "gross receipts from total production" of coal and other minerals, it was held that a railroad company is subject to the tax on coal mined by it on its properties, though the coal is not sold but used in the operation of the road.[65] But the court felt compelled to adopt this conclusion by a consideration of the context and the necessity of bringing the different provisions of the act into harmony and effective operation. It was said: "With respect to the controversy as to the application of the law to coal mined and used by the railway company, no receipts being realized from sales, the rule of construction to be followed is that all the provisions relative to the matter should be harmonized and given effect, if that may be done consistently with the evident legislative intent. The tax purports to be laid upon a per centum of the 'gross receipts from the total production of coal,' and from these words standing alone a meaning might be extracted that

[65] Missouri, K. & T. Ry. Co. v. Meyer, 204 Fed. 140.

only taxation based upon sales was contemplated. But the tax is payable by all persons engaged in the mining or production of coal, etc., and not in selling it. A sworn return is exacted showing the location of the mine or well, the kind, the gross production, actual cash value, and other information, and while the auditor is, under the same section, authorized to ascertain the gross receipts and compute the tax, the next section empowers him to ascertain the amount and value of production, compute the tax, etc. And section 7708, in providing for a rebate of taxes when asphalt, ores, or petroleum, or other minerals, have been manufactured or refined, contemplates a tax irrespective of sale of the natural product and not dependent on the sale after it has been manufactured or refined. The intent, from the several provisions taken together, seems therefore manifest to provide for the collection of a tax, whether the mineral is put on the market or used by the producer, and by the expression 'gross receipts from total production' to refer to equivalents in either case, and accomplish the object of obtaining revenues from all production of mineral, regardless of use. This conclusion appears to be necessary, notwithstanding the conceded principles that taxes must be imposed by law, and that the law should be construed favorably to the taxpayer and not extended by implication beyond its clear intent."

§ 42. Profits of Mercantile Business

In so far as the income tax falls upon the profits of a merchant, the amount of it is not dependent on or estimated by the amount of his gross sales or gross receipts, but the taxable income is that derived from sales of goods made in excess of their cost, after deducting from the income or profits the expenses and other items allowed by the statute.[66] The deductions ordinarily allowed include interest on borrowed capital, taxes paid, losses incurred which are not compensated by insurance or otherwise, bad debts written off, and depreciation

[66] Millar v. Douglass, 42 Tex. 288.

of property. Besides, the statutes allow a deduction of "necessary expenses actually paid in carrying on the business," as in the federal statute, or "the ordinary and necessary expenses actually paid within the year in carrying on the business from which the income is derived," as in the Wisconsin statute. These expenses, in the case of ordinary mercantile business, will include such items as the prime cost of goods, salaries and wages of employés, freight, advertising, insurance, and the like. But it must be observed that the income from a mercantile business, under the tax law, is not merely the profit arising from the sale of that particular stock of goods which the merchant had on hand at the beginning of the tax year, but it is the net profit arising from the whole year's commercial dealings in the goods handled by the merchant, no matter how often, in the course of the year, his stock may have been depleted, wholly or in part, and renewed.[67]

§ 43. Profits from Unauthorized Business

It is held that where a state tax is laid upon the gross receipts or the net income of corporations, or upon the volume of business transacted by them as measured by such receipts or income, it may include and apply to receipts by the company derived from a business beyond its charter powers or in which it had no authority to engage.[68] And so it was ruled that a corporation cannot escape payment of United States internal revenue taxes on the ground that the business in which it is engaged, or from which its profits or income are derived, is unauthorized by its charter or by the laws of the state, or is otherwise ultra vires.[69] It is undoubtedly proper to apply these rulings to the assessment of federal and state income taxes. It is true the act of Congress refers to profits

[67] Wilcox v. Middlesex County Com'rs, 103 Mass. 544.

[68] People v. Roberts, 32 App. Div. 113, 52 N. Y. Supp. 859, affirmed, 157 N. Y. 677, 51 N. E. 1093.

[69] Salt Lake City v. Hollister, 118 U. S. 256, 6 Sup. Ct. 1055, 30 L. Ed. 176.

derived from the transaction of "lawful" business. But a business may be none the less lawful because it is beyond the limited powers of a particular corporation engaging in it. And it is probable that the word quoted was meant only to exclude those occupations which are forbidden to all persons, as being immoral or contrary to public policy, and the reason for excluding them was the apprehension that taxing them might appear to legalize them.

§ 44. Income from Partnership Business

The profit accruing from one's share in the business conducted by a partnership is a part of his income.[70] The net earnings of the partnership constitute income of the firm so long as they remain in the possession or to the credit of the firm as such. But when a proportionate part is drawn out and paid over to an individual partner, it becomes and constitutes a part of his private income. And although an interest in the stock in trade of a partnership or in the business which it conducts may represent an investment of capital, and therefore be "principal" or "capital" of the partner, it does not follow that his share of the earnings is impressed with the same character. On the contrary, the dividends of a partnership in which a decedent was interested, and which was continued after his death, have been held not to constitute a part of the corpus of his estate, any more than interest on money constitutes a portion of the principal invested; but such dividends are income and go to the life tenant or beneficiary under a trust.[71] It is true, however, that it would be unjust and double taxation to assess a partnership upon its income derived from its business, and then to tax each partner for his share of the profits as constituting his individual income. But this matter has generally been provided for in the statutes.

[70] In re Rogers, 37 Misc. Rep. (N. Y.) 54, 74 N. Y. Supp. 829; In re Slocum, 169 N. Y. 153, 62 N. E. 130.

[71] Heighe v. Littig, 63 Md. 301, 52 Am. Rep. 510.

The act of Congress does not tax partnerships at all. The Wisconsin statute taxes partnerships as well as individuals and corporations, but the individual is allowed to deduct from his taxable income "dividends or income received" from an "interest in any firm or copartnership, the income of which shall have been assessed under the provisions of this act." If the other existing statutes leave the subject in doubt, still it is thought that no court would sustain the attempt to assess and collect the tax twice upon the same income.

As to the undivided earnings of a partnership, it is true, as above stated, that they properly constitute income of the firm but not of the individual partners. Nevertheless, the act of Congress subjects them to taxation in the names of the partners. The provision is as follows: "Any persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid, under the provisions of this section, and any such firm, when requested by the Commissioner of Internal Revenue, or any district collector, shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same, if distributed."

§ 45. Profits on Sale of Real Estate

Where a parcel of real estate is sold for a price above its cost, the difference is not properly "income" of the vendor. It is more correctly described as an increase of capital assets. But it is certainly a "gain" or "profit," and falls within the meaning of either of those terms as used in the income tax laws. And it has always been the policy of such laws to assess the tax on a profit thus made, though it has been usual to set a limitation upon the time elapsing between the purchase and sale of the property, since land is often held for long periods and the increase in its value, in ordinary cases, may be

supposed to have been gradually accruing during the entire time. The federal income tax law of 1864 provided that "net profits realized by sales of real estate purchased within the year for which income is estimated shall be chargeable as income." The act of 1870 included in the description of taxable income "profits realized within the year from sales of real estate purchased within two years previous to the year for which income is estimated." The act of 1894 taxed "profits realized within the year from sales of real estate purchased within two years previous to the close of the year for which income is estimated." As to the state statutes, that of Wisconsin expressly includes as taxable income "all profits derived from the purchase and sale of any property acquired within three years previous," and this is construed by the state tax commission as referring to capital assets and not to ordinary stocks of merchandise, and therefore it would be applicable to real estate. The income tax law of Hawaii enumerates in the classes of taxable income "profits realized within the year from sales of real estate, including leaseholds, purchased within two years." The statutes of the other states contain no specific provision as to the profits on sales of land, but their general terms are broad enough to include this case.

The act of Congress of 1913 contains the following very ambiguous clause: "The net income of a taxable person shall include gains, profits, and income derived from * * * sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property." As to the latter part of this sentence, though it is difficult to discern any precise meaning in it, one may hazard the guess that it was intended to apply to the purchase and sale of leaseholds, life estates, undivided joint interests, and other estates less than a fee. Another possible construction might be suggested, and one which would give meaning and effect to the whole sentence. This might be accomplished by reading the word "or" into the clause between the words "per-

sonal" and "growing," as having been inadvertently omitted, and by a slight transposition of some of the other terms. The sentence would then read: "The net income of a taxable person shall include gains, profits, and income derived from * * * sales or dealings in property, whether real or personal, *or* growing out of the ownership or use of real or personal property or an interest therein." As thus reconstructed, the provision would lay the tax on what is called the "unearned increment" of land, that is, an increase in its market value, accruing within the year from any other cause than its improvement by the owner, or the corresponding profit or advantage to the owner, in view of the fact that he could now command a higher price for it than formerly, although he does not actually realize his profit by selling the property, but continues to hold it. But since this would greatly enlarge the scope of the statute, and subject to taxation various items which would be exempt under any other interpretation, it is doubtful whether the courts would feel justified in taking this course with it.

The term "dealings" has a definite meaning in law. It is equivalent to "traffic." It does not apply to the operations of one who buys to keep, though he may afterwards sell, but to the buying of any kind of property or commodity for the purpose of selling again at a profit, and that, not merely on a single occasion, but as an occupation or pursuit; or in other words, "dealing" in any article is making successive purchases and sales of it as a business.[72] It appears therefore that where one purchases a piece of real estate for residence purposes or as an investment, and sells it for a higher price than he paid, the profit must be included in his taxable income for that

[72] See Clifford v. State, 29 Wis. 327; Saunders v. Russell, 10 Lea (Tenn.) 293; Bates v. Bank of Alabama, 2 Ala. 451; Buckley v. Briggs, 30 Mo. 452; Norris v. Commonwealth, 27 Pa. St. 494; Overall v. Bezeau, 37 Mich. 506; State v. Barnes, 126 N. C. 1063, 35 S. E. 605; Vernon v. Manhattan Co., 17 Wend. (N. Y.) 524; Goodwin v. Clark, 65 Me. 280.

year. It might be argued that the word "sales" should take color from the word "dealings" with which it is associated. But it seems more probable that the legislative intention was to tax not only profits arising from dealing in real estate as a business, but also the profit accruing on single or isolated sales, not frequent enough to constitute dealing in it, and that the words were placed in juxtaposition to mark this distinction. The term "dealings" may be applied to one who buys and sells land as a speculation, or who buys vacant land and builds houses on it for the purpose of selling the property as so improved, or buys, opens up, and sells suburban property, or otherwise derives his income or a considerable part of it from traffic in real estate.

The construction which the English courts have put upon the income tax law of that country excludes the profit arising from a single sale of land, while including profits derived from buying and selling realty as a business. In a leading case, it appeared that a company was formed to buy land in the Malay Peninsula and there plant and cultivate rubber trees. It bought two estates and planted a considerable acreage, but did not produce or sell any rubber. Then, its capital being exhausted, it sold the entire property to another company for a price exceeding the amount of capital expended. It was held that the profit arising from the sale was an appreciation of capital, and not taxable as income. In delivering judgment, Lord Salvesen said: "I am unable to distinguish the position of the appellants from that of a person who acquires a property by way of investment and who realizes it afterwards at a profit. It is well settled that in such a case the profit is not part of the person's annual income liable to be assessed for income tax, but results from an appreciation of his capital. No doubt if it is a part of his business to deal in lands or investments, any profits which in the course of that business he realizes form part of his income; but the mere fact that a person or company has invested funds in the purchase of an es-

tate which has subsequently appreciated, and so has realized a profit on his purchase, does not make that profit liable to assessment." [73]

§ 46. Profits on Sales of Securities

In the general law (apart from matters of taxation) an addition to one's wealth obtained by selling stocks, bonds, or any other form of securities or investments at a price above their cost is not "income" but an appreciation of capital. Nor is it "profit" in the ordinary or commercial sense. Profit is the acquisition of gain above expenditures arising from some transaction or operation, and does not include premiums received on the sale of securities.[74] A similar rule prevails in the law of trusts and of wills. Thus, where a trustee invests money of the trust estate in bonds, and subsequently sells the bonds at an advance, and invests the proceeds in other securities, the profit on the bonds is part of the principal of the estate, and not income, as between the life tenant and the remainderman.[75] So the words "dividends and income" in a will devising property in trust, the dividends and income thereof to be paid to the testator's daughter, with remainder over after her death, do not include the increase in the value of the corpus of the estate caused by the investment of the funds and stocks and their sale and investment in other stocks at a profit.[76] But it seems that the "profits and income" of an estate devised in trust for a named beneficiary will include the profits made on land purchased by the executor at a foreclosure sale of a mortgage to secure a loan of the funds of the estate.[77]

[73] Tebrau Rubber Syndicate v. Farmer, 5 Tax Cas. 658.

[74] Cross v. Long Island Loan & Trust Co., 75 Hun (N. Y.) 533, 27 N. Y. Supp. 495.

[75] In re Graham's Estate, 198 Pa. St. 216, 47 Atl. 1108.

[76] Smith v. Hooper, 95 Md. 16, 51 Atl. 844; Eley's Appeal, 103 Pa. St. 300.

[77] In re Park's Estate, 173 Pa. St. 190, 33 Atl. 884.

In the English law of taxation, a profit realized from the sale of securities is not reckoned as income, except in cases where the person pursues the buying and selling of securities as a business or occupation. "It is quite a well-settled principle in dealing with questions of assessment of income tax, that where the owner of an ordinary investment chooses to realize it, and obtains a greater price for it than he originally obtained it at, the enhanced price is not profit in the sense of the income tax law. But it is equally well settled that enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realization, the gain they make is liable to be assessed for income tax. What is the line that separates the two classes of cases may be difficult to define, and each case must be considered according to its facts, the question to be determined being: Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in the operation of business in carrying out a scheme for profit-making?" [78] So where a person buys a doubtful debt and recovers a larger sum than he paid for it, the gain is not profit in the sense of the income tax law, unless the purchaser is making a trade of buying such debts.[79] But on the other hand, where a company is empowered by its charter to vary its investments, and gen-

[78] Californian Copper Syndicate v. Harris, 6 Fraser, 894, 5 Tax Cas. 159; Tebrau Rubber Syndicate v. Farmer, 5 Tax Cas. 658.

[79] Assets Co. v. Inland Revenue [1897] W. N. 144.

erally to sell or exchange any of its assets, the net gain by realizing investments at larger prices than were paid for them constitutes profit chargeable with income tax.[80]

In this country, however, under both the federal and state income tax laws, dealing as they do with income or profit from the "sale of property," it is difficult to see how the premium obtained on even a single sale of stock, or of a bond or other security, could escape assessment. Under the income tax laws of 1861 to 1870, it was held that a bona fide exchange of stocks for other property, however much to the apparent advantage of the owner of the stocks, was not a sale thereof from which a profit was derived liable to taxation as income. But a transfer of stocks for a promissory note, which is collectible, or an exchange thereof for land, followed by a sale of such land within the year, whether for cash or collectible promissory notes, was considered as equivalent to a sale of such stock for so much cash.[81] But in view of the limitation of time in those statutes, it was held that the profit made upon bonds bought in one year and sold several years later was not to be included in the estimate of the owner's income for the year in which the sale was made.[82] It will be noticed, however, that there is no limitation of time in the present federal income tax law, while that prescribed by the Wisconsin statute is three years.

§ 47. Increase in Value Not Realized by Sale

In the law of trusts, an increase in the market value of securities of any kind held as investments is not accounted a part of the income of the same, nor is it to be added to the stated interest which they return in computing the income. Even if the securities are sold, and the increment of value thus converted into money, it is not properly speaking a

[80] Scottish Investment Trust Co. v. Forbes, 31 Scotch Law Rep. 219, 3 Tax Cas. 231.

[81] United States v. Smith, 1 Sawy. 277, Fed. Cas. No. 16,341.

[82] Gray v. Darlington, 15 Wall. 63, 21 L. Ed. 45.

"profit," as we have shown in the preceding section. For an even stronger reason, therefore, it cannot be either a "profit" or a "gain" so long as not realized by sale. It is merely an appreciation of capital. "The rule, as settled, may be stated to be that an increase from natural causes in the value of real and personal estate held as an investment does not constitute profits, to go to a life tenant, but becomes principal and goes to the remainderman." [83] Thus, a life tenant entitled to the income of a certain legacy, which was invested, was held not entitled to the gain over the original amount invested, arising from an increase in the value of the subject of the investment as it existed in the life-time of the testator.[84] But a more direct authority for the application of these principles to the subject of income taxation is found in a decision of the United States Supreme Court, construing the act of Congress of 1864 imposing taxes on "gains, profits, and income." It was held that a mere increase in the market value of securities does not come within the definition of any one of those terms, and specifically, that the word "gains," as used in the statute, means such gains or profits as may be realized from a business transaction begun and completed during the preceding year. The court said: "The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital." [85] Notwithstanding this, the officers of the treasury department applied a different construction to the corporation excise tax law of 1909, which specified, as

[83] In re Vedder, 2 Con. Sur. (N. Y.) 548, 15 N. Y. Supp. 798. And see In re Gerry, 103 N. Y. 445, 9 N. E. 235; Jennery v. Olmstead, 36 Hun (N. Y.) 536; In re Proctor, 85 Hun (N. Y.) 572, 33 N. Y. Supp. 196; Linsly v. Bogert, 87 Hun (N. Y.) 137, 33 N. Y. Supp. 975.

[84] Thomson's Estate, 11 Pa. Co. Ct. R. 198.

[85] Gray v. Darlington, 15 Wall. 63, 21 L. Ed. 45.

the measure of taxation, the "net income" of the corporation, above a certain amount, "received from all sources," a narrower expression, it will be noticed, than that of the income tax law. They ruled that a corporation must return, in its estimate of net income, not only profits realized on the sale of real estate during the year, but also an increase in the value of unsold property, if taken up on the books of the corporation; and that any increase in the value of the capital assets, as determined by a physical revaluation, and taken cognizance of by the corporation in book entries, is gain and must be accounted for as income for the year in which such increase is so recognized and recorded.[86] And it must further be remarked that, if the courts should eventually adopt such a construction of the act of Congress of 1913 as would permit the taxation of the "unearned increment" of land, as suggested above (supra, § 45), it is probable that the same principle would have to be applied to the increase in value of securities, since the statute, at this point, carefully specifies both real and personal property as sources of gains, profits, or income.

§ 48. Uncollected Interest and Accounts

It is an unsettled question whether a person's income for a given year should be held to include interest on securities accruing within the year but remaining uncollected at its close, and promissory notes and due-bills taken in discharge of a pre-existing indebtedness, but not paid within the year in which they are given, and the price of goods sold within the year, evidenced by book entries, but not received in cash. Some of the statutes have expressly included such items; others have not mentioned them. Thus, the act of Congress of 1864 laid the tax, among other things, on "interest received or accrued upon all notes, bonds, and mortgages, or other forms of indebtedness bearing interest, wheth-

[86] Treasury Decision No. 1742, pars. 43, 48, and 85.

er paid or not, if good and collectible." And the same language was included in the act of 1870 and in that of 1894. It will be noticed that this specified only "interest," and as to notes and accounts, the courts did not agree. In one case it was held that, within the meaning of the statute, the word "income" must be taken to mean money, and not the expectation of receiving it or the right to receive it at a future time. And hence it was ruled that the amount of a promissory note taken in 1871 on the sale of a patent right, but not due until 1872, and paid in the latter year, was not taxable as income of the former year.[87] But in another case it was said that promissory notes, book accounts, and the like, due during a given year, may or may not be income of that year. This depends on their value intrinsically or their convertibility into money, property, or available assets. If they have only a nominal, and not a real value or convertible quality, and a man has realized nothing from them, and therefore does not return them as a part of his income, because he honestly believes that they are not real gains or profits, he cannot be convicted of making a false return.[88] And in construing the corporation excise tax law of 1909, it was held that the word "income," as there used, meant that which has "come in" or which has been already received, and that the net income so taxable should be determined on a cash basis, as distinguished from a revenue basis, and hence (in the case of an insurance company) did not include uncollected and deferred premiums and interest, accrued and due, but not actually received.[89]

The federal income tax law of 1913 makes no specific mention of this point, and its intention in regard thereto is not easy to discern. Yet it is a significant fact that, in enumerating the deductions which the taxpayer is allowed to

[87] United States v. Schillinger, 14 Blatchf. 71, Fed. Cas. No. 16,228.
[88] United States v. Frost, 9 Int. Rev. Rec. 41, Fed. Cas. No. 15,172.
[89] Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199.

make from his return of income for taxation, aside from business losses, bad debts, and depreciation of property, only those items are included which represent an outlay in cash, such as "interest paid within the year," "necessary expenses actually paid," and "taxes paid." Hence it may be argued that if Congress did not allow the deduction of items falling due within the year but not actually paid, it would not be equitable to require the taxpayer to include in his income interest and other items accrued and due within the year, though not actually collected. This same argument (as regards the propriety of looking to the one part of the statute to ascertain the meaning of Congress in the other part) was advanced by the court in deciding a leading case under the corporation tax law of 1909. Since that statute allowed as deductions only cash outlays, as, "expenses actually paid," "interest actually paid," and "sums paid for taxes," it was argued that "it would be strange indeed if, on the opposite side of the account, the company were charged with what it had not received during the current year." [90]

And it cannot be denied that it is shocking to the common sense of business men to call that "income" of the year which has not been received or "come in," but which has merely fallen due. And so the courts have ruled in several cases. In one, it was held that interest accrued but not payable, and interest accrued but not paid, secured by mortgages drawing interest, are not "surplus profits" of a corporation. "It is not easy to comprehend," said the court, "how profits or surplus profits can consist of earnings never yet received. The term imports an excess of receipts over expenditures, and without receipts there cannot properly be said to be profits. Money earned as interest, however well secured, or certain to be eventually paid, cannot, in fact, be distributed as dividends to stockholders and does not con-

[90] Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199.

stitute surplus profits within the meaning of the statute." [91] In another case, it was held that a tax directed to be levied and collected for and during a certain year on the amount of all interest or coupons paid on the bonds of certain corporations, "whenever and wherever the same shall be payable," did not cover interest earned during the year, but payable afterwards.[92] And in a third decision we find the court saying: "It seems almost to border upon absurdity to speak of income as including that which has not been received, and which in the ordinary uncertainties of business may never be received. How can it be affirmed of unpaid interest that it will ever be paid, or, if so, when? The same is true of uncollected and deferred premiums. It is manifestly impossible to tell when, if ever, they will be paid. They are neither receipts nor income until paid." [93]

Turning to the statutes of the various states, we find that the Wisconsin income tax law does not mention this specific point, but that it lays the tax on "income received," and makes the term "income" include "interest derived from money loaned or invested in bonds, mortgages, or other evidences of debt of any kind whatsoever." And the statute of South Carolina contains substantially the same language. Under these laws, it seems a fair inference that there was no intention to tax uncollected interest, since it could not be described as "income received." The statute of Virginia is most ambiguous on this point, inasmuch as it professes to tax "income in excess of one thousand dollars, whether received or due but not received, within the year," but at the same time makes the term "income" include "interest upon bonds, notes, or other evidences of debt collected or received during the year."

[91] People v. San Francisco Sav. Union, 72 Cal. 199, 13 Pac. 498.
[92] United States v. Indianapolis & St. L. R. Co., 113 U. S. 711, 5 Sup. Ct. 716, 28 L. Ed. 1140.
[93] Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199.

§ 49. Profit to Accrue on Uncompleted Contracts

In construing the corporation tax law of 1909, which laid a tax measured by the "entire net income received from all sources," the officers of the treasury department ruled that "net income on uncompleted contracts may be estimated on the basis of the percentage of the work completed as compared with the contract price of the whole work." [94] But this ruling is believed to be wholly indefensible. First, because it fails to distinguish between earnings and income. The price to be paid for work done under a contract may be considered to have been earned when the work is completed, and it may be said to have been earned pro tanto as the work progresses. But in neither case can it be described as "income" until it has been actually paid over and received. That term does not mean the right to receive, or the expectation of receiving, a payment in the future. Secondly, no contractor can be absolutely certain of receiving the price when the work is done. His expectation of so doing may be more or less confident according to the circumstances, but even at the best he cannot be sure that he will not have to reckon with claims for offsets or deductions. And it would seem clear that money which may or may not be paid in the future, and, if paid, may be greater or less in amount, is in no sense income. Further, the ruling in question would be entirely inapplicable to those contracts which involve personal skill, personal confidence, professional services, or the like, where the stipulated compensation is not apportionable.

§ 50. Profits from Sale or Lease of Patent Rights

The Commissioner of Internal Revenue ruled, under the corporation tax law of 1909, that receipts from the sale of patent rights are to be included in taxable income, and also that royalties received on patent rights (presumably either on the sale or lease of such rights or on the use of the pat-

[94] Treasury Decisions, No. 1742, par. 88.

ented article) are also to be reckoned and reported as income, though an allowance would be made for depreciation of patents expiring during the year.[95] And the Wisconsin income tax law makes the term "income" include "all royalties derived from the possession or use of franchises or legalized privileges of any kind," which is construed by the tax commission of that state as including royalties received from patents. As to royalties on sale or lease the case is clear, but not so as to receipts from the sale of patents or patent rights. One who buys a patent or rights under a patent, and then sells it at an advanced price, may be said to have made a "profit" which should be taxable as a part of his income. But where the patentee sells (for example) his rights under the patent in foreign countries, it would rather seem to be a conversion of capital assets into the form of money than the receipt of income.

§ 51. Annuities

The revenue law in Massachusetts provides that "personal estate, for the purpose of taxation, shall include * * * the income from an annuity." [96] And the act of Congress of 1913 provides that "all persons, firms, copartnerships, companies, corporations, * * * and insurance companies, * * * having the control, receipt, custody, disposal, or payment, directly or indirectly, of * * * annuities * * * or other fixed or determinable annual gains, profits, and income of another person," exceeding the statutory minimum, shall not only make the necessary return thereof, but also deduct and withhold the income tax and pay it over to the United States. From this it may plainly be seen that, at least under the two statutes mentioned, an annuity is regarded and treated as taxable income, whether it be created by grant, by testamentary trust, or by the contract of an insurance company.

[95] Treasury Decisions, No. 1742, pars. 46 and 61.
[96] Rev. Laws Mass. 1902, p. 206; Gen. Stat. Mass. c. 11, § 4.

§ 52. Interest on Government Bonds

The federal statute now in force provides that, in computing the net income of a taxpayer, for the purpose of the income tax, there shall be excluded "interest upon the obligations of the United States or its possessions." In former statutes of the same kind Congress did not hesitate to include the obligations of the federal government. In the act of 1861, the tax was imposed, among other things, upon "interest upon treasury notes or other securities of the United States." The act of 1862 taxed "interest upon notes, bonds, or other securities of the United States," as did also the act of 1864 and that of 1870. In the act of 1894, the provision was that "there shall be included all income derived from interest upon notes, bonds, and other securities, except such bonds of the United States the principal and interest of which are by the law of their issuance exempt from all federal taxation." Under the corporation excise tax law of 1909, it was ruled that interest on United States bonds must be included in estimating the net income of corporations, because this statute imposed a tax, not on the property of the corporation nor directly upon its income, but upon the privilege of carrying on business in a corporate capacity, the net income being used only as a measure of the tax in each particular case.[97]

It is not competent for the several states to tax income derived from the bonds or other obligations of the federal government. This limitation might be inferred from general principles of constitutional law.[98] But it is also expressly provided by act of Congress that "all stocks, bonds, treasury notes, and other obligations of the United States shall be exempt from taxation by or under state or municipal or local authority." [99] Some of the states having income tax laws expressly recognize this restriction. Thus, in Wisconsin, the

[97] 28 Op. Att. Gen. 138; Treasury Decisions, No. 1742, par. 37.
[98] See, supra, § 17.
[99] Rev. Stat. U. S., § 3701, U. S. Comp. St. 1901, p. 2480.

taxpayer is allowed to deduct from his income as returned for taxation "interest received from bonds or other securities exempt from taxation under the laws of the United States." [100] In South Carolina, the provision is that, "in estimating the gains, profits, and income, there shall not be included interest upon such bonds or securities of this state, or of the United States, the principal and interest of which are, by the law of their issue, exempt from taxation." [101] In two other states, the law purports on its face specifically to tax income derived from United States bonds. But to that extent, these statutes must necessarily be held invalid in any case in which the attempt was made to enforce such a provision. The states intended are Virginia and Tennessee. In the former, the law provides that "income shall include * * * interest upon notes, bonds, or other evidences of debt, of whatever description, of the United States or any other state or country." [102] In Tennessee, the statute reads: "The amount of income derived from United States bonds, and all other stocks and bonds not taxed ad valorem, shall be taxable" at the rate of five per centum.[103]

§ 53. Dividends on Corporate Stock

Whatever the taxpayer may actually receive from a corporation, by way of dividends on the shares of its stock which he owns, constitutes a part of his income and will be taxable as such.[104] This rule, however, is subject to two limitations. First, a "dividend," properly so called, is a distribution to stockholders of the whole or a part of the current earnings or profits of the corporation, and not a distribution of capital assets. When a portion of the capital is thus returned to stockholders, it is not income, from their point of view, but a

100 Wisconsin Income Tax Law 1911, § 1087m, 4, e.
101 Civ. Code S. Car. 1902, § 325.
102 Acts Va. 1908, c. 10, p. 20, § 10.
103 Code Tenn., §§ 690, 710.
104 Magee v. Denton, 5 Blatchf. 130, Fed. Cas. No. 8,943.

replacement of capital, except in the few exceptional cases where it is permissible for a corporation to divide current receipts among the stockholders, although the property in which the capital is invested is correspondingly depleted, as in the case of mining and quarry companies and some others.[105] Secondly, where a statute taxing incomes lays its burden upon both individuals and corporations, it is usual to provide that the individual taxpayer may deduct from his return of income for taxation the amount of any dividends received by him from corporations which are subject to the tax, or which have been assessed for the tax or have paid it. This is a just provision, introduced for the purpose of avoiding the double taxation which would result if the corporation were taxed on its profits and the stockholders on the same profits when divided among them.

Subject to these provisions, the income tax laws quite commonly enumerate "dividends" among the specific sources of taxable income. But on general principles of law, and even when not so declared in the tax statute, revenue of this kind is always classed as "income." And it is immaterial whether a corporate dividend is declared and paid as a regular dividend (that is, regular in respect either to its periodicity or its amount) or as an extra dividend or a bonus in cash.[106] Thus, where a testator bequeathed to his wife for her life the "use, interest, and income" of his estate, part of which consisted in stock in an incorporated bank, and the bank afterwards reduced its capital, by returning to the stockholders one-half of it with a premium of 40 per cent to be paid out of the surplus, it was held that the word "income" included the 40 per cent premium returned to the testator"s estate, and that it passed under the will to the widow.[107] And the rule is not

[105] Supra, § 41. And see Reed v. Head, 6 Allen (Mass.) 174; Harvard College v. Amory, 9 Pick. (Mass.) 446.

[106] Lord v. Brooks, 52 N. H. 72.

[107] In re Warren, 2 Con. Sur. (N. Y.) 411, 11 N. Y. Supp. 787.

restricted to dividends declared and paid by corporations truly so called, but extends also to any distribution of profits among the members of an unincorporated society, syndicate, pool, trust, or other joint enterprise. For instance, where an investment is made in an unincorporated association organized to deal in land as a commodity, and profits are realized from the business, which are divided among the members, with no impairment of the principal, such profits are personalty, representing income, and go to the life tenant under the will of one of the members.[108] And it has been ruled that, when a dividend has been declared and is immediately payable, so that the stockholder can have it on demand, it is to be reckoned as a part of his income for the year, though it has not actually come into his hands as yet in the form of cash. It was said: "If the plaintiff's counsel is correct in his position that the profits of an incorporated company, itself an artificial person, are not, in the contemplation of the act of Congress, a portion of the gains, profits, or income of the stockholders, until they are distributed as dividends, or embraced in a dividend declared by the managers of the corporation, I think it quite clear that, when a dividend has been declared and has become payable, the mere omission of the stockholder to receive or obtain the dividend subject to his call would not excuse him from embracing the amount of such dividend in his statement of his taxable income for the year." [109]

§ 54. Same; Stock Dividends

It is a debatable and unsettled question whether a dividend declared by a corporation, but not payable in cash but in the form of new stock distributable among the present stockholders proportionally, the nominal capital being correspondingly increased, is to be accounted "income" or "capital" in the

[108] In re Thomson's Estate, 153 Pa. St. 333, 26 Atl. 652.
[109] Magee v. Denton, 5 Blatchf. 130, Fed. Cas. No. 8,943.

hands of the stockholder. And this is immediately pertinent to the subject in hand, because if the stockholder receives such a dividend as an accretion to his capital, it is not subject to the income tax, while, on the other hand, if it is income, he should include it in his return, and probably at its market value. Probably it may be stated that the rule as stated by the Court of Appeals of New York is sustained by a majority of the decisions. It is this: Where a dividend is declared by a corporation on its capital stock, payable in new stock certificates based on accumulated but undivided profits, it is received as "income" by the stockholders, and not as capital, since the substance and intent of such a transaction is the distribution of earnings, and it does not result in any actual addition to capital, for although the nominal amount of the corporation's capital stock is thereby increased, yet the corporation actually has neither more property nor more capital.[110] But in Massachusetts and some other states, a contrary rule prevails.[111] In Maryland, the court has ruled that, in determining whether a stock dividend declared on stock constituting the corpus of a trust estate is a part of the corpus, so as to pass to the remainderman, or income available for the life beneficiary, the court is not governed by the form in which the dividend has been declared, but the character of the fund out of which the dividend is paid controls; and where the dividend represents earnings, the dividend is income, while if it is an appropriation of capital, it is a part of the corpus.[112]

[110] Lowry v. Farmers' Loan & Trust Co., 172 N. Y. 137, 64 N. E. 796. And see Soehlein v. Soehlein (Wis.) 131 N. W. 739; Earp's Appeal, 28 Pa. St. 368; Hite's Devisees v. Hite's Ex'r, 93 Ky. 257, 20 S. W. 778; Pritchett v. Nashville Trust Co., 96 Tenn. 472, 36 S. W. 1064, 33 L. R. A. 856; Moss' Appeal, 83 Pa. St. 264.

[111] Minot v. Paine, 99 Mass. 101, 96 Am. Dec. 705; Parker v. Mason, 8 R. I. 427; Chester v. Buffalo Car Mfg. Co., 70 App. Div. 443, 75 N. Y. Supp. 428.

[112] Ex parte Humbird (Md.) 80 Atl. 209.

§ 55. Accumulated Earnings or Undivided Profits of Corporations

These are taxable under the act of Congress of 1913, as income of the stockholder, but only in cases where the taxable income, including such items, is large enough to be subject to the super-tax or additional tax, and only in cases where the device of a corporation, accumulating its profits instead of dividing them, is resorted to for the purpose of evading the tax. The provision is that "for the purpose of this additional tax, the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint stock companies, or corporations however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint stock company, or association is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such cases unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint stock company, or association shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same if distributed." From the fact that this applies only "for the purpose of the additional tax" it may be inferred that Congress did not regard a stockholder's in-

terest in the undivided earnings or surplus of the corporation as taxable income in ordinary cases or under ordinary conditions. But the attempt has sometimes been made, under other statutes, to tax such interest as income. Thus, the United States income tax law of 1870 provided that, "in estimating the gains, profits, and income of any person, there shall be included * * * the share of any person of the gains and profits, whether divided or not, of all companies or partnerships." And there is a Canadian decision to the effect that the undivided profits of a corporation, or a portion of its profits derived from the employment of capital and annually carried into a reserve fund, may be "income" for the purposes of a testamentary trust, by which it was provided that the trustee might make advances to the beneficiaries "out of income." [113] But this is contrary to all the weight of authority.[114] In several of the cases on the subject, it is said that the word "income" is not broad enough to include things not separated in some way from the principal. It is not synonymous with "increase." The value of corporate stock may be increased by good management, prospects of business, and the like, but such increase is not income. It may also be increased by the accumulation of a surplus fund. But so long as that surplus is retained by the corporation, either as a surplus or as increased stock, it can in no proper sense be called income. It may become income-producing, but it is not income.[115] Thus, where the profits of a manufacturing or banking corporation have been accumulating for many years, until the market value of the stock is more than double its original price, and the owner dies, directing the "income" of his estate to be applied to

[113] Worts v. Worts, 18 Ontario, 332.

[114] Lauman v. Foster (Iowa) 135 N. W. 14; Tubb v. Fowler (Tenn.) 99 S. W. 988.

[115] Spooner v. Phillips, 62 Conn. 62, 24 Atl. 524, 16 L. R. A. 461; Mills v. Britton, 64 Conn. 4, 29 Atl. 231, 24 L. R. A. 536; Smith v. Hooper, 95 Md. 16, 51 Atl. 844.

particular objects, these extraordinary accumulations are as much a part of his capital as any other portion of his estate, and must therefore be regarded, not as income, but as part of the principal from which the future income is to arise.[116] This subject has been fully and conclusively discussed by the United States Supreme Court in the following terms: "Money earned by a corporation remains the property of the corporation, and does not become the property of the stockholders, unless and until it is distributed among them by the corporation. The corporation may treat it and deal with it either as profits of its business or as an addition to its capital. Acting in good faith and for the best interests of all concerned, the corporation may distribute its earnings at once to the stockholders as income; or it may reserve a part of the earnings of a prosperous year to make up for a possible lack of profits in future years; or it may retain portions of its earnings, and allow them to accumulate, and then invest them in its own works and plant, so as to secure and increase the permanent value of its property. Which of these courses shall be pursued is to be determined by the directors, with due regard to the condition of the company's property as a whole; and, unless in case of fraud or bad faith on their part, their discretion in this respect cannot be controlled by the courts, even at the suit of owners of preferred stock, entitled by express agreement with the corporation to dividends at a certain yearly rate in preference to the payment of any dividend on the common stock, but dependent on the profits of each particular year, as declared by the board of directors. Reserved and accumulated earnings, so long as they are held and invested by the corporation, being part of its corporate property, it follows that the interest therein, represented by each share, is capital, and not income of that share, as between

[116] Earp's Appeal, 28 Pa. St. 368.

the tenant for life and remainderman, legal or equitable thereof." [117]

But it is not only on general principles of law that this result is reached, but decisions to the same effect have been made under the earlier income tax laws. It was held that undivided earnings of a corporation are not taxable as income of the stockholders.[118] And the Supreme Court, construing the provisions of the income tax act of 1870, laying a tax on all undivided profits of corporations accrued and earned and added to a surplus, contingent, or other fund, held it to be plain that it was the intention of Congress not to subject to that tax profits of a railroad corporation during the year, which were not divided but used for construction.[119]

§ 56. Right to Subscribe for New Stock of Corporation

It is a familiar rule in the law of corporations that when a company issues new stock (or stock previously held in reserve in the treasury), it must first be allotted to the existing stockholders, each being entitled to take his proportionate share at a price fixed. This price is usually and properly the par value of the stock, and if its market value is greater, a considerable advantage may accrue to the shareholder, who may either take his new stock and sell it at a premium or sell his right of subscription for it, and indeed the sale of these "rights" is a common occurrence on the stock exchanges. The courts all hold that the gain realized by a stockholder, either from a sale of the privilege or from its exercise and the subsequent sale of the stock at a profit, is capital or principal in his hands and not a part of his in-

[117] Gibbons v. Mahon, 136 U. S. 549, 10 Sup. Ct. 1057, 34 L. Ed. 525.

[118] Ex parte Ives, Fed. Cas. No. 7,114.

[119] Marquette, H. & O. R. Co. v. United States, 123 U. S. 722, 8 Sup. Ct. 319, 31 L. Ed. 302.

come.[120] Thus, in a case in Pennsylvania, it appeared that a testator held stock in the B. railroad company, which, in order to extend its line, organized another company, with sufficient capital stock to build it, and the unbuilt line was mortgaged for a sum sufficient to build it, and the B. company issued bonds for the amount secured by the mortgage, and such bonds the stockholders of the B. company were permitted to take at par, in proportion to their holdings, and the capital stock of the new company was thrown in as a bonus to those who subscribed for the bonds. It was held that the premium at which the option to subscribe to the stock of the new company was sold was principal, and not income from stock of the B. company.[121] But under the income tax laws it might be argued that the premium obtained by the sale of a stockholder's subscription rights, though it is not income, may be described as "gain" or "profit," and so be taxable, especially where the statute, like the act of Congress now in force, taxes gains and profits arising from the sale of or dealing in personal property. But in the absence of any decision on this point, the opinion may be hazarded that such a transaction is not within the spirit or the equity of a statute purporting to tax "incomes" as its principal feature, though it might come within the literal meaning of the language employed.

§ 57. Sale and Distribution of Assets of Corporation

A distribution among stockholders of the assets of a corporation, upon its dissolution or preparatory to dissolution, is a return of capital, at least to the extent of the original in-

[120] Lauman v. Foster (Iowa) 135 N. W. 14; Brinley v. Grou, 50 Conn. 66, 47 Am. Rep. 618; Moss' Appeal, 83 Pa. St. 264, 24 Am. Rep. 164; Biddle's Appeal, 99 Pa. St. 278; In re Thomson's Estate, 153 Pa. St. 333, 26 Atl. 652. But compare Wiltbank's Appeal, 64 Pa. St. 256, 3 Am. Rep. 585.

[121] In re Thomson's Estate, 153 Pa. St. 333, 26 Atl. 652.

vestment, and not in any sense income in their hands.[122] Thus, a fund resulting from sales of materials, manufactured articles, products from the land, or the general personal property of a corporation, all indicating a final winding up of its business, cannot be called income of the stockholders when apportioned among them.[123] And where a corporation sells part of its original franchise and property, and distributes the proceeds of the same as a dividend among its stockholders, such dividend is to be regarded, as between a life tenant and remainderman of part of the stock, as capital and not as income.[124]

[122] In re Thomson's Estate, 153 Pa. St. 333, 26 Atl. 652.
[123] Gehr v. Mont Alto Iron Co., 174 Pa. St. 430, 34 Atl. 638.
[124] Vinton's Appeal, 99 Pa. St. 434, 44 Am. Rep. 116.

CHAPTER VI

PERSONS AND CORPORATIONS SUBJECT TO TAX

§ 58. Residents

Every person residing within the United States, whether he is an American citizen or an alien, is subject to the federal income tax. And in the states where similar tax laws are in force, they are generally made applicable to "residents" of the state, without regard to whether such persons are citizens of the United States or of the taxing state, although in South Carolina the statute refers to "every citizen of this state." Disputed questions chiefly arise in the case of persons who maintain homes in two or more states (or in the United States and also abroad) or who spend a large part of their time in travelling. In such cases, the test of "residence" will be the location of that establishment which the person regards as his home, and to which he has the intention of returning whenever absent, however protracted may

be his absence. Or, according to the circumstances, it will be determined by the proportion between the time which the person spends within the given jurisdiction and that which he spends elsewhere, "residence" implying a more or less fixed and permanent abode, as distinguished from a temporary sojourn for business or other purposes.

These rules, as specially applicable to matters of taxation, may be illustrated by the following cases: In a late case in Iowa, it was held that one who, after living continuously for many years in the same house, starts on a tour of the world, leaving the house in charge of a care-taker, remains a "resident" of the state and city where his house is, for purposes of taxation, during his absence from the country, even though he may intend, on his return, to remove to another state.[1] In England it is held that a master mariner, trading between an English port and various foreign ports, who maintains a home for his family in the English port, is liable for the income tax on his salary, notwithstanding the fact that he is abroad for much the greater part of the year, and that most of his salary is earned on the high seas and not in England.[2] In another English case it appeared that an American citizen had for the last twenty years lived on board his own yacht, which was anchored in tidal navigable waters in England, obtaining his provisions and necessaries from the nearest village. The yacht had always been kept fully manned and ready to go to sea at any moment. It was held that the owner was a person "residing in the United Kingdom" within the income tax act, and was assessable accordingly.[3] A similar decision was made in the case of an American citizen, having no place of business in Great Britain, but who rented a house and shooting rights in Scotland, where he spent about

[1] Barhydt v. Cross (Iowa) 136 N. W. 525.

[2] In re Young, 12 Scotch Law Rep. 602, 1 Tax Cas. 57; Rogers v. Inland Revenue, 16 Scotch Law Rep. 682, 1 Tax Cas. 225.

[3] Brown v. Burt, 81 Law J. K. B. 17.

two months continuously in each year, accompanied by his valet, as he had no family. His house in New York was always kept in readiness for his return, but so was the house in Scotland, which was kept furnished and ready for his occupation at any time. It was held that he was a person "residing in the United Kingdom" for the purposes of the income tax.[4] So also, where a merchant carried on business in Italy, where he ordinarily resided, but also owned a place of residence in England, where he dwelt with his family for several months in the year, it was held that he was a resident of England, and was liable to taxation in respect to the profits of the business carried on abroad.[5]

§ 59. Residents Deriving Income from Abroad

Under the act of Congress, persons residing within the United States are required to pay the tax upon "the entire net income received from all sources," which includes foreign investments and business as well as domestic. This is further shown by the provision that the amount of the tax "shall be deducted and withheld from coupons, checks, or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations, not payable in the United States, and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations, and insurance companies engaged in business in foreign countries." Under similar provisions in the corporation tax law of 1909, it was ruled that American corporations should include in their returns not only the income derived from the business carried on within the confines of the United States, but income received from business transacted in any foreign country as well.[6] This is

[4] Cooper v. Cadwalader, 5 Tax Cas. 101.
[5] Lloyd v. Sulley, 21 Scotch Law Rep. 482, 2 Tax Cas. 37.
[6] Treasury Decisions, No. 1742, par. 9.

also the law in England. Thus, a corporation organized in that country and maintaining a head office there, where its directors meet and administer its general affairs, and to which its revenues are remitted, is assessable for the income tax in England, though all its profits are derived from plantations, mines, or other enterprises conducted in foreign countries.[7] And so, dividends declared by a foreign corporation and payable at its agency in London, on shares owned by a British citizen and resident, are taxable as part of his income.[8]

It is also within the competence of the several states to tax their resident citizens upon intangible personal property, consisting, for example, of shares of stock in foreign corporations, and no constitutional provision is thereby violated.[9] Naturally, therefore, they also have the power to tax income derived from such sources, and this has generally been provided for in the income tax laws of the states. In Hawaii, it is true, the tax is levied on "income derived by every person residing in the territory of Hawaii from all property owned, and all business, trade, profession, employment, or vocation carried on in the territory." [10] But this is exceptional. In South Carolina, the provision of the statute is somewhat ambiguous. It lays the tax upon "income received during the preceding calendar year by every citizen of this state, whether such gains, profits, or income be derived from any kind of property, rents, interests, dividends, or salaries, or from any profession, trade, employment or vocation carried on in this state, or from any other source whatever." [11] On the ordinary principles of statutory construction, the words

[7] Cesena Sulphur Co. v. Nicholson, L. R. 1 Ex. Div. 428; Imperial Continental Gas Ass'n v. Nicholson, 37 Law T. 717, 1 Tax Cas. 138; Scottish Mortgage Co. v. McKelvie, 24 Scotch Law Rep. 87, 2 Tax Cas. 165.

[8] Gilbertson v. Fergusson, L. R. 7 Q. B. Div. 562, 1 Tax Cas. 501.

[9] Darnell v. Indiana, 226 U. S. 390, 33 Sup. Ct. 120, 57 L. Ed. ——.

[10] Session Laws Hawaii 1901, p. 31.

[11] Civ. Code S. Car. 1902, § 325.

"carried on in this state" should be referred to the phrase "profession, trade, employment or vocation," leaving the provision as to "property, rents, interests, dividends, or salaries" entirely unrestricted. And even if this argument should fail, the following clause, "from any other source whatever," is broad enough to include income from foreign investments or business. In Wisconsin a distinction is made between income from foreign investments and income from foreign business. It is provided that "so much of the income of any person residing within the state as is derived from rentals, stocks, bonds, securities or evidences of indebtedness shall be assessed and taxed, whether such income is derived from sources within or without the state," which is explained by the tax commission of that state as being "in analogy to the rule that intangible property follows the residence of the owner for purposes of taxation." But the statute further provides that "any person engaged in business within and without the state shall, with respect to income other than that derived from rentals, stocks, bonds, securities or evidences of indebtedness, be taxed only upon that proportion of such income as is derived from business transacted and property located within the state." [12] And a rule for determining the proportion is prescribed.[13]

[12] Wisconsin Income Tax Law 1911, § 1087m, par. 2, cl. 3.

[13] The rule to be followed, as far as applicable, is that prescribed for determining the proportion of a corporation's capital stock which is employed in business within the state, and is as follows: "In determining the proportion of capital stock employed in the state, the same shall be computed by taking the gross business in dollars of the corporation in the state and adding the same to the full value in dollars of the property of the corporation located in the state. The sum so obtained shall be the numerator of a fraction of which the denominator shall consist of the total gross business in dollars of the corporation, both within and without the state, added to the full value in dollars of the entire property of the corporation both within and without the state. The fraction so obtained shall represent the proportion of the capital stock represented within the state." Stat. Wis., § 1770b, subd. e.

§ 60. Domestic Corporations with Foreign Branches or Agencies

Where a domestic corporation has established branch offices or agencies for the transaction of its business in foreign countries, the profits accruing at such branches or agencies are part of the income of the corporation, and will be taxable at its domicile, if the law of that jurisdiction taxes income from foreign business as well as from foreign investments, as is the case with the act of Congress now in force. But it is important to distinguish this case from the case where two companies, one domestic and the other foreign, are really independent of each other, though constituent members of a pool or trust, or united in interest through one owning stock of the other, interlocking directorates, and so on. Thus, in an English case, it appeared that a company was formed in England for the purpose of bringing under a single control all the manufacturers of a particular kind of photographic camera. To do this, the company acquired 98 per cent. of the stock of an American company, and retained the services of the manager of the American business. The remaining shareholders of the American company were independent of the English company. The English company by power of attorney appointed the American manager its proxy to vote for it at meetings of the American company. The two companies bought and sold goods to each other in the ordinary way. On this state of facts it was held that the business of the American company was not the business of the English company, so as to be assessable for income tax in England, the control exercised by the English company being the control of the stockholders only.[14] But on the other hand, a contrary decision was made in the case of an English company formed for the purpose of acquiring breweries in the United States, because it was shown that the English directors exercised effective and constant control over

[14] Kodak Limited v. Clark [1901] 2 K. B. 879, 4 Tax Cas. 549.

the business. The operations connected with the manufacture and sale of the beer took place in the United States, and were carried on by an American committee of management appointed by the company. This committee were in constant correspondence with the board of directors in England, and the general meetings of the company were held in England, where the company's books were kept, except those relating to business carried on in the United States. The dividends were declared in England by the company in general meeting. Only a portion of the profits made was remitted to England, the amount needed for the dividends payable to American shareholders being retained in America for distribution. It was held that the business of the company was carried on in England, and that the company was there assessable to income tax upon the whole of the profits made, whether remitted to England or not.[15]

But in view of the fact that the income tax laws affect only "income received" by the person or corporation, it is important to inquire more closely whether profits earned at the foreign branches or agencies of a domestic corporation are taxable as a part of its income if they are not remitted in money to the home office, but retained abroad for payment of dividends, investment, or other purposes. On this question there are no American decisions. The English cases are numerous and instructive, but not entirely harmonious. At first, it was the disposition of those courts to regard the tax as falling only on profits actually received in cash. Thus, in a leading case it appeared that a company was formed in England to acquire certain brewing businesses in the state of New York, and as the law of that state would not permit a foreign corporation to own and carry on a brewery there, an American company was formed, the whole of the shares of which were taken by the English company, except seven shares which

[15] Frank Jones Brewing Co. v. Apthorpe, 4 Tax Cas. 6; Apthorpe v. Peter Schoenhofen Brewing Co., 80 Law T. 395, 4 Tax Cas. 41.

were held by the directors of the American company. So much of the profit was sent over to the English company in London as was required for distribution in dividends to such of its shareholders as resided in England, but the shareholders resident in America received their dividends there out of profits retained in America for that purpose. It was held that the income tax was chargeable only on the profits received in England by the English company.[16] Another case concerned a life insurance company established in Scotland and carrying on business abroad. The business was managed by directors, who had the power of accepting risks, but all investments abroad had to be sanctioned at the head office. Remittances in cash of interest received abroad were not made, and remittances out of the receipts abroad of interest and premiums were made only as required by the general policy of the company. At a quinquennial valuation, and in the yearly statements of accounts, the whole of the receipts abroad, including the interest on investments abroad, was brought into account in the division of the profits of the company. It was held that the interest received abroad and invested or applied abroad was not "received" in Scotland, so as to be taxable there.[17]

But other cases, including some of the later decisions, have evolved the rule that income may be "constructively received," so as to be taxable, if it is entered on the books of the company as cash, or locally applied or invested by direction of the head office. Thus, an English insurance company with branches in India was in the receipt of certain interest moneys, paid in

[16] Bartholomay Brewing Co. v. Wyatt [1893] 2 Q. B. 499, 3 Tax Cas. 213. And see Stanley v. The Gramophone & Typewriter Limited [1908] 2 K. B. 89, 5 Tax Cas. 358; Gresham Life Assur. Soc. v. Bishop [1902] App. Cas. 287, reversing [1901] 1 K. B. 153, 4 Tax Cas. 464; Nobel Dynamite Trust Co. v. Wyatt [1893] 2 Q. B. 499, 3 Tax Cas. 224.

[17] Standard Life Assur. Co. v. Allan, 38 Scotch Law Rep. 628, 4 Tax Cas. 446.

India, from investments there and in the colonies. This interest was applied in India towards the payment of the various obligations of the company arising for settlement in India, including losses under its policies, and was not remitted in money to England, but it was treated in the company's accounts as if it had been so remitted. It was held that the interest was constructively received in England and was therefore taxable.[18] In another case it appeared that an insurance company was organized in England, and had its head office and directorate there, but also carried on business in certain foreign countries, and by the laws of those countries it was required, as a condition to the right to do business there, to deposit certain sums of money with government officials and to invest the money in accordance with local laws. In addition to this, the company also voluntarily invested abroad certain other sums representing accumulated profits of its business. Both classes of investments yielded interest, which was received by the company abroad, but was not remitted to England. It was held that the company was taxable in England on the income consisting of such interest from both classes of investments.[19] Again, an English corporation had its head office in London, where meetings of the directors and shareholders were held, and from whence the affairs of the company were directed and managed. The company carried on the business of banking in London, Mexico, and Lima. At the branch offices it transacted all ordinary banking business, and in London it transacted the London business of the branches, but not the business of current banking accounts. It was held that the whole profits were chargeable for the income tax,

[18] Universal Life Assur. Soc. v. Bishop, 68 Law J. Q. B. 962, 4 Tax Cas. 139. And see Scottish Provident Inst. v. Allan, 38 Scotch Law Rep. 874, 4 Tax Cas. 409; San Paulo Ry. Co. v. Carter [1895] 1 Q. B. 580, 3 Tax Cas. 344, affirmed [1896] App. Cas. 31; Grove v. Elliots, 3 Tax Cas. 481.

[19] Liverpool, L. & G. Ins. Co. v. Bennett [1911] 2 K. B. 577. And see Norwich Union Fire Ins. Co. v. Magee, 3 Tax Cas. 457.

whether remitted to England or not.[20] But this doctrine has not met with universal acceptance. In a case arising in Scotland, it was shown that a Scotch insurance company lent out sums of money at interest in Australia, and that the interest accruing was not remitted to Great Britain in forma specifica, but was retained abroad and invested there, but it was entered in the revenue account of the company as received. On this state of facts it was held that interest not received in Great Britain was not assessable for the income tax, and that the facts in the case did not show a constructive remittance.[21]

§ 61. Non-Residents and Aliens

The federal income tax law provides for the taxation of the income "received from all sources" of "every citizen of the United States, whether residing at home or abroad." Hence American citizens who take up a residence abroad, whether temporary or permanent, and whether from choice or for business purposes (including diplomatic and consular officers) remain liable for the income tax. Theoretically such persons are taxable upon their entire income (above the statutory exemption) no matter how or whence derived. But practically, of course, the tax could be collected only on so much of the income as accrued and was payable within the United States; so that, while the language of the statute would apply, for example, to the case of an American residing abroad and receiving a salary from a foreign government or from a foreign corporation, the necessity of the case would restrict its application.

The law also is made applicable to the case of an alien living within the United States. For it includes "every person residing in the United States, though not a citizen thereof," and

[20] London Bank of Mexico v. Apthorpe [1892] 2 Q. B. Div. 378, 3 Tax Cas. 143.

[21] Forbes v. Scottish Provident Inst., 33 Scotch Law Rep. 228, 3 Tax Cas. 443.

resident aliens are taxed on exactly the same basis as citizens. Such a provision is common in the income tax laws of other countries,[22] and the authority of any government to tax, not only the property, but also the income, of foreigners residing within its territory cannot be doubted. Indeed it has been expressly decided that such a feature does not render an income tax law unconstitutional or in any way invalid.[23]

A further case is that of persons who are neither citizens of the United States nor resident within its borders, but a part of whose income is earned or gained in this country. As to this, the act of Congress provides for the levy of the income tax upon "the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere." And the income tax laws of the several states contain almost exactly similar provisions, which of course are applicable not only to non-resident aliens, but also to residents and citizens of other states owning property or doing business within the taxing state. In Wisconsin, however, the provision is expressed in broader terms, for the tax is made payable "by every non-resident of the state upon such income as is derived from sources within the state or within its jurisdiction." The earlier acts of Congress on the subject made no attempt to tax income accruing in America to non-resident aliens. That is to say, no such provision was found in the acts of 1861, 1862, or 1864, though it was introduced in the statute of 1866 and continued in subsequent enactments. And it was held, under the act of 1864, that a non-resident alien was not subject to the income tax in respect to his investments in American securities; and though that act required corporations paying interest on their bonds to de-

[22] For instances of American citizens held subject to the English income tax, because more or less permanently "resident" in Great Britain, see Brown v. Burt, 81 Law J. K. B. 17; Cooper v. Cadwalader, 5 Tax Cas. 101.

[23] Moore v. Miller, 5 App. D. C. 413.

duct from the interest payments the amounts due as income tax thereon from the several bondholders, this did not apply to a non-resident alien owning such bonds, and if the corporation deducted such tax from the interest due him, he could recover it by suit.[24] This being changed by the explicit provisions of the act now in force, it becomes important to notice a decision of the Supreme Court of the United States under one of the earlier statutes. It was held that an excise tax on corporations, laid on or measured by the amount paid out by them in the form of dividends or interest, is not invalidated by a provision that the amount of such tax may be withheld from the dividend or interest due or payable to a stockholder or bondholder, who is a citizen or subject of a foreign government with no residence in this country.[25]

As to a non-resident "doing business" within the jurisdiction imposing the tax, the state laws may apply to the ordinary case of a person residing in one state and conducting a business in another, as well as to corporations organized under the laws of one state, but having offices, branches, or agencies in many others, and to railroads or other transportation companies which traverse two or more states. Under the laws of the United States, the incidence of the income tax will chiefly affect corporations, whose business is of an international character, foreign insurance companies writing risks in the United States, and foreign corporations owning and operating mills, factories, or mines in this country. As concerns this subject, no American decisions have as yet been rendered. But upon the construction of the corporation tax law of 1909, an opinion was given by the Attorney General to the effect that foreign steamship companies engaged in the business of transporting passengers, goods, and merchandise between ports in this country and for-

[24] Jackson v. Northern Cent. Ry., Chase, 268, Fed. Cas. No. 7,142.
[25] Railroad Company v. Collector (Michigan Central R. Co. v. Slack) 100 U. S. 595, 25 L. Ed. 647.

eign ports, and maintaining freight and passenger agencies in this country, were subject to the tax; and whereas it was contended that a part of the business of such companies was the transportation of articles of merchandise shipped from this country for foreign trade, and that such business could not constitutionally be taxed, the opinion was given that a tax imposed upon an exporter of merchandise, as an incident to his business, is not a tax upon the exported article, as an export, and hence not forbidden by the constitution.[26] But a foreign steamship company having no office in the United States, and whose vessels only occasionally touch at American ports, was not regarded as doing business in this country, within the meaning of that act.[27]

The British income tax law includes non-resident aliens, in so far as they "exercise a trade" in Great Britain. And it is held when a foreign corporation or individual has an agency for the sale of its products in England, the agent being charged with the duty of procuring orders, which are then sent to the head office abroad, and the goods are shipped either to the agent for distribution or direct to the customers, and payment is made either to the agent or direct to the foreign office, such corporation or person "exercises a trade" in England and is subject to the income tax on the profits thereof, collectible from the agent.[28] So in a Scotch case, it appeared that a company registered in Norway, where its head office was maintained and its books kept and corporate meetings held, was under the general management of two Norwegians, elected by the stockholders. This company owned a ship, and all the business of the chartering of the vessel, and all voyage receipts

[26] 28 Opin. Atty. Gen. 211.

[27] Treasury Decisions, No. 1742, par. 21.

[28] Werle & Co. v. Colquhoun, L. R. 20 Q. B. Div. 753, 2 Tax Cas. 402; Turner v. Rickman, 4 Tax Cas. 25; Tischler v. Apthorpe, 52 Law T. 814, 2 Tax Cas. 89. But see Grainger v. Gough [1896] App. Cas. 325.

and disbursements, were dealt with by a firm resident in Glasgow, who received and retained all the funds until required for payment of expenses or dividends. It was held that, although the company was not resident in Great Britain, it exercised a trade within the United Kingdom, for the profits of which the Glasgow firm, as its agents, were assessable for the purpose of the income tax.[29] In another case it was shown that a foreign corporation, domiciled abroad, had submarine cables in connection with England and other foreign cables not so connected. The company, under an agreement with the English authorities, also had separate wires, worked by its own staff, between several English towns and cities. No profits were derived from the transmission of messages over these last-mentioned wires. It was held that the company exercised a trade in Great Britain and was assessable on the net profits derived from the receipts in England.[30]

§ 62. Carrying on of Business or Trade

In addition to the illustrations given in the preceding section, which had to do only with the particular case of non-residents, we may here give some further account of what is meant by "business" and "trade" in general, since these terms are constantly used in describing the sources of taxable income or the persons and corporations subject to the tax. The two words quoted, when associated together, take color from each other. But even as thus limited, the term "business" is a word of very wide import and embraces every thing about which a person can be employed or which he can pursue as an occupation and for profit.[31] It implies, however, continuity of action or effort, and does not include an isolated act or operation, when transactions of the same sort do not constitute the per-

[29] Wingate v. Webber, 34 Scotch Law Rep. 699, 3 Tax Cas. 569.
[30] Erichsen v. Last, L. R. 7 Q. B. Div. 12, 1 Tax Cas. 351.
[31] People v. Commissioners of Taxes, 22 How. Prac. (N. Y.) 143.

son's vocation,[32] and probably it should not be so extended as to include illicit pursuits, such as keeping a gaming house or selling liquor without a license.[33] In construing the corporation tax law of 1909, the Supreme Court of the United States, not meaning to enumerate all possible kinds of "business," but with reference to the facts in the group of cases before it, said: "We think it clear that corporations organized for the purpose of doing business, and actually engaged in such activities as leasing property, collecting rents, managing office buildings, making investments of profits, or leasing ore lands and collecting royalties, managing wharves, dividing profits, and in some cases investing the surplus, are engaged in business within the meaning of this statute, and in the capacity necessary to make such organizations subject to the law." [34] And in the same case it was specifically held that a company owning and leasing taxicabs and collecting rents therefrom was engaged in business within the meaning of the statute. "Trade" is a term more particularly applied to the operations of commerce, and especially to the buying and selling of commodities or the traffic, sale, or barter of goods. But it is legitimately capable of a wider meaning, and may be so intended when used in a tax statute and in connection with "business." Thus, an English decision holds that the ownership and employment of vessels, which are employed in the transportation of merchandise for hire, is a "trade" or concern in the nature of a trade, within the meaning of an act imposing taxes.[35] So in a case in North Carolina, construing a provision of the constitution authorizing the legislature to tax "trades, professions,

[32] People v. Commissioners of Taxes, 23 N. Y. 242; Parkhurst v. Brock, 72 Vt. 355, 47 Atl. 1068; Delaware & H. Canal Co. v. Mahlenbrock, 63 N. J. Law, 281, 43 Atl. 978, 45 L. R. A. 538.

[33] Odell v. City of Atlanta, 97 Ga. 670, 25 S. E. 173; Walsch v. Call, 32 Wis. 159.

[34] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

[35] Attorney General v. Borrodaile, 1 Price, 148.

franchises, and income," it was said that the word "trade" is employed in its broadest signification, and comprehends, not only all who are engaged in buying and selling merchandise, but all whose occupation or business it is to manufacture and sell the products of their plants, and includes in this sense any employment or business embarked in for gain or profit.[36]

§ 63. Carrying on Several Lines of Business

If a person or corporation carries on, at the same time, several different lines or branches of business, the resulting income is to be assessed and taxed as an entirety, and not as so many separate incomes from the different kinds of business. This is shown by the language of the act of Congress, which imposes the tax, both in the case of individuals and of corporations, on "the entire net income received from all sources." And under the corporation excise tax law of 1909, it was ruled that railroad companies operating leased or purchased lines must include all receipts derived therefrom in their return of net income.[37] This is also the rule in England. Thus, where an insurance company, being a single concern and having only one body of stockholders, carries on the business of fire, marine, and life insurance, and the funds and accounts of the several branches of the business are kept separate, but the results of the whole business are thrown into one profit and loss account, and the dividends are declared out of the balance of that account, it is held that, for the purpose of the income tax, the several branches must be treated as one business, and the net profits from all are assessable as one undivided income.[38] There is, however, one decision of the Court of Session in Scotland which is not easily to be reconciled with the general

[36] State v. Worth, 116 N. C. 1007, 21 S. E. 204.

[37] Treasury Decisions, No. 1742, par. 8.

[38] Last v. London Assur. Corp., L. R. 12 Q. B. Div. 389, 2 Tax Cas. 100; Scottish Union & N. Ins. Co. v. Smiles, 26 Scotch Law Rep. 330, 2 Tax Cas. 551.

rule as thus stated. It was there held that a seed-merchant, taking a farm and working it in connection with his seed business, cannot claim any deduction from the assessment on his profits as seedsman in respect of losses incurred in the operation of the farm, that is, profits arising from one branch of the business cannot be offset by the expenses or losses of the other.[39]

But the general rule applies only in cases where each branch or department of the business is wholly owned and operated by the taxable person or corporation. If any is owned and operated jointly with another person or company, it must be segregated and separately assessed. Thus, in an English case, it appeared that the corporation in question originally owned one steamship and derived its income from the operation of the vessel as a carrier of freight. Afterwards it acquired a very large interest, but not quite the entire ownership, in a second steamship, taking over the management and keeping the accounts thereof, and it claimed to be assessed on the average of the profits derived from the two ships in one sum. But it was held that the second ship was a concern carried on by two or more persons jointly, and therefore its profits must be separately assessed.[40]

§ 64. Salaried Officers

Attention was given in an earlier section of this volume to the constitutional validity of income taxation as applied to the salaries of federal and state officers.[41] And it was there shown that, although the United States cannot tax the salary of a state officer, or vice versa, yet, in the absence of explicit constitutional restrictions, there is nothing to prevent Congress from taxing the compensation of the officers of the federal

[39] Brown v. Watt, 23 Scotch Law Rep. 403, 50 J. P. 583, 2 Tax Cas. 143.

[40] Farrell v. Sunderland Steamship Co., 88 Law T. 741, 4 Tax Cas. 605.

[41] Supra, § 18.

government, or to prevent a state from taxing the salaries of its own officers or those of its municipalities. This is in accordance with the rules prevailing in other countries where income tax laws are in force. Thus, in Canada, a government official or employe is taxable on his income received in the form of a salary.[42] It was held in Ontario that the income of an officer of the House of Commons of the Dominion of Canada could not be taxed by a provincial legislature or by a municipality of the province.[43] But this was overruled by the Supreme Court of Canada, which held that any civil or other officer of the Dominion might be lawfully taxed in respect to his income as such by the municipality in which he resides.[44] And the highest court in England has ruled that an officer of the Commonwealth of Australia who resides in Victoria and receives his salary in that state, is liable to be assessed in respect of his official salary for an income tax imposed by the legislature of Victoria.[45]

But laws of this kind are construed with strictness, and the salary attached to a public office is not to be brought within the reach of the income tax without explicit language to that effect. Thus it was ruled, in an early case in South Carolina, that the salaries of public officers are not liable to be taxed under an ordinance imposing a tax on all profit or income arising from the "pursuit of any faculty, profession, occupation, trade, or employment."[46] And the court in Virginia decided that, when the tax is laid upon salary or compensation for services, received by any person in the employment of a corporation, it will be held not to include the salary paid to a minister of the Gospel by the church or congregation of

[42] Abbott v. City of St. John, 40 Can. Sup. Ct. 597, 12 Am. & Eng. Ann. Cas. 821; Robson v. Regina, 4 Terr. L. R. 80.

[43] Leprohon v. Ottawa, 2 Ont. App. 522.

[44] Abbott v. City of St. John, 40 Can. Sup. Ct. 597, 12 Am. & Eng. Ann. Cas. 821.

[45] Webb v. Outrim [1907] App. Cas. 81, 7 Am. & Eng. Ann. Cas. 84.

[46] City Council v. Lee, 1 Treadw. (S. C.) 57.

which he has charge, for it must be understood that the legislature meant only secular employment.[47] But the modern statutes employ language broad enough to cover all kinds of remuneration for services rendered by employés, however denominated. Thus, the act of Congress applies to "income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid." And the Wisconsin statute, in defining "income," includes "all wages, salaries, or fees derived from services." The tax commission of that state explains that "fees derived from services would not include the fees belonging to the state or any political subdivision. For example, if a sheriff receives a salary and turns over the fees received by him in his official capacity to the county, they would not be reckoned as income. If he receives the fees in lieu of salary, such fees would constitute income."[48] In this connection it is also necessary to remark that, although a corporation may be exempt from taxation, in respect to its own income, as being a religious, charitable, or educational institution, it does not follow that its employés are likewise exempt. Thus, the salary of a professor in a college is not exempt from the income tax, though the revenue of the college may be exempt.[49] The act of Congress of 1913 contains a provision that "nothing in this section shall be held to exclude from the computation of the net income the compensation paid any official by the governments of the District of Columbia, Porto Rico, and the Philippine Islands or any political subdivision thereof," in other words, the salaries of these officers are subject to the income tax.

47 Plumer v. Commonwealth, 3 Gratt. (Va.) 645.

48 Wisconsin Income Tax Law, edition issued by State Tax Commission, Madison, Wis., November 1911, pp. 9, 10.

49 Union County v. James, 21 Pa. St. 525.

§ 65. Bankrupt and Insolvent Persons and Companies

It may seem an anomaly to speak of a bankrupt or insolvent person being subject to the income tax, but it was evidently in the contemplation of Congress, in enacting the law of 1913, that such cases might arise, as witness the provision that the penalty for non-payment shall not be exacted "from the estates of insane, deceased, or insolvent persons." It is a general rule of law that a bankrupt's estate is not withdrawn from taxation by the proceedings in bankruptcy, but remains subject to taxation in the hands of his trustee.[50] And it was ruled under the corporation excise tax law of 1909 that, where a corporation subject to the tax had gone into bankruptcy, the return of net income was to be made by the trustee in bankruptcy.[51] So, where an assignee for the benefit of creditors carries on the business of the assignor, and makes a profit, it is subject to the income tax. For it is not necessary that a business should be carried on for the purpose of making a profit for the owner; it is none the less carried on because the object is to earn a larger dividend for creditors.[52] The same principle would apply to a corporation in the hands of a receiver. It is true that a contrary doctrine prevailed under the corporation tax law of 1909, but that was only because the tax was not laid on the income of the corporation, but on the privilege of doing business in a corporate capacity. Hence it was held that receivers of an insolvent corporation, duly appointed by a court of equity, which corporation was not doing business when the act was passed, and had done no business since, were not within the act, and not required to make returns or pay taxes on the income realized by them while acting as officers of the court and under its direction.[53] But the act

[50] In re Crowell, 199 Fed. 659.

[51] Treasury Decisions, No. 1742, par. 7.

[52] Armitage v. Moore [1900] 2 Q. B. 363, 4 Tax Cas. 199.

[53] Pennsylvania Steel Co. v. New York City Ry. Co., 198 Fed. 774, 117 C. C. A. 556.

of Congress now in force imposes, not an excise tax on corporate business, but a tax on all incomes. And it is somewhat significant, in this connection, that it specially mentions "receivers" as among those persons administering the affairs of others who are required to make returns for them and withhold and deduct the income tax.

§ 66. Estates of Decedents and Dissolved Corporations

The death of a taxpayer does not exempt his income from taxation for the current year, but his estate, in the hands of the executor or administrator, is liable for the tax on so much of the income of the year as accrued prior to the day of his death,[54] the income for the remainder of the year being of course taxable to the distributees of the estate. The same principle applies upon the dissolution of a corporation. But it was held that a corporation which had continued in business through a calendar year could not evade liability for the tax imposed by the act of Congress of 1909, by dissolving before the time when it was required to make a return and have the tax assessed, but that the officers of the corporation still had the authority, and it was their duty, to make and render the return.[55]

§ 67. Partnerships

It has never been the policy of the United States income tax laws to lay the tax on partnerships, as distinct from the individuals composing them. And in the statute now in force, partnerships are carefully distinguished from corporations, as in the section relating to the taxation of corporations, where the tax is made payable by "every corporation, joint stock company or association, and every insurance company, organized in the United States, no matter how created or organized, but not including partnerships." Under provisions

[54] Mandell v. Pierce, 3 Cliff. 134, Fed. Cas. No. 9,008.

[55] United States v. General Inspection & Loading Co., 192 Fed. 223.

of this kind the individual taxpayer is chargeable with the tax on so much of his income as is derived from the profits of a firm in which he may be a member (after allowing the statutory deductions and exemptions), but the firm, as such, is neither required to make a return nor pay a tax. This was expressly provided for in the act of 1864, and though omitted in the present statute, the rule must be read into it by necessary implication.

The laws of the states have generally pursued a contrary policy. That of South Carolina, for instance, provides that "the words 'citizen' and 'person,' as used in this article, shall be deemed to include all natural persons, all copartnerships, and all members of any incorporated association, and to exclude, except as hereinafter included, all corporations duly chartered by the laws of the United States or of this or any other state." [56] Under this statute, it appears, both the individual and the firm of which he is a member must make a return and pay the tax. But if the partnership pays the tax on its income, it would be inequitable, and double taxation, to exact a tax from the individual upon his share of the firm's profits, and such an exception should be held to be necessarily implied. This point is more fully covered by the provisions of the Wisconsin income tax law, which declares that the term "person," as used in the act, shall include "any individual, firm, copartnership," etc., but also provides that the individual taxpayer may deduct from his income as returned for taxation "dividends or income received from stocks, or interest in any firm, copartnership, corporation," etc.[57]

§ 68. Limited Partnerships

Under the laws of some of the states (for example, Pennsylvania) limited partnership associations may be organized

[56] Civ. Code S. Car. 1902, § 327.

[57] Wisconsin Income Tax Law 1911, § 1087m, part 2, par. 1; Id., § 1087m, part 4, subd. c.

which possess all the essential privileges and powers of corporations, including the right to transact business under a name indicating rather a corporate existence than an association of partners, as, by the use of the word "Company" in the name, provided that the name shall also include the word "Limited," the right to sue and be sued in that name, the right to fix the limit of its own existence, within certain bounds, and to have a capital stock divided into shares. The members of such an association are not individually liable for its debts, and the shares or interests in it are transferable by the owner, provided that the transferee must either be elected to membership by the remaining members or bought out. Under the corporation excise tax law of 1909, which required payment of the tax from "every corporation, joint stock company or association," the opinion was given by the Attorney General, and followed by the officers of the treasury department, that such a limited partnership was within the meaning of the act, and was liable to the tax if organized for profit and having a capital stock represented by shares, although no certificates of stock were issued.[58] It seems clear that such an association would also be included within the scope of the income tax law of 1913, the language of the law being the same, and the same reasons existing as formerly for so holding.

§ 69. Corporations

Corporations are subject to the income tax under the act of Congress of 1913, which lays the tax, subject to certain enumerated exceptions, upon "every corporation, joint stock company or association, and every insurance company, organized in the United States, no matter how created or organized," and also upon similar companies "organized, authorized,

[58] 28 Opin. Atty. Gen. p. 189; Treasury Decisions, No. 1742, par. 36. And see Liverpool Ins. Co. v. Massachusetts, 10 Wall. 556, 19 L. Ed. 1029; Moorhead v. Seymour, 77 N. Y. Supp. 1050. Compare Chapman v. Barney, 129 U. S. 677, 9 Sup. Ct. 426, 32 L. Ed. 800.

or existing under the laws of any foreign country," in so far as the latter transact business or have capital invested in the United States. The income tax law of Hawaii taxes, subject to specified exceptions, "all corporations doing business for profit in the territory, no matter where created and organized." The law of Wisconsin taxes "persons," but declares that the term "person" shall include "every corporation, joint stock company or association organized for profit, and having a capital stock represented by shares, unless otherwise expressly stated." These terms were copied from the provisions of the corporation excise tax law of 1909. And under that statute it was ruled that mutual savings banks, such as may be organized under the laws of some of the states, were not subject to the tax. Such banks receive deposits, invest the money deposited, and divide the profits among the depositors. But they have no capital stock, and the depositors are not stockholders. And though they are in a certain sense organized for profit, yet their organization and the transaction of their business are not for the profit of those who constitute the managing body, except in so far as they may also be depositors.[59] And such banks are expressly excepted from taxability under the act of Congress of 1913.

§ 70. Public Service Corporations

The various kinds of corporations now commonly classed under this designation are not exempt from the income tax unless specially released from it by statute. The attempt was made to withdraw them from the operation of the corporation tax law of 1909, on the ground that they exercised a delegated authority from the states which created them and bore such a relation to the general public as to make their functions quasi-governmental in character. But the Supreme Court of the United States ruled otherwise, saying: "In the

[59] 28 Opin. Atty. Gen. p. 189, citing Huntington v. Savings Bank, 96 U. S. 388, 24 L. Ed. 777; Hannon v. Williams, 34 N. J. Eq. 255; Savings Bank v. Town of New London, 20 Conn. 111.

case of South Carolina v. United States, [60] this court held that when a state, acting within its lawful authority, undertook to carry on the liquor business, it did not withdraw the agencies of the state, carrying on the traffic, from the operation of the internal revenue laws of the United States. If a state may not thus withdraw from the operation of a federal taxing law a subject-matter of such taxation, it is difficult to see how the incorporation of companies whose service, though of a public nature, is nevertheless with a view to private profit, can have the effect of denying the federal right to reach such properties and activities for the purposes of revenue. It is no part of the essential governmental functions of a state to provide means of transportation, supply artificial light, water, and the like. These objects are often accomplished through the medium of private corporations, and though the public may derive a benefit from such operations, the companies carrying on such enterprises are nevertheless private companies, whose business is prosecuted for private emolument and advantage. For the purpose of taxation, they stand upon the same footing as other private corporations upon which special franchises have been conferred. The true distinction is between the attempted taxation of those operations of the states essential to the execution of their governmental functions, and which the state can only do itself, and those activities which are of a private character. The former the United States may not interfere with by taxing the agencies of the state in carrying out its purposes; the latter, although regulated by the state, and exercising delegated authority, such as the right of eminent domain, are not removed from the field of legitimate federal taxation." [61]

The Wisconsin income tax law, however, explicitly exempts

[60] 199 U. S. 437, 26 Sup. Ct. 110, 50 L. Ed. 261, 4 Am. & Eng. Ann. Cas. 737.

[61] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

"incomes derived from property and privileges by persons now required by law to pay taxes or license fees directly into the treasury of the state in lieu of taxes, and such persons shall continue to pay taxes and license fees as heretofore." And the state tax commission rules that this clause exempts from the payment of the income tax railroad companies and street railway companies, including, in the latter case, connected electric light, heat, and power companies; also palace and sleeping car companies, freight line and equipment companies, express companies, telegraph and telephone companies, boom and improvement companies, plank road companies, fire, life, and accident insurance companies and surety companies, and title guaranty companies, but not water, light, heat, and power companies and other public utilities which are taxable locally.[62]

§ 71. Unincorporated Associations

The federal income tax law, as well as the statutes of some of the states, couple with the word "corporations," in describing those subject to the tax, the term "joint stock companies or associations." This term describes an anomalous kind of body, a hybrid in the law, occupying a position midway between a corporation and a partnership. A joint stock company or association is a body of persons united and acting together without a charter (or without being incorporated under a general law), but upon the methods and forms used by incorporated bodies, for the prosecution of some common enterprise. Such an association possesses a common capital contributed by the members composing it, such capital being commonly divided into shares, of which each member possesses one or more, and which are transferable by the owner. It usually transacts business under a company name, by which, under the laws of some states, it may sue and be sued,

[62] Wisconsin Income Tax Law 1911, edition published by State Tax Commission, Madison, Wis., p. 21.

and its affairs are generally administered by a board of managers or directors. But it differs from a corporation proper, both in the fact that it is not a legal entity separate and distinct from the members composing it, and also in the fact that all the members are personally liable for its debts.[63] A company or association of this kind may be formed and exist at common law. But the statutory law of some of the states (but not all) also authorizes the organization of such associations, or confers upon them more or less of the characteristics and privileges of a corporation. In some cases these statutes go so far in this direction that the only practical difference between a corporation, properly so called, and a joint stock company organized under the state law is that, in the latter case, the stockholders remain personally liable for the debts. The federal corporation tax law of 1909 applied to "every corporation, joint stock company or association organized for profit and having a capital stock represented by shares, organized under the laws of the United States or of any state or territory." And the federal supreme court held that real estate trusts created by deed, for the purpose of purchasing, improving, holding, or selling lands and buildings for the benefit of the shareholders, which are not organized under any statute of the state where they are formed, and do not derive any benefit or privilege from any such statute, and which are not intended to have perpetual duration, but are limited by their terms to a fixed period, were not subject to the federal tax.[64] But it is important to notice that the act of 1913 is made applicable to "every

[63] See Allen v. Long, 80 Tex. 261, 16 S. W. 43, 26 Am. St. Rep. 735; Adams Express Co. v. Schofield, 111 Ky. 832, 64 S. W. 903; Kossakowski v. People, 177 Ill. 563, 53 N. E. 115; Lyon v. Denison, 80 Mich. 371, 45 N. W. 358, 8 L. R. A. 358; Sandford v. Board of Sup'rs of New York, 15 How. Prac. (N. Y.) 172; In re Jones, 28 Misc. Rep. (N. Y.) 356, 59 N. Y. Supp. 983; Lane v. Albertson, 78 App. Div. 607, 79 N. Y. Supp. 947.

[64] Eliot v. Freeman, 220 U. S. 178, 31 Sup. Ct. 360, 55 L. Ed. 424.

corporation, joint stock company or association organized in the United States, no matter how created or organized." In view of the decision above referred to, this change of language must be considered highly significant, and manifests an intention on the part of Congress to apply the tax to all kinds of joint stock companies or associations, whether organized in accordance with the law of any given state or merely with such powers and characteristics as they may possess at common law.

§ 72. Incorporated Clubs

An incorporated club, organized for social purposes or for sport, and not eleemosynary or educational in character nor in the nature of a benefit or insurance society, is apparently subject to the payment of the income tax imposed by the act of Congress of 1913, if it derives a revenue from membrship dues, rent of rooms, profits of restaurant or bar, etc., and has any net income after paying expenses and deducting the other items allowed by the statute. For it must be observed that the act in question does not require that a corporation, to be taxable, should be "organized for profit" or have "a capital stock represented by shares," as was the case in earlier statutes, but only (with reference to domestic corporations) that it should be "organized within the United States." And the provision exempting certain kinds of corporations specifically enumerates and describes those which Congress intended to release from the tax, from which it follows, by a well-known rule of statutory construction, that no other exceptions can be implied. A similar rule prevails in England. Thus, where a golf club (an ordinary bona fide members' club) allowed members to introduce visitors and the visitors to play golf on its links, but such visitors paid "green fees" for the privilege, and the fees so collected amounted to a considerable sum every year, it was held that the club was carrying on an enterprise which was beyond the scope of the ordinary

functions of a club, and as to which it was possible to keep separate accounts, so as to ascertain what profits it was making, if any, and therefore such profits were liable to assessment for the income tax.[65] And in another case, where a society formed for the improvement, spiritual, mental, social, and physical, of young men, carried on a restaurant, as well as educational classes, a gymnasium, and a publication department, the restaurant being conducted on the usual commercial principles and being open to the public, it was held that the association was liable to pay the income tax on the profits made by the restaurant.[66]

But such clubs are not subject to taxation under the statute in Wisconsin, which describes, as subject to the tax, corporations "organized for profit and having a capital stock represented by shares," and which also specifically exempts any "association of individuals not organized or conducted for pecuniary profits." So also in Hawaii, where corporations are taxed only when "doing business for profit in the territory."

§ 73. Inactive Corporations and Holding Companies

The federal corporation tax law of 1909 imposed a tax on all corporations organized for profit and having a capital stock represented by shares, and the tax was levied "with respect to the carrying on or doing business" by such corporations. It was held that a corporation, to be subject to the tax, must not only be organized for the purpose of doing business, but must also be actually engaged in that business. Hence a corporation organized solely for the purpose of taking over and holding the real estate and leasehold interests owned by a mercantile company, leasing such property to the company, collecting the rents and distributing them among

[65] Carlisle & S. Golf Club v. Smith [1912] 2 K. B. 177.

[66] Grove v. Young Men's Christian Ass'n, 88 Law T. 696, 4 Tax Cas. 613.

its stockholders, and which had actually executed a long term lease of such property to the mercantile company and surrendered the management and control thereof, was held not subject to the tax, although it was organized under a provision of law relative to the organization of business and manufacturing corporations for profit, since, even though a corporation be deemed to have been organized for business purposes, it was not subject to the tax if it abstained from doing business.[67] On the same principle, a corporation organized for the purpose of owning and renting an office building, but which had wholly parted with the management and control of the property, and by the terms of a reorganization had disqualified itself from any activity in respect to it, its sole authority being to hold the title subject to a lease for 130 years, and to receive and distribute the rentals which might accrue under the terms of the lease, or the proceeds of any sale of the land, if it should be sold, was held not subject to the tax, because not doing business within the meaning of the law.[68] So also, a railroad company which had leased its entire road and all its rights and privileges for a term of years at an annual rental, the lessees operating the road and agreeing to return it at the expiration of the lease, was held not to be "engaged in business" with respect to the road, within the meaning of the statute, although it retained a franchise of corporate existence, and was ready to resume possession at the expiration of the lease, and to exercise its franchise of eminent domain when required by the lessee. Also it was held in the same case that the receipt by a lessor railroad of the income from its road and of interest and dividends from invested funds, and the payment of expenses incidental to the receipt of such moneys and their distribution among stockholders, did not constitute a business taxable

[67] Emery, Bird, Thayer Realty Co. v. United States, 198 Fed. 242.
[68] Zonne v. Minneapolis Syndicate, 220 U. S. 187, 31 Sup. Ct. 361, 55 L. Ed. 428. And see Abrast Realty Co. v. Maxwell, 206 Fed. 333.

under the federal statute.[69] And it was ruled by the treasury department that so-called "holding companies," which do not transact any business of their own, but merely receive and disburse the dividends on the stock which they own in the constituent companies, were not subject to the tax.[70]

But in this particular, the act of Congress of 1913 differs widely from that of 1909. It does not lay the tax on the transaction of corporate business or on the privilege of doing business in a corporate capacity, but on the income of the corporation. As to domestic corporations, it does not require that they should be organized for profit or for business, nor that they should be engaged in business, but only that they should have a net income. And as to that income, the tax is not laid on income derived from business, but on "income received from all sources." These changes are too significant to have been made without intention. And since the decisions of the Supreme Court above referred to must have been within the cognizance of Congress in enacting the statute, there is a very strong presumption that the law as now framed was meant to include holding companies and inactive corporations, provided only that they are in receipt of an income over and above expenses and the proper deductions.

And it is further to be noted that the present act of Congress makes a very significant mention of holding companies in the provision relating to the taxation of accumulated earnings or undivided profits as part of the income of the stockholder. (Subsection A, subdivision 2.) The share to which the individual stockholder would be entitled, if such earnings or profits were divided, is taxable to him as income, though no division or distribution is made, in case the company was "formed or fraudulently availed of" for the purpose of es-

[69] McCoach v. Minehill & S. H. R. Co., 228 U. S. 295, 33 Sup. Ct. 419, 57 L. Ed. ——, affirming Minehill & S. H. R. Co. v. McCoach, 192 Fed. 670.

[70] Treasury Decisions, No. 1742, par. 18.

caping the tax. And the fact that it is "a mere holding company" is made prima facie evidence of such fraudulent purpose.

§ 74. Corporations of Philippines, and Porto Rico

The corporation tax law of 1909 applied to corporations "organized under the laws of the United States or of any state or territory of the United States" or "organized under the laws of any foreign country and engaged in business in any state or territory of the United States." And an opinion was rendered by the Attorney General that, as the Philippine Islands are not a state or territory of the United States, and not, on the other hand, a "foreign country," a corporation created by the government of the Islands would not be subject to the corporation tax at all. So also, he ruled, a corporation "organized under the laws of a foreign country" would not be subject to the income tax with respect to its business done in the Philippines, because such business is not done "within the United States or its territories." But a corporation organized under the laws of one of the states, and doing business wholly within the Philippines, and operating under a concessionary contract granted by the Philippine legislature, would be liable to the tax. "The resulting discrimination against American, and in favor of foreign, corporations as to business carried on in the Philippines and Porto Rico cannot serve to alter the construction of the act, although it may invite to amendment." [71] And the officers of the treasury department ruled that companies organized in Porto Rico and not engaged in business in the United States were not subject to the tax.[72] But this also has been changed by the act of Congress of 1913, by the provision that "the provisions of this section shall extend to Porto Rico and the Philippine Islands; Provided, that the administration of the law and

[71] 29 Opin. Atty. Gen. p. 164.
[72] Treasury Decisions, No. 1742, par. 22.

the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal-revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general governments thereof, respectively."

§ 75. Insurance Companies

The act of Congress of 1913 expressly applies to "every insurance company" organized in the United States, or organized under the laws of a foreign country and doing business in the United States. But as to mutual insurance companies, special rules are provided for ascertaining their taxable net income. In the case of mutual life insurance companies, it is enacted that they "shall not include as income in any year such portion of any actual premium received from any individual policy holder as shall have been paid back or credited to such individual policy holder, or treated as an abatement of premium of such individual policy holder, within such year." This provision was doubtless inserted in the act in view of the decisions which had been made on this point under the corporation excise tax law of 1909. That statute allowed insurance companies to deduct from their returns of income for taxation "sums other than dividends paid within the year on policy and annuity contracts." And it was held that the word "dividends" was here used in its popular sense as representing profits, and that so-called dividends of a mutual company doing business on the level premium plan, consisting merely of the portion of the loading of the premium charged in excess of the cost of insurance and returned annually to the policy holders after the first year, so far as the same were used to reduce subsequent premiums, were not income received and not subject to the tax. At the same time it was held that this rule does not apply to a dividend declared in the case of a full-paid participating policy, wherein the policy holder has no further premium payments to make, which divi-

dend constitutes a participation in the profits and income of the invested funds of the company.[73]

In the case of mutual fire insurance companies "requiring their members to make premium deposits to provide for losses and expenses," it is provided that they "shall not return as income any portion of the premium deposits returned to their policy holders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves." And in the case of mutual marine insurance companies, they "shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policy holders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof."

[73] Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199, affirmed, 201 Fed. 918. And see New York Life Ins. Co. v. Styles, L. R. 14 App. Cas. 381, 59 Law J. Q. B. 291. But compare Last v. London Assur. Corp., L. R. 10 App. Cas. 438. In the latter case it appeared that a life insurance company issued "participating policies" at an increased premium, according to the terms of which, at the end of each five year period, the gross profits of such policies were dealt with as follows: Two-thirds were returned by way of bonus of abatement of premiums to the holders of such policies then in force, and the remaining one-third went to the company, which bore the whole expense of the business, the portion remaining after payment of expenses constituting the only profit available for dividends among the shareholders. It was held that the two-thirds returned to policy holders were "annual profits or gains" and assessable for the income tax.

CHAPTER VII

EXEMPTIONS AND EXCEPTIONS

§ 76. Revenues of United States

The legislature of Wisconsin, in enacting the income tax law of that state, in 1911, was at pains to exempt from taxation under the statute "income received by the United States." But a similar exception would be necessarily implied in any tax law of any state. In the federal income tax law of 1913 the precise point is not covered, but it is a fixed principle of statutory construction that the sovereign or government is never included within the scope of a statute imposing taxes unless expressly named. Besides, the government of the United States could not properly be described as a "person," a "citizen of the United States," or a "corporation, joint stock company or association." This point might be of practical importance in its application to the case of a federal officer receiving fees for services or a postmaster taking in money from the sale of stamps. If the receipts of the office (or fees) constitute the officer's compensation, they are a part of his private income, and may be taxable; but if he is paid a salary and required to turn in the fees or re-

ceipts of his office to the treasury, such moneys are public revenues and not taxable.[1]

§ 77. States and Municipal Corporations

It is not within the constitutional authority of Congress to lay the burden of federal taxation upon the revenues of a state or a municipal corporation, at least in so far as the same are raised by the ordinary methods of state and local taxation, or accrue from property owned or money invested by a state. Thus, it has been held that the word "corporation," in an internal revenue law, does not include a state, so that a railroad wholly owned by a state, managed by state agents, and the profits of which form a part of the revenue of the state, is not liable to taxation under such law.[2] So also, a municipal corporation is, at least in its political aspects, a portion of the sovereign power of the state, or a depository thereof, and therefore is not subject to taxation by Congress upon its municipal revenues.[3] But the exemption of a state from taxation extends no further than the functions belonging to a state in its ordinary capacity, the exemption of sovereignty being limited by the attributes of sovereignty. Hence if a state unites in one undertaking an exercise of the police power with a commercial business,—as in the case of the South Carolina dispensary law, where regulation of the sale of intoxicating liquors was effected by the state itself engaging in the business and monopolizing the traffic,—the United States cannot be compelled to aid the operation of the police power by foregoing its right to lay an impost or excise tax on the business part of the transaction. And hence, the agents of the state government employed in the operation of the dispensary law were held lia-

[1] Supra, § 64.

[2] Georgia v. Atkins, 35 Ga. 315, 1 Abb. U. S. 22, Fed. Cas. No. 5,350.

[3] United States v. Baltimore & O. R. Co., 17 Wall. 322, 21 L. Ed. 597.

ble to pay the internal revenue tax imposed by the act of Congress.[4] And the Supreme Court of the United States has also ruled that a municipal corporation engaged in the business of distilling spirits is subject to internal revenue taxation under the laws of the United States, whether its acts in that respect are or are not ultra vires.[5] It was probably with a view to just such cases as these that Congress, in the income tax law of 1913, has expressly disclaimed the intention to apply the statute to the revenues of states or municipal corporations. (Subsection G, clause "a," at the end. See Appendix.)

It is undoubtedly within the power of a state to tax the revenues of its own municipal corporations if it shall see fit to do so. And so far as concerns income taxation, the principle appears to be that profits derived by a municipality from anything outside the scope of its ordinary and necessary municipal functions, and in the nature of a business enterprise, will be subject to the income tax. Thus, in England, a municipal corporation owning and operating its own system of waterworks, for distribution to its inhabitants, is held not taxable on the income derived therefrom,[6] but it is liable to assessment in respect to surplus revenue derived from supplying water beyond the area of compulsory supply and from the sale of water for the purposes of trade or manufacture.[7] So also, a municipal corporation is subject to taxation upon profits derived from the maintenance of a market or a market hall.[8] And in a case where a quasi-mu-

[4] South Carolina v. United States, 199 U. S. 437, 26 Sup. Ct. 110, 50 L. Ed. 261, 4 Am. & Eng. Ann. Cas. 737.

[5] Salt Lake City v. Hollister, 118 U. S. 256, 6 Sup. Ct. 1055, 30 L. Ed. 176.

[6] In re Glasgow Corp. Waterworks, 12 Scotch Law Rep. 466, 1 Tax Cas. 28.

[7] Glasgow Corp. Water Com'rs v. Miller, 23 Scotch Law Rep. 285, 2 Tax Cas. 131.

[8] In re Birmingham Corp., 1 Tax Cas. 26; Attorney General v. Scott, 28 Law T. 302, 1 Tax Cas. 55.

nicipal corporation had constructed and was maintaining a sewer, the funds being raised by a public loan repayable in annual installments, and the money for such repayment was found partly by contributions levied from neighboring district councils, whose sewage went through the sewer, and partly from rates, and this was the only income, it was held nevertheless that the corporation was liable to the income tax.[9] It was ruled by the officers of the treasury department that a municipal corporation which owns and operates its own waterworks, or a plant for the production and distribution of gas or electric light to its citizens, was not subject to the corporation tax under the act of Congress of 1909, although it makes and collects fixed charges for the service so rendered and derives a profit therefrom. But this was on the explicit ground that a municipality is not a corporation "organized for profit" or one "having a capital stock represented by shares," within the language of that statute.[10] Such questions are by no means free from doubt. But they are not of great practical importance at the present time, since the modern income tax laws generally exclude municipal corporations, either expressly or by the use of language which cannot be held to include them. Thus in Wisconsin, the statute exempts "income received by the state and all counties, cities, villages, school districts, or other political units of this state." In South Carolina, the statute is made applicable to "persons" and "citizens of the state," but expressly excludes all corporations. In Hawaii, the phrase employed is more ambiguous; but a municipality could hardly be described as a "corporation doing business for profit within the territory."

[9] Ystradyfodwg & Pontypridd Main Sewerage Board v. Bensted [1907] App. Cas. 264.

[10] Treasury Decisions, No. 1634.

§ 78. Agricultural and Horticultural Organizations

Following the language of the act of 1909, the income tax law of 1913 specifically exempts from its operation "agricultural or horticultural organizations." The phrase has not been judicially construed by the courts, but several rulings of the treasury department have indicated its meaning, as viewed by the officers charged with the administration of the law. Agricultural organizations, it was ruled, do not come within the statutory exemption, unless their chief object is the promotion or advancement of agricultural interests, and no part of the income inures to the benefit of their stockholders. "A corporation engaged in agricultural, horticultural, or similar pursuits, evidently for profit, is not, within the meaning of the law, such an agricultural or horticultural association as is specifically enumerated as exempt from the requirements of the act cited. Corporations, to come within the exempted class, must be such associations as, by means of exhibits, contests, awards, and premiums, are designed to encourage better production of agricultural or horticultural products, not themselves engaged in agricultural or horticultural pursuits, such as county fairs and like organizations of a quasi public character, whose income, derived from gate receipts, entry fees, donations, etc., is used to meet the necessary expenses of the association, the payment of premiums, making improvements, etc., no part of which income inures to the benefit of any private stockholder or individual. A corporation engaged in the business of raising stock or poultry, or growing grain, fruits, or other products of this character, is an agricultural or horticultural society only in the sense that it indicates the kind of business in which it is engaged. If the business of the corporation so engaged is so carried on that its income inures or may inure to the benefit of its stockholders, it will be held to be a corporation organized for profit, and, regardless of the fact that it may be engaged in agricultural or horticultural

pursuits, it must make returns of annual net income for each calendar year, and pay any special excise tax to which such returns may show it to be liable." [11] Thus, fruit growers' associations whose purpose is to promote the mutual benefit of their members in growing, harvesting, and marketing their products, and which are not organized for profit and have no capital stock represented by shares, and whose income is derived wholly from membership fees, dues, and assessments to meet necessary expenses, are not liable to the tax.[12] But on the other hand, corporations owning sugar or other plantations and disposing of the products thereof, are not entitled to the exemption simply in view of the nature of their business.[13] And corporations engaged in growing fruits, vegetables, and like products for profit, and which distribute such profits among their members on the basis of the capital invested, are liable to the statute, and must make returns and pay the taxes if any are found to be due.[14]

§ 79. Labor Organizations

A specific exemption is made in the federal income tax law in favor of "labor organizations." This phrase is not elsewhere defined in the act, but the intention of Congress in this behalf is plainly indicated by the events of political history and the trend of legislation in recent years. The term "labor," as here used, evidently cannot be taken in the rather wide sense given to it in some other phrases familiar in the law, such as "work and labor," "common labor," "worldly labor," and the like. But the organizations referred to are those associations of mechanics and artisans, and even of unskilled laborers, which are formed for the purpose of the mutual advantage and protection of their mem-

11 Treasury Decisions, No. 1737.
12 Treasury Decisions, No. 1742, par. 29.
13 Treasury Decisions, No. 1742, par. 23.
14 Treasury Decisions, No. 1742, par. 30.

bers, for enforcing the regulations which they prescribe with reference to the conditions and hours of labor and the rate of wages, and other such objects, and which are commonly called "trades unions" or "brotherhoods," "federations," "guilds," or "unions" of the mechanics employed in any given trade or craft. Though such associations are not explicitly exempted in the income tax laws of the states, they do not ordinarily come within the definition of the kinds of corporations which shall be taxable, or else they fall within the terms of a general exempting clause, as in Wisconsin, where the statute exempts "associations of individuals not organized or conducted for pecuniary profit."

§ 80. Fraternal Orders and Benefit Societies

There is also a specific exemption in the act of Congress in favor of "fraternal and beneficiary societies, orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such associations and dependents of such members." As here used, the word "lodge" means the meeting place (and hence the meeting itself or the aggregate of the members) of a secret society or fraternity.[15] Such bodies are very numerous in the United States, and for the most part they combine with their social, moral, or philanthropic objects the grant of pecuniary relief to sick or disabled members and to the families of deceased members. Many are in fact but mutual insurance associations, their revenues being derived from entrance fees, membership dues, and occasional assessments levied on the members, and expended (over and above the cost of management and other small necessary expenses) in the payment of sick, accident, and death benefits. The officers of the treasury department have ruled that such an association, if it does not "oper-

[15] State v. Farmers' & Mechanics' Mut. Aid Ass'n, 35 Kan. 51, 9 Pac. 956.

ate under the lodge system," is simply an insurance company and subject to the tax, notwithstanding that all its funds are derived from membership fees and assessments and expended in the payment of such benefits.[16]

§ 81. Religious, Charitable, and Benevolent Associations

The act of Congress also exempts "any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual." And the statute of Wisconsin exempts any "association of individuals" organized for "religious or benevolent" purposes, and not "organized or conducted for pecuniary profit." The rules with reference to the exemption of such associations from the burdens of ordinary taxation have been well worked out by the courts, and will generally be found applicable in the case of the special tax here under consideration. Specifically with regard to the corporation excise tax of 1909, it was ruled that a charitable institution was exempt whether it was supported by voluntary contributions or by state appropriations.[17] In England, the rule has been stated that, in the income tax law, the words "charitable purposes" are to be interpreted, not according to their popular meaning, but according to their technical legal signification, though it was held in the same case that the phrase would include a home or asylum for the maintenance of single persons and widows belonging to the Moravian brotherhood.[18] And it is a general rule, in the construction of exemptions from taxation that the word "charity" is not to be restricted to the relief of the sick or poor, but extends to any form of philanthropic endeavor or public

[16] Treasury Decisions, No. 1738.
[17] Treasury Decisions, No. 1742, par. 4.
[18] Income Tax Com'rs v. Pemsel [1891] App. Cas. 531, 3 Tax Cas. 53.

beneficence.[19] And even under the more restricted form of exemption under the tax laws of some of the states, extending to "public" charities, or "institutions of purely public charity," it is held that the term "public" is not equivalent to "universal." The exemption would not apply to a charity limited to a certain class of privileged individuals. But on the other hand, it need not be open to all persons alike, for the "public" to which it administers relief may be limited to the inhabitants of a given city or other place, or may be restricted to the sufferers from particular diseases or forms of need, or with reference to nationality, color, or religious connections.[20] Also it is a well-recognized rule that an institution such as a hospital or asylum does not lose its character as a "charitable institution" because it receives pay patients, or in other words requires those of sufficient pecuniary ability to pay for the accommodation and treatment which they receive, if the income thus derived is not distributed among the corporators or stockholders, but applied exclusively to the purposes of the institution, and if, at the same time, poor or indigent patients are received and treated without charge.[21] But an English decision holds that if a hospital takes paying patients at remunerative prices, and applies its surplus income to the extension and improvement of the hospital buildings, the sur-

[19] See Gerke v. Purcell, 25 Ohio St. 229; Cleveland Library Ass'n v. Pelton, 36 Ohio St. 253; State v. Academy of Science, 13 Mo. App. 213; Massachusetts Society v. Boston, 142 Mass. 24, 6 N. E. 840.

[20] Bangor v. Masonic Lodge, 73 Me. 428; Burd Orphan Asylum v. School Dist., 90 Pa. St. 21; Hebrew Orphan Asylum v. New York, 11 Hun (N. Y.) 116; Income Tax Com'rs v. Pemsel [1891] App. Cas. 531, 3 Tax Cas. 53; Hastings v. Long, 11 Pa. Dist. R. 70.

[21] State v. Board of Assessors, 52 La. Ann. 223, 26 South. 872; Hennepin County v. Brotherhood of Gethsemane, 27 Minn. 460, 8 N. W. 595, 38 Am. Rep. 298; Philadelphia v. Pennsylvania Hospital, 154 Pa. St. 9, 25 Atl. 1076; Cawse v. Nottingham Lunatic Asylum [1891] 1 Q. B. 585, 60 Law J. Q. B. 485; Blake v. London, 18 Q. B. Div. 437. But see Needham v. Bowers, L. R. 21 Q. B. Div. 437, 2 Tax Cas. 360.

plus is profit and assessable for the income tax.[22] The business of maintaining a cemetery, from which revenues are derived in the form of cash for the sale of grave-sites or burial lots and annual dues or assessments upon lot-owners for the care of the grounds, is not a charity, and a corporation owning and conducting the cemetery is taxable on the income derived from it.[23] But the federal income tax law of 1913 contains a specific exception in favor of "cemetery companies organized and operated exclusively for the mutual benefit of their members."

§ 82. Educational and Scientific Institutions

The act of Congress exempts corporations organized for "scientific or educational purposes," and that of Wisconsin "scientific and educational associations." It has been held that a provision of an income tax law exempting from its operation private schools, colleges, and other educational institutions does not make an illegal discrimination such as to render the law invalid as to other corporations or persons upon whom the tax is imposed.[24] But it seems clear that a private school, in which tuition fees are charged, and from which a revenue is derived over and above the expenses, would not be exempt under either of the provisions quoted, since the federal statute applies only to educational institutions "no part of the net income of which inures to the benefit of any private stockholder or individual," and the state law applies to such institutions only when "not organized or conducted for pecuniary profit." On the other hand, the exemption under these statutes is appar-

[22] St. Andrew's Hospital v. Shearsmith, L. R. 19 Q. B. Div. 624, 2 Tax Cas. 219.

[23] Paddington Burial Board v. Com'rs of Inland Revenue, L. R. 13 Q. B. Div. 9, 2 Tax Cas. 46; Paisley Cemetery Co. v. Reith, 35 Scotch Law Rep. 947, 4 Tax Cas. 1; Edinburgh Southern Cemetery Co. v. Kinmont, 2 Tax Cas. 516.

[24] Peacock v. Pratt, 121 Fed. 772, 58 C. C. A. 48.

ently broad enough to include various kinds of institutions which derive their current revenues partly from endowment funds and partly from small charges to the public for admission to their buildings or for the use of their privileges, such as art galleries, museums of curiosities or antiquities, academies of the fine arts, institutions for the exhibition of objects illustrating the natural sciences, public libraries, and the like. In the general law of taxation, and with reference to exemptions, there has been much doubt as to whether such institutions could be classed as "schools," "institutions of learning," "purely public charities," or the like.[25] But under the income tax laws, the test is in the question whether or not they are conducted for profit, or whether or not any part of the income is distributed to the proprietors, corporators, or shareholders as a gain or profit. And on the analogy of many similar cases, it would seem that the mere fact of admission fees being charged would not make them institutions conducted for profit, if the revenue so obtained is applied to the upkeep or expansion of the institution, rather than to the benefit of any private person interested in it.

§ 83. Building and Loan Associations

Domestic building and loan associations are exempt under the act of Congress of 1913 when "organized and operated exclusively for the mutual benefit of their members," following the language of the corporation tax law of 1909. And a similar exemption is found in the Wisconsin statute. It was ruled by the treasury department that "building and loan associations are not exempt if they loan money to others than

[25] Academy of Fine Arts v. Philadelphia County, 22 Pa. St. 496; Gerke v. Purcell, 25 Ohio St. 229; Salem Lyceum v. Salem, 154 Mass. 15, 27 N. E. 672; Mercantile Library Co. v. Philadelphia, 14 Pa. Co. Ct. R. 204; Cleveland Library Ass'n v. Pelton, 36 Ohio St. 253; Philadelphia Library Co. v. Donohugh, 12 Phila. (Pa.) 284; Manchester v. McAdam [1896] App. Cas. 500.

their members, thus doing a business similar to that engaged in by banks and trust companies. It is also held that building and loan associations which receive sums of money on deposit, which is not in payment of stock, and on which the depositor receives a fixed rate of interest, regardless of the earnings of the association, are conducting a business similar to a banking business, and are therefore subject to the special excise tax on corporations and should be required to make a return showing their net income." [26] It was likewise held that such associations, providing for the loaning of funds to nonmembers, for issuing preferred or guarantied interest-paying stock, and allowing directors to cancel outstanding certificates of general stock not borrowed upon, paying the holder the book value of stock canceled, thereby being authorized to retire any and all stock in their discretion, are not exempt from the tax.[27] But it was held in a later case that, when a building and loan association is organized under the New Jersey statute solely for the purpose of making building loans to its members, who are entitled to vote in the management of the association's affairs, according to membership and not by virtue of stockholding, it is an association for the mutual benefit of its members, within the meaning of the statute, although, under its plan of operation, there may be inequality in the returns to the prepaying stockholder, etc., since the word "mutual" is not to be taken as synonymous with "equal." Reference was made to the decision above cited, but it was said: "That case does not appear to be applicable. The shareholders in that association voted for the directors by the share, thereby affording opportunity for a few individuals, by the acquisition of shares, to control the policy of the association. The funds of that association appear to have been a subject of loans to any borrower, without respect to member-

[26] Treasury Decisions, No. 1655.
[27] Pacific B. & L. Ass'n v. Hartson, 201 Fed. 1011.

ship in the association; and there was a provision for the cancellation of outstanding certificates of stock not borrowed upon whenever the board of directors deemed advisable to pay the holder the book value of the stock so canceled. In almost every aspect the case cited on behalf of the collector is not applicable to the present case." [28]

§ 84. Savings Institutions

In Wisconsin, "mutual savings associations" are exempt from the payment of the income tax. Whether or not an institution exercising some of the functions of a bank is to be classed as a "savings bank," "savings institution," or "savings association," must be determined not by the name which it assumes or by which it is chartered, but by its organization, powers, and mode of doing business, as provided in its articles of incorporation.[29] And the phrases above quoted do not apply to every bank merely because it receives deposits of savings. The kind of associations intended by the law in Wisconsin are those which are operated exclusively for the mutual benefit of the depositors, who alone—and not any stockholders or proprietors—are entitled to participate in the profits. Such associations are authorized under the laws of numerous states, as for example, Massachusetts, where they are thus described: A savings bank, as existing in this state, subject to the general laws, is an institution for the purpose of receiving deposits for the benefit of depositors, investing the same, accumulating the profits or interest thereof, paying such profits or interest to the depositor, or retaining the same for his greater security. There is no capital stock, and no stockholders who are entitled to receive profits from the business; but its affairs are administered by a board of trustees, the securities in which the deposits shall be invested are prescribed by law, and the conduct of its affairs is under the super-

[28] Parkview B. & L. Ass'n v. Herold, 203 Fed. 876.
[29] State v. Lincoln Sav. Bank, 14 Lea (Tenn.) 42.

vision of a public officer.[30] So, in New Jersey, it is said that a savings bank is a quasi charitable and purely benevolent institution, its only object being the safe keeping and provident investment of the funds of the depositors. The members of the corporation have no property interest in its funds, of which they are by law constituted the managers and guardians. The depositors, who alone are beneficially interested, have no voice in the management, nor even in the selection of the persons to whom the management is intrusted. Savings banks have no capital stock. They are incorporated and organized, not for the benefit of the corporators, but solely for the advantage of their depositors.[31]

Also under the federal income tax law of 1913 there is a special exemption in favor of "mutual savings banks not having a capital stock represented by shares."

§ 85. Civic Organizations and Chambers of Commerce

It is specially provided in the federal income tax law that its terms shall not apply to "business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare." A board of trade, as the term is used in America, is an organization of the principal merchants, manufacturers, tradesmen, etc., of a city, for the purpose of furthering its commercial interests, encouraging the establishment of manufactures, promoting trade, securing or improving shipping facilities, and generally advancing the prosperity of the place as an industrial and commercial community.[32] Exactly similar organizations are sometimes called

[30] Commonwealth v. Reading Sav. Bank, 133 Mass. 13, 43 Am. Rep. 495.

[31] Barrett v. Bloomfield Sav. Inst., 64 N. J. Eq. 425, 54 Atl. 543.

[32] Black, Law Dict., voc. "Board."

"chambers of commerce," and the two terms are frequently stated to be synonymous.[33] But more strictly speaking, one of the objects of a chamber of commerce is to promote convenience or facility in buying, selling, and exchanging commodities. If these commodities include stocks, bonds, and other securities, the body practically fulfills the functions of a stock exchange. And in fact, in some cities, the stock exchange is officially denominated the "chamber of commerce" or the "board of trade." If, in this sense, it is organized for profit, or has a net income which inures to the benefit of the members, it is clearly not within the exemption, but is subject to taxation under the act.

§ 86. Income from Property Otherwise Taxed

In the several states, particularly Massachusetts, North Carolina, and Oklahoma, the law specifically exempts from the income tax such income as is derived from property which is itself subject to a tax or on which a tax has already been paid for the current year. The Wisconsin statute contains the following provision: "Any person who shall have paid a tax upon his personal property during any year shall be permitted to present the receipt therefor to, and have the same accepted by, the tax collector to its full amount in the payment of taxes due upon the income of such person during said year." But one who claims exemption from an income tax on the ground that his income consists of or is derived from property not liable to taxation, must affirmatively show that such is the case,[34] and it is believed the same rule should apply to the case of one who claims exemption on the ground that the property which has yielded the income is subject to taxation or has paid the tax. And income derived from an independent source is not exempted from the income tax because it has been applied to the payment of a debt due for real estate, pur-

[33] Century Dict., voc. "Chamber," "Trade."
[34] City of New Orleans v. Fourchy, 30 La. Ann. 910.

chased on credit, and upon which real estate a tax has been assessed and paid for the same period within which such income accrued.[35]

§ 87. Proceeds of Life Insurance Policies

Money received from a life insurance company in settlement of a claim under a policy for the death of the assured would probably have to be reckoned as part of the "income" of the beneficiary or recipient, if not specifically exempted. But in pursuance of a humane and wise policy, the income tax laws have generally provided for the exemption of such funds. The act of Congress excepts from the description of taxable income the proceeds of life insurance policies paid upon the death of the person insured, without any limitation as to the amount. The statutes in Wisconsin exempts "insurance to the total amount of ten thousand dollars received by any person or persons legally dependent upon the decedent, in payment of a death claim by any insurance company, fraternal benefit society, or other insurer." It will be observed that insurance money is not exempt in the hands of any beneficiary who was not "legally dependent upon the decedent," and that any amount of money so received above the sum of ten thousand dollars is taxable as income of the year, without regard to the relation between the decedent and the beneficiary. It may also be remarked that, under either of these statutes, money received by the assured himself, as in the case of accident insurance, will not be exempt, since in theory it merely takes the place of what he would have earned during the period of his disability. But as to life insurance proper, the act of Congress also exempts "payments made by or credited to the insured, on life insurance, endowment, or annuity contracts, upon the return thereof to the insured at the maturity of the term mentioned in the contract, or upon surrender of the

[35] Lott v. Hubbard, 44 Ala. 593.

contract." Money so returned, it is provided, "shall not be included as income."

§ 88. Exemption of Fixed Amount of Income

All income tax laws have wholly exempted incomes below a certain fixed minimum, and allowed the deduction of a like amount from incomes large enough to be subject to the tax. The object is to relieve from the burden of this tax those persons whose annual earnings or gains are no more than sufficient to maintain a decently comfortable existence, and to permit persons of larger means to deduct a sum which may represent the ordinary living expenses of the average family, so that the tax may not fall upon the necessaries of life or a reasonable share of its comforts, but only upon superfluous income. As corporations and partnerships have no corresponding expenses, they are not entitled to the exemption of a fixed sum. The amount of this fixed exemption has varied enormously in different localities and at different times. In the European countries deriving a revenue from this source, it is very small, as, for instance, in Great Britain, $800; in Prussia, $214; in Norway, $270; in Denmark, $540; in Austria, $250. Under the act of Congress of 1861, the exemption was $800. This was reduced to $600 in the acts of 1862 and 1864, but was raised to $2,000 in the act of 1870. In the act of 1894, it was fixed at $4,000. The income tax law of North Carolina exempts incomes below $1,000; in South Carolina the exemption is $2,500; in Oklahoma, $3,500; in Virginia, $1,000; in Hawaii, $1,000. The Massachusetts statute taxes "The excess above two thousand dollars of the income from a profession, trade, or employment." The Wisconsin statute allows exemptions as follows: (a) To an individual, income up to and including $800; (b) To husband and wife, $1,200; (c) For each child under the age of eighteen years, $200; (d) For each additional person, for whose support the taxpayer is legally liable and who is entirely dependent upon the tax-

payer for his support, $200. The provision of the act of Congress of 1913 is that each taxable person shall be entitled to an exemption of $3,000, with an additional exemption of $1,000 in case the taxpayer is either a "married man with a wife living with him" or a "married woman with a husband living with her." But in no event shall this additional exemption be deducted by both a husband and wife, and only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together. It is, in fact, a common provision of income tax laws that only one deduction of the fixed amount is allowed to be made from the aggregate income of a family, the husband and father, if he makes the return, being required to include the separate income of his wife and of any of his minor children who may have independent sources of income. In the case of guardians making the return for their wards, the deduction is allowed to be made from the income of each ward, except where two or more of them are included in the same family, in which event only one deduction from the aggregate is allowed. Objection has been made to the constitutional validity of such a provision, but it has been sustained by the courts.[36]

In regard to the federal income tax, special provision had to be made with reference to taxing the income of the year 1913, since, prior to the adoption of the Sixteenth Amendment, Congress had no constitutional authority to lay a tax on incomes, unless the tax should be apportioned among the several states. This point has been covered by the insertion of the following proviso: "That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions herein provided for."

[36] Robertson v. Pratt, 13 Hawaii, 590.

CHAPTER VIII

DEDUCTIONS AND ALLOWANCES

§ 89. Expenses of Business

The income tax act of Congress of 1913 allows the individual taxpayer to deduct from his return of net income "the necessary expenses actually paid in carrying on any business, not including personal, living, or family expenses." In the case of domestic corporations, it allows the deduction of "all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties." In the case of foreign corporations, the deduction may include "all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States." The Wisconsin income tax law allows a corporation to deduct "ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its

business and property," and in the case of an individual, "the ordinary and necessary expenses actually paid within the year in carrying on the profession, occupation, or business from which the income is derived." In South Carolina, the deduction includes "the necessary expenses actually incurred in carrying on any business, occupation, or profession, not including remuneration to the taxpayer for personal supervision or the support and maintenance of his or her family." The statute of Hawaii allows the deduction of "the necessary expenses actually incurred in carrying on any business, trade, profession, or occupation, or in managing any property." The provision in Virginia is more restricted, as it relates only to so much of the income as may be derived from farming or other agricultural pursuits, and allows the deduction of "all sums paid for taxes or for labor, fences, fertilizers, clover or other seed purchased and used upon the land upon which the vegetable and agricultural productions were grown or produced, and the rent of said land paid by said person, if he be not the owner thereof."

It is the very evident purpose of all these statutes to lay the tax only upon net income, that is to say, upon so much of the gross income of the person or corporation as may remain after deducting the expenses incurred directly in the production or earning of the income.[1] At the same time, the individual taxpayer is not allowed to deduct so much of his current income as he has spent in the satisfaction of his personal wants or desires or in the support and maintenance of his family, because in the first place such expenditures have not contributed directly to the production of the income to be taxed, and in the second place, such expenses are supposed to be covered, in the case of the ordinary or average family, by the money exemption which the statutes also allow. But provisions of this kind should be construed with some measure of liberality. Thus it is held that, where a statute taxes a cer-

[1] Poland v. Lamoille Valley R. Co., 52 Vt. 144, 177.

tain class of corporations (such as insurance companies) only upon income derived from one particular source (such as mortgages), and allows all taxpayers to deduct expenses incurred "in the production of their income," such a company is entitled to deduct all the expenses incurred in the production, not merely of its income from mortgages, but of its income as a whole.[2]

What may be comprehended in the general description of "ordinary and necessary expenses" will depend greatly upon the nature of the business, trade, or pursuit carried on. But in all cases the prime distinction is to be taken between investment of capital assets and current expenses. Thus, in the case of a manufacturing establishment, the purchase and renewal of the machinery necessary for the operation of the plant would be regarded as an investment of capital, and could not be deducted as an item of expense. This was brought out in an English case, where a corporation, with a view to extending its business, opened a factory and installed machinery, but subsequently closed it, removed a portion of the machinery, and re-opened the factory on a smaller scale, and thereby lost a portion of the original expenditure. This was held to be a loss of capital, and that no deduction could be allowed therefor in assessing its income for taxation.[3] On the other hand, where the business is one which is carried on in an office, whatever constitutes permanent equipment might be regarded as an investment of capital, but whatever is currently consumed or used up in the ordinary business of the office (stationery, for example) would come under the description of expense. Thus it is held that ordinary expenditures made by an insurance company for the renewal of office furniture and other such perishable equipment does not constitute an addition to its assets, but is an expense of maintenance and operation, which it is entitled to deduct in computing net income

[2] Commissioners of Taxation v. Teece [1899] App. Cas. 254.
[3] Smith v. Westinghouse Brake Co., 2 Tax Cas. 357.

for the purpose of the tax.[4] The cost of raw materials is naturally an "expense" to the manufacturer, and the merchant will reckon as an "expense" the prime cost of the goods which he buys to sell again, including such items as freight or expressage. But in an English case, where part of the business taken over by a company consisted of unexecuted contracts, it was held that the price paid for such contracts was not a proper deduction from the profits arising from their performance.[5] Wages and salaries paid to clerks, salesmen, operatives, managers, and so on, are always an expense of operating any business in which their employment is necessary (see the next section), and although the point has not been decided with reference to tax laws, it can hardly be doubted that the cost of advertising should be accounted an "ordinary and necessary expense," in view of the conditions under which all modern business is transacted.[6] And if the law of the state or an ordinance of the municipality requires the payment of an annual license fee or occupation tax, as a condition to the right to carry on the particular business, it is a part of the necessary and proper expense thereof.[7] But in England it is held that brewers supplying "tied" houses (that is, public houses for which the brewers procure and pay for the license, on the condition that the house shall sell no other beer but theirs) are not entitled to deduct from their profits, for the purpose of the income tax, the expenses of unsuccessful applications for new licenses for such houses.[8] It appears also—though the question has more frequently arisen in other connections—that money paid to an attorney at law for his professional services, in advising concerning legal problems which arise in the course of the business conducted, and in drawing

[4] Mutual Benefit Life Ins. Co. v. Herold, 198 Fed. 199.
[5] City of London Contract Corp. v. Styles, 2 Tax Cas. 239.
[6] See Foster v. Goddard, 1 Black (U. S.) 506, 17 L. Ed. 228.
[7] Kane v. Schuylkill Fire Ins. Co., 199 Pa. St. 205, 48 Atl. 989.
[8] Southwell v. Savill Brothers, Limited [1901] 2 K. B. 349, 4 Tax Cas. 430.

such papers as require legal skill and knowledge, may justly be treated as a part of the "expenses" of the business,[9] and similar decisions are to be found in regard to the costs and expenses of prosecuting or defending suits at law, when litigation becomes a necessary incident of the business, either for the recovery of debts or the repulse of unjust claims.[10] Many other items of expenditure may present much more difficult problems, but in general it may be said that the test is to determine whether a particular outlay was an investment or an expense of "maintenance or operation," and, in the latter case, whether it was "necessary" and "ordinary." In an English case, it appeared that a colliery company was a member of a "coal owners' association," to which it paid an annual subscription based on its output of coal. The object of the association was to pay to its members an indemnity in the event of deficiency or stoppage of output caused by strikes or other such interferences. The company contended that the subscription made for this purpose was a kind of insurance and therefore deductible as an expense of its business. But the court held otherwise, and refused to permit it as a deduction in estimating the profits of the company for income taxation.[11] But this decision was "distinguished" in a later case, not very easy to reconcile with it. It appeared that the company in question was a member of an association of manufacturers, which was mainly formed for the purpose of keeping up prices. Under the rules and pooling arrangements of the association, the members were entitled each to a fixed proportion of all orders received, and any member invoicing more than its proportion must pay a fixed sum per ton on the excess to the pool account, which was distributed among those members which had invoiced less than their proportions. It was held that the

[9] Brady v. Dilley, 27 Md. 570.

[10] Babbitt v. Selectmen of Savoy, 3 Cush. (Mass.) 530; Scofield v. Moore, 58 Hun (N. Y.) 601, 11 N. Y. Supp. 303.

[11] Rhymney Iron Co. v. Fowler [1896] 2 Q. B. 79, 3 Tax Cas. 476.

net payments made by the company to the association (including a share of administration expenses) in excess of those received from the association by the company, were an admissible deduction for the purpose of arriving at the company's taxable profits.[12] Under the corporation tax law of 1909, the officers of the treasury department ruled that sales of stock and bonds were to be regarded as sales of capital assets, and should be so accounted for, but that the proceeds derived from the sale of bonds, used in defraying ordinary and necessary expenses, were a proper deduction in determining the company's net income.[13]

§ 90. Same; Wages and Salaries

Wages and salaries paid to clerks, servants, agents, salesmen, managers, superintendents, officers, and other employés of the individual or corporate taxpayer are deductible from income, either because specially mentioned, as they are in some of the statutes, or as a necessary expense of conducting the business.[14] But this applies only to the compensation of those employés or agents who are engaged in the conduct of the business from which the income is derived, as under the Wisconsin statute, where a deduction is allowed for "payments made within the year for personal services of officers and employés actually employed in the production of such income." This might cover the compensation of a secretary, amanuensis, or stenographer, if occupied in the work of a profession or vocation carried on by his employer and from which the latter's taxable income was derived. But the wages of domestic servants would be classed as "family or living expenses," for which no deduction is allowed. It is probably immaterial whether the compensation of an employé is paid in

[12] Guest, Keen, & Nettlefolds, Limited, v. Fowler [1910] 1 K. B. 713, 5 Tax Cas. 511.

[13] Treasury Decisions, No. 1742, par. 55.

[14] See Dunwoody v. United States, 22 Ct. Cl. 269, 278; Foster v. Goddard, 1 Black (U. S.) 506, 17 L. Ed. 228.

the form of a fixed annual or monthly wage or in the form of a commission on sales or business transacted. But it must be compensation for services rendered, and not a bonus or a present. It was ruled under the corporation tax law of 1909 that amounts paid for pensions to retired employés, or to their families or others dependent upon them, or paid on account of injuries received by employés, are proper deductions as "ordinary and necessary expenses," but that gifts or gratuities to employés in the service of a corporation are not properly deductible in ascertaining its net income.[15] And in England there is a decision that voluntary contributions made by a minister towards the stipend of his assistant minister are not an allowable deduction, although it was necessary for him to supplement the stipend in this way in order to secure a competent assistant.[16]

It should also be observed that an individual taxpayer cannot escape paying the income tax, or reduce its burden, by paying himself a salary for his own services in supervising and conducting his own business, and then deducting the amount of it from the income which the business yields. Some statutes specially provide against this, as in South Carolina, where the deduction includes "the necessary expenses actually incurred in carrying on any business, occupation, or profession, not including remuneration to the taxpayer for personal supervision." And under any such statute, it is believed, this would be regarded as a cheat or evasion which the courts would not sanction. Thus, in a Scotch case, it was ruled that, where testamentary trustees receive annually the income of property and distribute it among the beneficiaries, the whole of such income is taxable, without deduction of the expenses incurred in the management or administration of the trust.[17] And in the case of a corporation where practically

[15] Treasury Decisions, No. 1742, par. 64.

[16] Lothian v. Macrae, 22 Scotch Law Rep. 219, 2 Tax Cas. 65.

[17] Aikin v. Macdonald's Trustees, 32 Scotch Law Rep. 85, 3 Tax Cas. 306.

the whole of the stock is owned by one person, or perhaps by two former partners who have simply incorporated their business, the same principle applies. It has been ruled that salaries paid to an officer who is a stockholder, to constitute an allowable deduction, must be a reasonable and fair compensation for the services rendered, without regard to the amount of stock which such officer may hold, and must have been authorized by the board of directors and made a matter of record on the minute books of the corporation.[18]

§ 91. Same; Traveling Expenses

The expenses of a journey may be included in the "necessary and ordinary expenses" of carrying on a given business, where the journey is made as a necessary incident of the business or is otherwise undertaken directly for its expansion or advantage, as, where a traveling salesman is allowed his expenses on the road, where the business of an individual necessarily requires him to move from place to place, where a buyer for a store is sent to a distant market to replenish the stock, or where an officer of a corporation travels on its necessary and proper errands. But traveling expenses are not deductible where they are incurred merely for the comfort or convenience of the person concerned. Thus, a public officer, whose duties are to be performed in one place, but who chooses to reside in another, is not entitled to deduct, for the purpose of the income tax, his expenses incurred in going to and fro between the two places.[19] And where the directors of a corporation travel from their places of residence to the place of meeting of the company, their traveling expenses are not an allowable deduction.[20] But it is at least doubtful whether hotel bills and other items of personal expenditure can be brought under the description of "traveling expenses"

[18] Treasury Decisions, No. 1742, par. 81.
[19] Cook v. Knott, 2 Tax Cas. 246.
[20] Revell v. Directors of Elworthy Bros., Limited, 3 Tax Cas. 12.

in any case where such expenses might constitute a proper deduction from income. The precise question has not arisen under the income tax laws, but analogous cases are not wanting. Thus, in a contract of employment of a traveling salesman for a certain salary per annum and an allowance for expenses not to exceed a certain sum per day, the word "expenses" was construed as not including the living expenses of the salesman.[21] And a similar decision was made in a case in Ohio, on the construction of a statute allowing to a county commissioner his "reasonable and necessary expenses actually paid in the discharge of his official duties." It was held that this meant official expenses only, as distinguished from those which pertained to the commissioner's personal comfort and necessities. The court said that, for his personal expenses of any kind, he could claim nothing beyond his per diem compensation and mileage; and it was a fair inference that, if it had been intended to reimburse him for board or traveling expenses in addition to mileage, when traveling on county business, the legislature would have expressed that intention in plain terms.[22]

§ 92. Same; Cost of Insurance

Premiums paid for policies of fire insurance were allowed to be deducted from the taxpayer's net income under the federal income tax act of 1894, and although this item is not specified in the statute now in force, nor in the laws of the states, it cannot be doubted that it should be allowed as a part of the "necessary and ordinary" expense of conducting a business, where the insurance is written on any building in which the business is carried on, or on a stock in trade, or on unfinished products of a factory, or on office furniture and fixtures, though of course the cost of insuring one's dwelling could not be so deducted. This is also the rule in Eng-

[21] Dowd v. Krall, 32 Misc. Rep. (N. Y.) 252, 65 N. Y. Supp. 797.
[22] Richardson v. State, 66 Ohio St. 108, 63 N. E. 593.

land under the income tax law of that country,[23] and it is a general principle of law that the cost of insurance is properly included under the head of "expenses" in almost any connection in which that term can be used.[24] Thus, as between a life beneficiary and a remainderman, premiums paid for fire insurance on the premises are a proper expense of administering the property and are therefore payable out of income.[25]

§ 93. Same; Rent of Land, Buildings, or Equipment

The act of Congress in force allows corporations to deduct from net income, under the head of expenses, "rentals or other payments required to be made as a condition to the continued use or possession of property," and although this is not repeated in the provisions relating to individual taxpayers, it seems clear that, in the case of any business conducted on leased premises, the rent is a "necessary expense" of the business. Rent is not specially mentioned in the statutes of the several states, except Virginia, where the rent paid for agricultural land is allowed to be deducted from the profit realized on the crops. But only the actual rent paid, or the actual rental value of the premises, can be thus deducted, and not the additional expense which may be incurred in the purchase of a lease for a term of years. Thus, the English courts hold that where leasehold premises are purchased and used for trade purposes, the deduction from the assessment on the trade profits in respect to such premises must be limited to the existing annual value thereof, whatever may have been the premium originally paid, that is, the tenant is only entitled to deduct the annual rent, and not to amortize the premium by distributing it over the years yet to run.[26] So they hold that a brewer paying a premium for a lease of a public

[23] Society of Writers to the Signet v. Inland Revenue, 24 Scotch Law Rep. 27, 2 Tax Cas. 257.

[24] See Foster v. Goddard, 1 Black (U. S.) 506, 17 L. Ed. 228.

[25] Bridge v. Bridge, 146 Mass. 373, 15 N. E. 899.

[26] Gillatt v. Colquhoun, 2 Tax Cas. 76.

house, for the purpose of letting it to a tenant under a covenant to buy beer brewed by him, is not entitled to a deduction on account of the gradual exhaustion of the premium.[27] That rent paid for personal property, as well as for land, may be an expense of the business in which it is employed, appears from a case in Pennsylvania, where it was held that compensation for the use of rolling-stock or other equipment which is hired, and not owned, by a railroad company, is certainly a part of the expense of the business which it transacts, and is therefore a part of the operating expenses of the road.[28]

§ 94. Same; Mining Operations

The rule is settled in England that the cost of sinking a pit or shaft on a coal or iron mining property, to open up new seams or deposits, is an expenditure of capital and properly chargeable to that account, and cannot be regarded as an ordinary expense of the business, so as to be deductible from income for the purpose of estimating the taxable net income.[29] And a tenant of minerals, though he may be under a constant vanishing expense in sinking new pits as the old ones become exhausted, is not entitled, in computing his profits for the assessment of the income tax, to deduct from the gross profits a sum estimated as representing the amount of capital expended in making bores and sinking pits which have become exhausted by the year's work.[30] But in construing and applying the corporation tax act of Congress of 1909, the Commissioner of Internal Revenue made a regulation that the cost of drilling wells, by natural-gas companies, might be charged to expense account, rather than investment account, and so allowed in their returns. It was said: "The cost of drilling gas wells has been held by competent authorities as

[27] Watney v. Musgrave, L. R. 5 Ex. Div. 241, 1 Tax Cas. 272.
[28] Commonwealth v. Philadelphia & E. R. R., 164 Pa. St. 252, 30 Atl. 145.
[29] In re Addie & Sons, 12 Scotch Law Rep. 274, 1 Tax Cas. 1.
[30] Coltness Iron Co. v. Black, L. R. 6 App. Cas. 315.

properly chargeable to either investment or expense. While it is preferred that the cost of drilling wells be charged to investment, the general custom of producers of natural gas in charging the cost of drilling to expense will be recognized, and returns of net income may be made in accordance therewith. Each return of annual net income should in such case state that the expense of drilling gas wells has been charged to expense. All other expenditures in tangible property in development work shall be chargeable to capital assets." [31] But the Commissioner also ruled that, in the case of petroleum producing properties, the cost of drilling and equipping new producing wells should be considered and treated as an addition to capital investment account, but that the expense of drilling holes which proved to be dry might be charged to profit and loss.[32]

§ 95. Same; Judgments

If a judgment is recovered against the taxpayer (whether an individual or a corporation) and paid within the year for which the return is to be made, the question whether it is deductible as an "ordinary and necessary expense" should be determined by reference to the cause of action on which it was recovered. If the claim was for goods sold, money had and received, services rendered, or otherwise founded on contract or quasi contract, it should be easy to determine whether the plaintiff's demand arose out of or was incident to the conduct of the defendant's business, and if so, the change in its form, from a disputed claim to a judgment, should not affect the question of its allowance as a deduction. But in the case of a judgment for a tort, the matter is not so clear. So far as the authorities go, they may be said to favor the rule that if the tort was committed directly in the course of the business operations of the

[31] Treasury Decisions, No. 1754.
[32] Treasury Decisions, No. 1755.

defendant, or the circumstances constituting it were such as might ordinarily arise in the prosecution of that business, then the payment of the damages (whether by settlement out of court or after judgment) may be regarded as an "expense" of the business. But if the tort had no connection with the business carried on, and did not arise out of its usual or ordinary conduct, it cannot be considered as an expense of that business. And this would naturally apply also to torts having also a criminal aspect, such as libel or slander or assault and battery. Thus it was ruled, under the corporation tax law of 1909, that amounts paid on account of injuries received by employés in the course of their employment would be proper deductions as ordinary and necessary expenses of the business.[33] And in an English case, the Lord Chancellor gave as an illustration of an allowable deduction "losses sustained by a railway company in compensating passengers for accidents in traveling." [34] So again, a decision in Massachusetts holds that the "operating expenses" of a railroad company should be construed to include a claim for damages done to property by the railroad company in negligently running a train at a highway crossing.[35] But on the other hand, where a brewery company owned an inn, which was carried on by a manager as a part of its business, and a customer sleeping in the inn was injured by the fall of a chimney, which accident was attributable to the negligence of the company's servants, and he recovered a judgment for damages, it was held that the amount thereof could not be deducted in estimating the balance of profits for the purpose of the income tax, the loss not being connected with or arising out of the trade, and not being money wholly or exclusively laid out for the purposes of the trade.[36] And in the case in which this decision was made, a

[33] Treasury Decisions, No. 1742, par. 64.
[34] Strong & Co. v. Woodifield [1906] App. Cas. 448.
[35] Smith v. Eastern R. Co., 124 Mass. 154.
[36] Strong & Co. v. Woodifield [1906] App. Cas. 448.

further illustration was given, as follows: "If a man kept a grocer's shop, for keeping which a house is necessary, and one of the window shutters fell upon and injured a man walking in the street, the loss thereby arising to the grocer ought not to be deducted" from net taxable income.

§ 96. Repairs, New Buildings, and Improvements

The cost of repairs to property, such as may be necessary to restore dilapidation or to keep it in serviceable and efficient condition for the purpose of the business in which it is employed, is plainly deductible as an "ordinary and necessary expense" of the business or of "the maintenance and operation of the business or property," as these terms are used in the income tax laws. Thus, under the act of Congress of 1864, it was said: "The object of the law was to impose a tax on net income or profits only, and that cannot be regarded as net income or profits which is required and expended to keep the property up in the usual condition proper for operation. Such expenditure is properly classed with repairs, which are a part of the current expenses." [37] And it has been ruled that the cost of erecting a building, if included in the terms of a lease under which the property is held by a corporation, is a proper deduction from its return of income for taxation, but should be prorated according to the time fixed by the lease.[38] But if a corporation has been allowed a deduction for repairs to, and renewals of, its machinery and other appliances, sufficient to cover the actual loss by wear and tear, it cannot be allowed a further deduction for estimated depreciation of its plant; in other words, it cannot "get deduction for deterioration twice over." [39] But "repairs" do not include new constructions. And the income tax laws generally provide that no deduction

[37] Grant v. Hartford & N. H. R. Co., 93 U. S. 225, 23 L. Ed. 878.
[38] Treasury Decisions, No. 1742, par. 51.
[39] Caledonain Ry. Co. v. Banks, 18 Scotch Law Rep. 85, 1 Tax Cas. 487.

shall be allowed to the taxpayer for money laid out in the cost of new buildings, permanent improvements, or betterments, made to increase the value of his property or estate. This is in accordance with general principles of law. Thus, in estimating the profits of the business of a partnership, it is error to include among the expenditures such amounts as have been expended in permanent improvements to the real estate of the firm. Such improvements must be regarded as an investment of capital.[40] So, a corporation purchasing gas works in a defective structural condition is not entitled to deduct, in making its return of income for taxation, sums set aside annually out of the profits to be expended in future years on restoring the plant and apparatus.[41] And a railway company is not entitled to deduct from its profits sums expended in improving a section of the line so as to bring it up to the standard of the main line, nor the cost of the extra weight of heavy rails and other equipment substituted for lighter ones.[42] In this connection, however, it is pertinent to remark that modern ideas of sound corporation finance require that only those expenditures for improvements or betterments should be charged to capital accounts which will bring in new income, increase current income, or lessen the cost of production. Those which do not increase the productivity of the plant, in one way or the other, are charged against working expenses, repair or replacement account, or profit and loss. In this view, if a railroad company replaces a wooden bridge with a stone or steel bridge, it would not be treated as an investment of capital assets, unless, perhaps, it was part of a comprehensive system of improvements undertaken with a view to running heavier trains and handling a larger volume of traffic.[43] But in the

[40] Braun's Appeal, 105 Pa. St. 414.

[41] Clayton v. New Castle-Under-Lyme Corp., 2 Tax Cas. 416.

[42] Highland Ry. Co. v. Balderstone, 26 Scotch Law Rep. 657, 2 Tax Cas. 485.

[43] See Greene, Corporation Finance (3d edn., 1904) p. 86.

light of the decisions above referred to, it seems clear that such an expenditure could not be deducted (for the purpose of the income tax) as a part of the expense of conducting the business or maintaining the property, but must be treated as a new building, improvement, or betterment.

§ 97. Interest on Indebtedness

The income tax law of Wisconsin allows, in the case of the individual only, the deduction of "interest paid within the year on existing indebtedness." That of Hawaii provides for the deduction of "all interest paid by such person or corporation on existing indebtedness." The act of Congress of 1913 discriminates between individuals and corporations. In the case of the former, it allows a deduction of "all interest paid within the year by a taxable person on indebtedness." But in the case of a corporation, the deduction allowed is of "interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of the capital employed in the business at the close of the year." To this there is added a proviso that, "in case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation, joint stock company, or association, the total interest secured and paid by such company, corporation, or association within the year on any such indebtedness may be deducted as a part of its expense of doing business." And further it is provided that, "in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed." But in the case of a bank, banking association, or loan or trust company, the deduction may cov-

er "interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company."

Construing a similar provision in the act of 1909 (with reference to the capital stock of a corporation as the measure of the indebtedness for which it might claim a deduction with respect to interest paid), it was ruled that the full amount of stock as represented by the par value of the shares issued is to be regarded as the paid-up capital stock, except when such stock is assessable on account of deferred payments, in which case the amount actually paid on such shares will constitute the actual paid-up capital. Capital stock is also held to include both preferred and common stock, but surplus and undivided profits are not to be included.[44] There was also a ruling that interest on portions of bonded or other indebtedness bearing different rates of interest may be deducted from gross income, provided the aggregate amount of such indebtedness does not exceed the paid-up capital stock plus half the bonded debt.[45] An opinion was given by the Attorney General, on the construction of the same statute, that, in ascertaining the net income of a corporation for taxation under that act, the business of the corporation being holding and dealing in real estate, interest on an indebtedness assumed by the corporation and secured by mortgage on a property which it acquires, can be deducted only to an amount not exceeding interest at a corresponding rate on the amount of its paid-up capital stock. For by assuming the indebtedness, the corporation makes it "its" indebtedness, and the limitation of the statute applies. But where such a corporation takes title to real property subject to a mortgage, but does not assume the indebtedness secured thereby, the interest on such indebtedness may be deducted from its gross income, without limita-

[44] Treasury Decisions, No. 1742, pars. 15–17.
[45] Treasury Decisions, No. 1742, par. 67.

tion as to the amount of its paid-up capital stock, because the indebtedness in this case is not "its" indebtedness, but the interest payment is a "charge required to be made as a condition to the continued use or possession of property." [46]

In regard to interest payments in general, it has been held that the amount paid for accrued interest on securities purchased is properly chargeable to income account,[47] and therefore, on a parity of reasoning, should be deductible from the return of income for taxation. Under the English law, money paid in the form of interest on deposits by a company doing a banking business or a loan and discount business, is not deductible from its assessment for the income tax.[48] But the rule must be otherwise under the act of Congress now in force, since it explicitly provides for the deduction, "in the case of a bank, banking association, or trust company, of interest paid within the year on deposits." As to the case of bank discounts, it is held in England that where a mercantile company, in order to be able to pay cash for goods purchased and thereby secure them at a better price than if bought on credit, borrows money on short time paper from bankers, the interest on such banking loans is not a proper deduction for the purpose of the income tax.[49] But the officers of the treasury department, under the act of 1909, held that discounts, other than bank discounts on notes executed by the corporation, should be segregated from the interest item on the return, and should be included under the heading of expenses.[50] In Wisconsin, the state tax commission rules that "discounts on obligations incurred but not discharged within the year would not come under the head of interest paid. When the

[46] 28 Opin. Atty. Gen. p. 198.
[47] People v. Davenport, 30 Hun (N. Y.) 177.
[48] Mersey Loan & Discount Co. v. Wootton, 2 Tax Cas. 316.
[49] Anglo-Continental Guano Works v. Bell, 70 Law T. (N. S.) 670, 3 Tax Cas. 239.
[50] Treasury Decisions, No. 1742, par. 90.

interest is deducted from a loan in advance, such interest cannot be said to be 'paid' until the note is paid." [51]

But in any case, nothing can be deducted under this head except what is strictly and properly to be described as "interest." Thus, in an English case, where a mining company borrowed money to be employed in its business, and covenanted to pay interest thereon annually and also to repay the capital with an additional bonus of ten per cent, it was held that the bonus paid could not be claimed as a deduction in estimating the assessable profits of the company.[52] So where a mortgage company raises money on an issue of debentures, and lends the money at a higher rate of interest, a commission paid to brokers and other expenses incurred in raising the money cannot be deducted from its assessment.[53] And where a company is empowered by act of Parliament to raise money upon mortgage for the purpose of carrying out a government contract, but is required by the same act to establish a sinking fund for the extinction of the mortgage debt, and a sum is to be set aside for payment into the sinking fund out of each quarterly payment received under the contract or out of other money belonging to the company, the sums so set aside are not allowable as a deduction in arriving at the company's taxable profits.[54]

§ 98. Taxes Accrued or Paid

In the income tax law of Hawaii it is provided that "all government taxes and license fees paid within the year shall be deducted from the gains, profits or income of the person who, or the corporation which, has actually paid the same,

[51] Wisconsin Income Tax Law, edition published by State Tax Commission, 1911, p. 17.

[52] Arizona Copper Co. v. Smiles, 29 Scotch Law Rep. 134, 3 Tax Cas. 149.

[53] Texas Land & Mtg. Co. v. Holtham, 3 Tax Cas. 255.

[54] City of Dublin Steam Packet Co. v. O'Brien, 6 Tax Cas. 101, following Mersey Docks & Harbour Board v. Lucas, 2 Tax Cas. 25.

whether such person or corporation be owner, tenant, or mortgagor." The concluding clause of this provision was apparently copied from the act of Congress of 1894, which in turn, derived it from the acts of 1864 and 1870. In all these statutes, it is of course apparent that the use of the word "mortgagor" is a legislative blunder for "mortgagee." And although the other existing acts do not specially provide for this case, it can hardly be doubted that a mortgagee of realty paying the taxes thereon would be entitled to deduct them from his return of income for taxation. The statute in Wisconsin, however, is quite strict in this particular. In the case of corporations, it allows the deduction of "sums paid by such person [corporation] within the year for taxes imposed by any state of this Union or subdivision thereof, or any territory or possession of the United States, upon the source from which the income taxed by this act is derived." This excludes any taxes assessed under the authority of the federal government. As to individuals, it provides for the deduction of "taxes paid by such persons during the year, other than inheritance taxes, upon the property or business from which the income hereby taxed is derived." This would not allow the taxpayer to deduct the amount paid by him under the federal income tax law, since that is not a tax on his property or business, but upon the income itself.

The act of Congress of 1913, in its application to individual taxpayers, allows the deduction of "all national, state, county, school, and municipal taxes paid within the year, not including those assessed against local benefits." In the case of a corporation, it permits the deduction of "all sums paid by it within the year for taxes imposed under the authority of the United States or of any state or territory thereof, or imposed by the government of any foreign country." The meaning is that a domestic corporation may deduct any and all taxes assessed against it, and paid, under

federal, state, or municipal authority, and whether in the nature of franchise or occupation taxes or taxes on property, and that such a corporation, owning property or doing business in foreign countries, may also deduct such taxes paid abroad as are imposed by the foreign government. This was the practical construction placed on the corresponding provision of the act of 1909 by the officers of the government who were charged with its administration.[55] This is also in substantial accordance with the provisions of the English income tax law, which permit an English company doing business abroad to deduct from its assessment for income tax any amount paid by it for taxes assessed by the foreign government on the net profits of its business.[56] As to foreign corporations doing business in America, the provision of the act of 1913 is that such a company may deduct "all sums paid by it within the year for taxes imposed under the authority of the United States or of any state or territory thereof or the District of Columbia."

Funds set aside by a corporation out of its current earnings as a reserve for the payment of accruing taxes, or taxes which have accrued but which have not yet been paid, cannot be allowed as a deduction, since the statute specifically provides that only such sums as are "paid" within the year for taxes can be deducted.[57] And where the state law provides that stockholders in banking corporations shall be assessed and taxed upon the value of their shares of stock therein, and that the bank shall collect the tax and pay over the amount to the proper local authorities, this does not convert the tax into a tax upon or against the bank itself. Hence if a bank pays the taxes assessed upon its shareholders, but neglects or omits to collect the sums so paid from the several stockholders, or to reimburse itself by deducting

[55] Treasury Decisions, No. 1742, par. 73.
[56] Stevens v. Durban-Roodepoort Gold Min. Co., 5 Tax Cas. 402.
[57] Treasury Decisions, No. 1742, par. 77.

such sums from their dividends, it will not be entitled to claim a deduction thereof in its income-tax return under the heading of taxes paid.[58] Customs duties paid on the importation of goods from abroad may be classed as "taxes," for the purposes of this statute, but if an importing merchant has included such duties in estimating the cost of the goods, for the purpose of computing his profits on their sale, he will not be entitled to deduct them from his net income as taxes paid.[59] As to legacy or inheritance taxes, they are probably included under the broad general term "taxes" in the federal statute, but the Wisconsin statute expressly forbids their deduction. In New York, it is held that the federal inheritance tax to be paid under the War Revenue Act of 1898 is not to be deducted from the valuation of an estate for the purpose of a state transfer or inheritance tax, for it is not a tax upon property, but one against the legatee and payable out of his legacy.[60] But a contrary decision has been made in Massachusetts.[61]

§ 99. Losses Uncompensated

The federal income tax law allows the individual taxpayer to deduct "losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise." In the case of corporations, the deduction is to be for "all losses actually sustained within the year and not compensated by insurance or otherwise." Under the statute in Wisconsin, a deduction is allowed, in both cases, for "losses actually sustained within the year and not compensated for by insurance or otherwise." The law in Hawaii provides for the deduction of "all losses actually sustained during the year,

[58] Treasury Decisions, No. 1763.
[59] Treasury Decisions, No. 1742, par. 74.
[60] In re Gihon's Estate, 169 N. Y. 443, 62 N. E. 561.
[61] Hooper v. Bradford, 178 Mass. 95, 59 N. E. 678.

incurred in trade or arising from losses by fire not covered by insurance, or losses otherwise actually incurred." These phrases, if taken in their widest sense, might include the loss or impairment of capital assets by such causes as bad investments, the bankruptcy of a debtor, the failure of a bank, the enforcement of one's liability as indorser, and the like. But bearing in mind the purpose of the statutes in which they occur—to impose a tax on incomes, not on property or capital—and taking the context into consideration, it seems probable that a more restricted meaning should be given to them. Apparently the legislative purpose was to include only those losses which are incident to the business out of which the taxable income is produced, or such as involve the destruction or impairment of property employed, or capital invested, in that business. This is the doctrine prevailing in England, where it is said: "Only such losses can be deducted as are connected with, in the sense that they are really incidental to, the trade itself. They cannot be deducted if they are mainly incidental to some other vocation or fall on the trader in some other character than that of trader. The nature of the trade is to be considered," so that a taxpayer is not allowed to deduct a loss which he has sustained in being compelled to pay a judgment recovered against him in an action of tort, where the circumstances of the tort were not an incident of his business.[62] Under the English law it is also held that one who carries on two lines of business cannot deduct a loss sustained in one from the profits made in the other. Thus a seed merchant, taking a farm and working it in connection with his seed business, cannot claim any allowance from the assessment on his profits as seed merchant in respect of losses on the farm.[63] But on the other hand, a loss sustained by the embezzlement of funds by an employé is incurred in trade, or sustained in

[62] Strong & Co. v. Woodifield [1906] App. Cas. 448.
[63] Brown v. Watt, 23 Scotch Law Rep. 403, 2 Tax Cas. 143.

connection with the income-producing business, and therefore may be deducted.[64] But mere shrinkage in value of property or other assets is not properly to be described as a "loss," within the meaning of the statutes, though an allowance for it may be made under the head of "depreciation." And so, loss due to the voluntary removal of buildings, etc., incident to the making of improvements, is either a proper charge to the cost of the new additions or to depreciation already provided, as the facts may indicate, but in no case is it a proper deduction in determining net income, except as it may be reflected in the reasonable amount allowable as a deduction for depreciation.[65] It will be observed that losses cannot be deducted if compensated for by insurance or otherwise. But by a reasonable construction of the statute we should conclude that a loss partially compensated for by insurance or otherwise, if otherwise deductible, might be deducted to the extent of the excess of loss over insurance or other compensation received.

§ 100. Debts Written Off as Worthless

The federal income tax law of 1894 allowed the deduction of "debts ascertained to be worthless." That of 1913 copies this phrase with some enlargement, as follows: "Debts actually ascertained to be worthless and charged off during the year." But this applies only in the case of individual taxpayers. In that part of the law which relates to corporations there is no corresponding provision. This probably results from the fact that those portions of the act of 1913 which relate to corporations were copied almost bodily from the corporation tax law of 1909 (which made no provision for the deduction of bad debts) without adverting to the resulting discrimination between corporations and individuals. But the act of 1909 did contain a provision for deducting

[64] United States v. Central Nat. Bank, 10 Fed. 612.
[65] Treasury Decisions, No. 1742, par. 93.

uncompensated losses, and under this clause the officers of the treasury department ruled that bad debts, if so charged off on the company's books during the year, were proper deductions, though, if such debts were subsequently collected, they must be accounted for as income.[66] It is reasonable that a similar construction should be applied to the act now in force. Under the former income tax laws it was held that a merchant, in making his statement of income, was entitled to deduct from his gross profits the bad debts made during the year to which the statement related, or such as appeared to be uncollectible at the end of that year, but not debts which became worthless after the expiration of that year, although before the date of the return.[67]

The term "debts" should not be taken in its broadest sense. It is a term capable of a wide variety of meanings. But considering the connection in which it is found and the general purpose of the statute, it is apparent that it includes only such debts as arise in or are connected with the business of the year, or, in other words, debts which, if they had been paid, would have constituted a part of the year's taxable income. Money owing to one may constitute a part of his capital, so that its payment would not swell his income, but only change the form of the capital. In this case, if it should prove uncollectible, it would not constitute a proper deduction. Thus, in an English case, it appeared that the company in question carried on the business of zinc smelting, and for this purpose it required large quantities of "blende." To supply the blende a new company was formed, which from time to time received assistance from the smelting company in the form of advances on loan. The new company proving unsuccessful and going into liquidation, the amount due from it to the smelting company

[66] Treasury Decisions, No. 1742, par. 75.
[67] United States v. Mayer, Deady, 127, Fed. Cas. No. 15,753.

was written off as a bad debt. But it was held that the advances were an investment of capital, and that the loss was not deductible in estimating the profits of the company for assessment under the income tax.[68] On the other hand, where a brewing company made loans to its customers on the security of public houses, and if the security did not realize the amount of the loan, the company wrote off the loss as a bad debt, it was held that, in arriving at its profits for assessment to income tax, the company was entitled to deduct the amount of such losses as worthless debts.[69]

§ 101. Depreciation of Property

The act of Congress of 1913 provides, in the case of an individual taxpayer, for a deduction from his return of income for assessment of "a reasonable allowance for the exhaustion, wear and tear of property, arising out of its use or employment in the business," and in the case of a corporation "a reasonable allowance for depreciation by use, wear and tear of property, if any." According to the plain import of these terms, an allowance for depreciation can be claimed only in respect to tangible property which is directly employed in the production of the income taxed, such as buildings, machinery, furniture and fixtures, ships, vehicles, rolling stock and roadbed, and the like. For the language of the act only applies to property which is "used" or "employed" in business, and which, in the process of such use, is subject to "exhaustion" or "wear and tear." In this respect the act exhibits a departure, in the way of greater strictness, from the terms of the corporation tax law of 1909, which allowed a deduction of "a reasonable allowance for depreciation of property, if any." In accordance with the latter and broader phrase, the Wisconsin statute, both in the case of individuals and cor-

[68] English Crown Spelter Co. v. Baker, 99 Law T. 353, 5 Tax Cas. 327.

[69] Reid's Brewery Co. v. Male [1891] 2 Q. B. 1, 3 Tax Cas. 279.

porations, provides for "a reasonable allowance for depreciation of the property from which the income is derived."

Depreciation is a well-known and important item in all modern corporation accounting. And in estimating the net profits of any business, this item must be reckoned with, either by figuring a corresponding reduction in the value of capital assets, by the creation of a surplus or reserve fund for the eventual replacement of the plant or such portions of it as will become exhausted, or by the expenditure of current earnings in the restoration of machinery or other property which has been impaired or has deteriorated by use. In the latter case, there is no shrinkage in the value of assets, but there is an annual expenditure over and above the ordinary operating expenses. And under the income tax law, it is ruled that depreciation, to be an allowable deduction in the return of annual net income of a corporation, must be charged off on the ledger of the corporation, so as to show a reduction in its capital assets to the extent of the depreciation claimed.[70] In other words, if a corporation expends money in repairing or replacing depreciated property, it may claim an allowance therefor under the head of repairs or expenses of the business, but in that case will not be entitled to claim also for depreciation. The question of what is a "reasonable allowance" for depreciation is one depending on the circumstances of each particular case, and if the amount of the tax to be paid is brought into litigation, it is to be determined as a question of fact on the evidence.[71] The general rule prescribed by the Commissioner of Internal Revenue under the corporation tax law of 1909 was as follows: "The deduction for depreciation should be the estimated amount of the loss, accrued during the year to which the return relates, in the value of the property in respect of which such deduction is claimed, that arises from exhaustion, wear and tear, or obsolescence out of the uses

[70] Treasury Decisions, No. 1742, par. 83.
[71] United States v. Nipissing Mines Co., 202 Fed. 803.

to which the property is put, and which loss has not been made good by payments for ordinary maintenance and repairs deducted under the heading of expenses of maintenance and operation or in the ascertainment of gross income. This estimate should be formed upon the assumed life of the property, its cost value, and its use. Expenses paid in any one year in making good exhaustion, wear and tear, or obsolescence in respect of which any deduction for depreciation is claimed must not be included in the deduction for expenses of maintenance and operation of the property or in the ascertainment of gross income, but must be made out of accumulative allowances deducted for depreciation in current and previous years." [72]

The application of a general rule of this kind to a concrete case is well illustrated in a Scotch case, which concerned the method of figuring the deduction to be allowed for annual wear and tear of such a piece of property as a steamship. It was said that the proper method is to take the average life of such a property (here estimated at 22 years), and over that period spread the whole original cost, allowing for each year a deduction equal to the quotient obtained by dividing such cost by such number of years, without taking into account the value of the use of the money so annually allowed by way of deduction, or considering what the owner may do with it. The method pursued by the commissioners of inland revenue in this case was to calculate the sum which, being allowed annually and placed at interest, would amount to the original cost of the vessel at the end of the 22 years, thus in effect requiring the owner to establish a sinking fund and keep it invested, or to amortize the value of his property by the growth of a fund for its replacement. But this the court held to be incorrect.[73]

[72] Internal Revenue Regulations, No. 31, art. 4.

[73] Leith, Hull & Hamburg Steam Packet Co. v. Inland Revenue, 1 Sess. Cas. Scotch (1899) 1117. Further as to the allowance for de-

In the case of an income derived from the rent of a building—such as a dwelling, an apartment house, a hotel, a store, or an office building—no decision has apparently yet been rendered concerning the right of the owner to claim a deduction for depreciation. But applying the principles established in other cases, it may be stated in the first place, that a claim should not be allowed both for repairs and for depreciation, if the repairs make good the depreciation. But secondly, such a property is clearly subject to "wear and tear," and diminishes in value thereby, and its average life should be susceptible of calculation to a fair degree of certainty, considering not only its gradual physical impairment, but also the increasing difficulty of continuing to obtain the same rent for it as it becomes more and more old-fashioned or unsuited to modern requirements. On the question of obsolescence as an element of depreciation, however, we shall have more to say in a later paragraph.

If an allowance for depreciation can be applied to anything else than tangible property employed in the business, then an interesting question arises concerning shrinkage in the market value of stocks, bonds, and other investments. As above stated, the act of Congress now in force would exclude such a case, if read literally. But it was held otherwise under the somewhat broader terms of the act of 1909. The treasury department ruled that premiums on stocks and bonds arbitrarily charged off on the books of a corporation did not constitute a proper deduction on account of depreciation, unless there had been an actual shrinkage in value of such securities to the extent of the reduction claimed during the year for which the return was made.[74] The language of the Wisconsin statute, in this particular, is practically the same as that of the act of Congress of 1909. But its construction has not been ju-

preciation in the case of steamships, see Cunard S. S. Co. v. Coulson [1899] 1 Q. B. 865.

[74] Treasury Decisions, No. 1742, par. 87.

dicially settled, and the revenue officers of that state tentatively hold that it was not intended to apply to the case of diminishing market value of intangible property such as corporate stocks or bonds, while suggesting an amendment to the statute in the interest of greater clarity of expression.[75]

The question of allowing for depreciation in the case of property which, though not physically impaired, has become obsolete is one of great difficulty. Undoubtedly, a business property diminishes in value unless it is kept up to the standard of efficiency set by new inventions, new appliances, and new methods, since it cannot otherwise successfully compete with its better-equipped rivals. And in a broad sense, this is clearly "depreciation." But it is not depreciation by reason of "wear and tear," or by reason of its use in the business. And so

[75] "Deductions for losses under other income tax laws have generally been confined to damage to or destruction of physical property of the taxpayer, and bad accounts which had previously been reported as income. Losses resulting from fluctuation in market value have not been allowed. Various claims have been made for losses under the paragraph quoted, including depreciation in the value of corporate stocks and other like property resulting from change in market value or destruction of or damage to the physical property of the corporation issuing the stock. Considered as a whole, the income tax act does not seem to contemplate the assessment of appreciation in value until actually realized by sale or other disposition of the property. It would seem to follow that depreciation should not be allowed in such cases until the amount of the loss is determined in like manner. Following the English decisions and the precedents of the internal revenue department under the income tax of 1863, and the rules prescribed for administration of the income tax of 1894, the Commission felt compelled to deny deductions for depreciation of this character while the property was still held by the taxpayer. The soundness of this construction has been sharply challenged, and the law on the subject is not entirely clear. If the purpose of the legislature is to confine deductions for losses as above indicated, the statute should be amended so as to more clearly express that intention. If, on the other hand, a wider range of deduction is deemed advisable, there is equal reason for making the statute more specific. The subject is properly one for the consideration of the legislature and attention is called to it for that reason." Report of Wisconsin State Tax Commission, 1912, p. 49.

the decisions under income tax laws, in so far as they have adverted to this point, tend to the application of a stricter rule. Thus, in an English case it was held that depreciation on account of wear and tear does not include the loss on apparatus which is discarded because it has become old-fashioned or obsolete, as in the case where a street railway company changes its motive power from horse power to electric power, and thereupon is obliged to take up and cast aside the rails in use, which, though not worn out, cannot be used for the new track.[76] So again, under the English statute, which allows a deduction for "diminished value by reason of wear and tear during the year of any machinery or plant," it was ruled that the owners of a ship engaged in trade were not entitled to a deduction for depreciation in the value of their vessel caused by the building of ships of a better construction or better equipped, though this circumstance rendered their own property less desirable for the use of charterers and so diminished its earning power.[77]

Finally, it has been ruled that "good will" represents the value attached to a business over and above the value of the physical property, and is such an entirely intangible asset that no claim for depreciation in connection therewith can be allowed.[78]

§ 102. Depletion of Ores or Other Natural Deposits

It has been a vexed question whether or not a company engaged in the business of mining coal, ores of gold or silver, or other natural deposits, should be allowed to deduct from its income as returned for assessment, under the head of depreciation, an amount representing the diminution in the value of its property caused by the extraction of ores during the year.

[76] London County Council v. Edwards, 5 Tax Cas. 383.

[77] Burnley Steamship Co. v. Aikin, 31 Scotch Law Rep. 803, 3 Tax Cas. 275.

[78] Treasury Decisions, No. 1742, par. 82.

Two American decisions and one English case have ruled that this was not admissible.[79] But other decisions (in both countries) have maintained that such a deduction should be allowed, on the ground that a mining property is valuable only for the minerals which it contains, that its value constantly decreases as the minerals are extracted, until it reaches the vanishing point at the time when the mineral deposits are exhausted, and that each year's operations causes a shrinkage in the value of the property equal to the value (value in place) of the ores taken out, which is properly described as a "depreciation." [80] And this rule was also adopted by the officers of the internal revenue bureau.[81] So far as concerns taxation under the federal statute, this question is set at rest by the terms of the act of 1913, which includes under the head of allowance for depreciation "in the case of mines, a reasonable allowance for depletion of ores and all other natural deposits, not to exceed five per centum of the gross value at the mine of the output for the year for which the computation is made." The same rule will apply to the case of natural gas companies and those sinking oil wells. And under the corporation tax law of 1909, the administrative officers ruled that natural gas companies should be allowed to make deductions for depreciation on the basis of the gradual exhaustion of their deposits, and prescribed elaborate instructions for reckoning this depreciation,[82] which was also done with reference to com-

[79] Commonwealth v. Ocean Oil Co., 59 Pa. St. 61; Stratton's Independence v. Howbert (U. S. Dist. Ct. D. Colo., 1912) 207 Fed. —, reported in Treasury Decisions, No. 1796; Alianza Co. v. Bell [1906] App. Cas. 18.

[80] United States v. Nipissing Mines Co., 202 Fed. 803; Knowles v. McAdam, L. R. 3 Ex. Div. 23, 1 Tax Cas. 161.

[81] Treasury Decisions, No. 1742, par. 97.

[82] "For the purpose of enabling corporations engaged in the production and transportation of natural gas to properly gauge depreciation of investment in the field and main line divisions on account of depletion to be deducted each year, in making their annual return of net income, the following methods are recommended:

"First. That the producing gas area of said company be laid off

panies operating petroleum producing properties.[83] Apparently the same principle might justly be applied to the case of income derived from timber lands, if the property were not

in squares not exceeding one square mile, and that three months prior to September 30 of each year, one or more representative wells be shut in in each square or territory, and that as of September 30 an accurate gauge be taken of the rock pressure of said wells, and the decline in the average rock pressure from year to year shall be considered as the base of determining the exhaustion of deposit. For instance, a corporation may have 80 square miles of territory, and the average rock pressure September 30, 1909, may have been 600 pounds per square inch. On September 30, 1910, the average rock pressure may have been 540 pounds, or a decline of 10 per cent, and this percentage is to be applied as a basis of depreciation for the year 1910 on the cost of the field and main line divisions, less depreciation charged off prior to that date and any salvage value that may remain in the property.

"Second. If by reason of lack of area or for any other good and sufficient reason, any corporation engaged in the production of gas shall prefer the 'volume basis' as more accurately reflecting the rate of exhaustion of deposits, the amount of capital invested to be returned out of the income of any given year may be determined on that basis. In case the 'volume basis' is adopted, the volume of each well must be taken with instruments generally recognized as reliable for determining the daily volume produced by each well at stated periods each year, and the percentage of loss in daily production shall determine the percentage of the capital investment which shall be returnable out of gross income and the proper deduction to be made each year in the return of annual net income as return of capital invested.

"Any unreturned cash investment remaining when wells or territory have to be abandoned or lines taken up because of failure of the supply of gas, less salvage, may be deducted as part of the reasonable depreciation for the year in which such territory is abandoned, unless such values shall have been returned in the reduction made because of loss of volume or decrease in rock pressure, which in such case would be considered as having reached the vanishing point." Treasury Decisions, No. 1754.

[83] "In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits and for depreciation and obsolescence of improvements in accordance with the general regulations respecting depreciation allowances, on the basis of the original capital-investment cost, reduced to a cash basis, of the properties concerned to the company reporting. Claims for depreciation on account of depletion of deposits based on any values

otherwise valuable. The point seems not to have been adjudged. But the treasury department has ruled that the mere removal of timber by cutting from timber lands, unless the timber is disposed of through sales or plant operations, is to be considered simply as a change in the form of assets; but if the timber is disposed of through sales or otherwise, it is to be accounted for in accordance with the regulations governing the disposition of capital and other assets.[84]

other than the cost of the property in cash or cash values (including cost of development) will not be considered.

"In all producing oil fields an average value per barrel of the settled daily production shall be adopted as the guide in determining the value of the property, and the following method of depreciating said values is recommended:

"Each corporation will fix this valuation per barrel as of January 1, 1909, or upon the date of commencement of production, if after that date, for ascertaining the deductions for depreciation on the basis of depletion of deposits. This valuation per barrel should be based on the cost of the property to the corporation plus the cost of the development thereof with a proper deduction from that valuation for the number of years the property has been in operation, and the resulting proportioned decrease in daily production of oil. With this basis per barrel fixed as of January 1, 1909, or at the date of commencement of production, if after January 1, 1909, the value of the property as a whole is to be determined by applying this unit value per barrel to the daily average production for the month of December, or other representative month, in the year for which the return is made. The representative month chosen shall be the same in each year. This unit valuation per barrel is to be retained in arriving at all future depreciation deductions, except where an additional production is secured by drilling or an additional production is acquired by purchases, in which cases a new average rate per barrel based upon the actual cash invested in such development, or in the new properties and their development, may be adopted. The amount of income each year to be applied to the return of the cash investment shall be ascertained by multiplying the unit valuation ascertained as required above by the difference between the daily average production in barrels during the representative month of each year. The product of such multiplication will be the amount deductible from gross income on account of return of cash investment based upon the rate of depletion of deposits." Treasury Decisions, No. 1755.

[84] Treasury Decisions, No. 1742, par. 91.

§ 103. Amortization of Bonds

Closely connected with the subject of depreciations is the rule or principle of the amortization of various forms of securities, and particularly corporate bonds. This principle is well explained by a court in New York, as follows: "It is a common matter with bankers and dealers in stocks to compute, by the aid of tables, what the actual income is of a stock running a certain definite time, for which a certain premium is paid. The actual income is plainly less than the amount yearly received, because the premium paid must be so distributed, in the calculation, over the time the stock has to run, that the owner at the end of the time will have his original investment unimpaired. Otherwise, though he may not notice this, he will have been gradually impairing his capital, in fact, using it up in the form of income. The rule is that so much out of the moneys received annually on these bonds shall be treated as income as, according to the computations and tables above mentioned, they are found to produce. The residue belongs to principal, and annually added thereto will make up for the gradual depreciation which must come as the bonds approach maturity, and will keep the fund unimpaired when they are paid off." [85] Thus, if a trustee under a will, who holds a fund in trust to pay the income to a person during his life, with remainder over, makes an investment in bonds, which are payable at a day certain and are bought at a premium, he is not obliged to pay the entire net income to the tenant for life, but is entitled to deduct such an amount from the actual interest received on each bond as will, by successive deductions, make good to the capital the amount of the premium paid upon the original purchase of the bond, without regard to the market value of the bond at the time of making such deductions.[86] And under the corporation tax law of 1909, the

[85] People v. Davenport, 30 Hun (N. Y.) 177.

[86] New England Trust Co. v. Eaton, 140 Mass. 532, 4 N. E. 69, 54 Am. Rep. 493.

officers of the internal revenue bureau considered this gradual diminution in the market value of a bond (originally bought at a premium) as its maturity approaches, in the light of a "depreciation" of property, and made the following ruling in regard to it: "Relative to amortization of bonds, where a corporation holds bonds which were purchased at a rate above par, and said corporation shall proportionately reduce the value of those bonds on its books each year, so that the book value shall be the redemption value of the bonds when such bonds become due and payable, the return of annual net income of the corporation holding such bonds may show the depreciation on account of amortization of such bonds. The requirement is, however, that the amount carried to the amortization account each year shall be practically proportioned with respect to the difference between the purchase price and the maturing value and the number of years to elapse until the bonds become due and payable. With respect to bond issues, where such bonds are disposed of for a price less than par and are redeemable at par, it is also held that, because of the fact that such bonds must be redeemed at their face value, the loss sustained by reason of their sale for less than their face value may be prorated by the issuing corporation in accordance with the life of the bond." [87]

§ 104. Dividends from Corporations Subject to Tax

In order to avoid double taxation, it is customary for the income tax laws to allow the deduction of dividends received from corporations liable to the tax, or which have been assessed for it. In the act of Congress of 1909, the deduction was allowed of all amounts received within the year as dividends on the stock of any corporation "subject to the tax." And an opinion was given by the Attorney General that, in

[87] Treasury Decisions, No. 1727.

computing the income of a corporation for the purpose of taxation under that act, the dividends received by it as a stockholder in any other corporation of a character to which the act applied should be deducted from its gross earnings, although the dividend-paying corporation had not a sufficient net income to be taxable itself, for if such corporation was of the character described in the act (that is, not among those exempted entirely), it was "subject to the tax imposed" although its income for any given year might not reach the taxable limit.[88] The act of 1913, as applied to the individual taxpayer, allows the deduction of "the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association, or insurance company which is taxable upon its net income as hereinafter provided." But, whether from inadvertence or by design, there is no similar provision in the case of corporations, so that corporations, as distinguished from individuals, will not be allowed to deduct dividends received from other companies. This bears with special rigor upon "holding" companies, and this circumstance may have been influential in the mind of Congress in framing the provision.

In the Wisconsin income tax law, the provision on this subject is both more comprehensive and more explicit, and applies alike to individual taxpayers and corporations. It authorizes the deduction of "dividends or income received within the year from stocks or interest in any firm, copartnership, or corporation, joint stock company or association, the income of which shall have been assessed under the provisions of this act." In Hawaii, the provision is that "in assessing the income of any person or corporation, there shall not be included the amount received from any corporation, as dividends upon the stock of such corporation, if the tax of two per cent

[88] 28 Opin. Atty. Gen. 140.

has been assessed upon its net profits by said corporation as required by this act."

§ 105. Special Rules as to Insurance Companies

The act of Congress of 1913 allows a deduction, in the case of insurance companies of "sums other than dividends paid within the year on policy and annuity contracts." This covers the ordinary outgo of an insurance company in the way of payments of losses under its policies and periodical payments made to beneficiaries under annuity contracts. But special provision is also made for companies doing business on the mutual plan. In the case of mutual life insurance companies, they "shall not include as income in any year such portion of any actual premium received from any individual policy holder as shall have been paid back or credited to such individual policy holder, or treated as an abatement of premium of such individual policy holder, within such year." In the case of mutual fire insurance companies, they are likewise entitled to deduct "any portion of the premium deposits returned to their policy holders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves." As to mutual marine insurance companies, the direction is that they "shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policy holders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof."

This act also allows the deduction of "the net addition, if any, required by law to be made within the year to reserve funds," and provides that, "in the case of assessment insurance

companies, whether domestic or foreign, the actual deposit of funds with state or territorial officers, pursuant to law, as additions to guarantee or reserve funds, shall be treated as being payments required by law to reserve funds."

Aside from the matter of reserve funds required by law, it has been a vexed question whether or not an insurance company could claim a deduction in respect to premiums covering a risk which extends beyond the end of the fiscal year. In an English case, a fire insurance company set up a claim to deduct a portion of its premium receipts for the year, representing the unearned or unexhausted portion of such premiums, where it remained liable on the policies for one or several years longer. The company contended that such a deduction should be allowed to it either as a fixed percentage of the total premium receipts (suggesting one-third as a proper proportion), or else to the extent of the amount which it would cost to reinsure its unexpired risks. But the court held otherwise. Conceding that it would be impossible to ascertain the true net profits of an insurance company in this situation with such mathematical accuracy as to do perfect and absolute justice, it was held that the fair and proper method is to take on the one side the whole receipts, and on the other side the whole expenditure and disbursements, for the given year, the balance remaining being, for the time at least, net profits on which the income tax should be assessed. This being done year by year, there is an absolute balancing of accounts; and if any wrong is done by losses afterwards occurring in respect of premiums on which, as profits, the income tax has been assessed and paid, it will be taken into consideration in the ensuing year.[89] And later an exactly similar decision was rendered by the Court of Appeal.[90] But

[89] Imperial Fire Ins. Co. v. Wilson, 35 Law T. 271, 1 Tax Cas. 71.
[90] General Accident, etc., Co. v. McGowan [1908] App. Cas. 207, 5 Tax Cas. 308.

only four years afterwards, the same court ruled that the profits of a fire insurance company, for the purpose of the income tax, are not to be computed by merely deducting the total of losses and disbursements for the year from the total premium receipts for the same period, but allowance must be made for outstanding policies at the end of the year, or for the unearned portion of premiums received, which may be done by deducting a fair and reasonable percentage of the year's premium receipts.[91] Substantially the same view was taken by the internal revenue officers in construing the act of Congress of 1909, for it was ruled that unearned premiums set aside by insurance companies as reserves should not be included as income until earned, unless the same should be entered on the ledger as income during the year in which they were received.[92]

§ 106. Rules as to Foreign Corporations

As foreign corporations are taxed only upon so much of their income as they receive from business transacted or capital invested in the United States, under the federal statute, so their allowable deductions are correspondingly restricted. Thus, the item of "expenses" will cover only expenditures in the maintenance and operation of the business and property within the United States. So "losses" must be "actually sustained within the year in business conducted by it within the United States." And as to deducting interest paid by a foreign company, the rule prescribed is that it may claim a deduction for interest on its indebtedness, to an amount of such indebtedness not exceeding that portion of its paid-up capital stock (plus one half the sum of its bonded debt) which may be regarded as invested or employed in this country, which is to be ascertained by taking the ratio between "the

[91] Sun Insurance Office v. Clark [1912] App. Cas. 443.
[92] Treasury Decisions, No. 1742, par. 70.

gross amount of its income for the year from business transacted and capital invested within the United States" and "the gross amount of its income derived from all sources within and without the United States." As to taxes, a foreign company is allowed to deduct only "sums paid by it within the year for taxes imposed under the authority of the United States or of any state or territory thereof or the District of Columbia."

CHAPTER IX

RETURN OF INCOME AND COLLECTION OF TAX

§ 107. Taxpayers' Returns, Who Required to Make

The act of Congress of 1913 requires a return to be made by "each person of lawful age, except as hereinafter provided, subject to the tax imposed by this section, and having a net income of $3,000 or over for the taxable year." This includes married women having an independent income of the required amount, but not minors, the returns for the latter being made by their guardians or trustees. It might be a debatable question whether the phrase "net income" as here used, means the income of the person before or after subtracting the items specially allowed to be deducted, such as business expenses, interest and taxes paid, losses incurred, bad debts, depreciation of property, and dividends from corporations. But the legislative history of the act shows that "net income" is intended.

For the measure as originally passed by the House of Representatives required returns to be made by persons "having a net income" of the designated amount, and this was changed by the Senate so as to read "having an income," etc. But this amendment was rejected by the conference committee; hence, the omission of the word "net" must be regarded as significant. This part of the law applies to persons residing abroad, as well as to residents of the United States. As to corporations, the requirement is that a return shall be made by "all corporations, joint stock companies or associations, and insurance companies subject to the tax herein imposed," including foreign corporations doing business in the United States.

The Wisconsin statute requires a return from "every corporation, joint stock company or association, whether taxable under this act or not." As to individuals, the provision is that the assessor of incomes is to ascertain what persons in his district are subject to the tax, and any person who, in his judgment, is so subject shall be required by him to make a report. The state tax commission rules that the fact that the individual is not subject to the income tax will not relieve him from the duty of making a return when so demanded; and also that a person who is in fact subject to the tax is not relieved from the obligation to make a return by the fact that he has not been formally required to do so by the assessor, and there is a penalty prescribed for failure or refusal to make the return.

In South Carolina, the law provides that "all persons liable for the payment of any of the tax herein provided for," including non-residents, shall make a return. In North Carolina, the blank furnished to taxpayers for listing their real and personal property shall contain the following question: "Was your gross income from salaries, fees, trade, profession and property not taxed, any or all of them, for the year ending June first, in excess of one thousand dollars?" And if the

taxpayer answers this question in the affirmative, he is to be furnished with another blank on which to make his return of income for taxation. Provision is also made for reporting the names of persons who have not made this return but are believed to be liable for the income tax, and for requiring such persons to make the return. In Oklahoma, the provision is practically the same as in North Carolina, except that the question relates to income in excess of $3,500. In Hawaii, the statute provides that "it shall be the duty of all persons of lawful age having an income of six hundred dollars or more for the preceding year, from all sources, and of all corporations made liable to income tax, to make and render a list or return." All the statutes above referred to may be seen in full in the appendix to this volume.

The English cases hold that a corporation which is specifically exempted from the operation of the income tax law is not required to make any return.[1] But a contrary ruling was made by the internal revenue department in construing the act of Congress of 1909, for it was held that corporations claiming a special exemption must nevertheless make a return (which might be in blank, if desired) accompanied by a statement setting forth the ground on which the exemption was claimed.[2] It was also held by the courts that all corporations must make the required return, whether or not they had a sufficient income to be taxable, and if they omitted to do so, they were liable to the penalty imposed by the statute, though the only reason was the belief that no return was necessary where there was no taxable income.[3] But these decisions were based on the ground that the existence of a taxable income,

[1] Commissioners of Inland Revenue v. Incorporated Council of Law Reporting, 22 Q. B. Div. 291, 3 Tax Cas. 105.

[2] Treasury Decisions, No. 1742, par. 3.

[3] United States v. Acorn Roofing Co., 204 Fed. 157; United States v. Military Construction Co., 204 Fed. 153. See also 29 Opin. Atty. Gen. p. 217.

above the statutory exemption, might often be a matter of close calculation, and might depend on the allowance or rejection of many claims for deductions, under the headings of expenses, interest paid, depreciation of property, and the like. And it would obviously be improper to allow a corporation to decide for itself whether or not it was liable to the tax and to make or withhold a return accordingly. But these considerations do not apply in the case of a corporation which is expressly and entirely exempted from the payment of the tax. And no language could be chosen more broad and sweeping than the words employed in the act of Congress of 1913 in regard to exempt corporations, viz., "nothing in this section shall apply to" the companies thereafter specifically described. Since the whole of the income tax law is contained within one section of the tariff act in which it is found, it is evident that the word "section" in the phrase quoted cannot be restricted to the subdivision or paragraph in which the phrase occurs, but means the entire act in so far as it relates to income taxation. Hence if given classes of corporations are expressly exempted from the incidence of the tax, they are also expressly exempted from the duty of making a return.

§ 108. Returns by Guardians, Trustees, and Other Fiduciaries

The act of Congress of 1913 provides that "guardians, trustees, executors, administrators, agents, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management." The use of the word "agents" in this sentence is ambiguous, but its scope should be limited by the terms with which it is associated, and so should be understood as meaning agents who are charged with the collection of the whole or the chief part of another person's income, as guardians, receivers, and con-

servators of lunatics are. The act also provides that all persons, firms, and corporations, "in whatever capacity acting," that is, whether acting in a fiduciary capacity or not, "having the control, receipt, disposal or payment of fixed or determinable annual or periodical gains, profits, and income of another person subject to tax," and who are required to withhold the tax from such income and pay it over to the government, "shall in behalf of such person make and render a return, as aforesaid, but separate and distinct, of the portion of the income of each person from which the normal tax has been thus withheld." But in neither of these two cases is a return required where the income concerned does not exceed $3,000. There is also a provision that "any person for whom return has been made and the tax paid, or to be paid as aforesaid, shall not be required to make a return unless such person has other net income." As regards guardians, trustees, etc., almost identical terms are found in the statutes of the various states, requiring them to make returns for their wards or beneficiaries.

The federal statute also provides that "a return made by one of two or more joint guardians, trustees, executors, administrators, agents, receivers, and conservators, or other persons acting in a fiduciary capacity, filed in the district where such person resides, or in the district where the will or other instrument under which he acts is recorded, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph." It is also to be noted that the act lays the duty of making a return, and also of withholding the income tax, upon "lessees" with respect to rent payable by them in excess of $3,000 for any taxable year.

§ 109. Form and Contents of Return

The federal income tax law provides that returns, both of individuals and corporations, shall be "in such form as the

Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe." [4] But in the case of the return of an individual taxpayer, the statute requires that it shall set forth specifically the gross amount of income from all separate sources, and that, from the total thereof, there shall be deducted the "aggregate items or expenses and allowance herein authorized." In the case of corporations, the directions as to what shall appear on the face of the return are elaborate and detailed, and will not be repeated here, since they seem to call for no special comment, but may be seen at large in the appendix to this volume. It is also the policy of the state income tax laws to leave to the proper state officer or commission the settlement of the details and form of the taxpayer's return, except in North Carolina and Oklahoma, where the form of the return is prescribed in the statute and consists of a mere statement (under oath) that the person's income from the sources mentioned, during the fiscal year, over and above the statutory exemption, amounted to such and such a sum. All the statutes require the return to be verified by the oath or affirmation of the person making it. But the penalties for intentional falsehood in the statements of the return vary greatly in the different jurisdictions.[5] But it is believed that the penalties of perjury as at common law would attach to such false swearing, unless the statute expressly declares the offense to be a misdemeanor or expressly prescribes a punishment in the nature of a fine. For it has been decided that although an act imposing a tax on incomes makes no provision for compelling a person to make oath to his return, yet if it permits

[4] Regulations made by the Commissioner pursuant to statutory authority, with the approval of the Secretary of the Treasury, in respect to the assessment and collection of internal revenue taxes, have the force of statutes; and the acts of the Commissioner are presumed to be the acts of the Secretary. In re Huttman, 70 Fed. 699.

[5] See, infra, § 121.

him to do so, and he avails himself of the privilege, and makes a false return, he is guilty of perjury.[6]

§ 110. Including Income of Wife and Children

The Wisconsin statute provides that, in computing the exemptions allowed and the amount of the tax payable, "the income of a wife shall be added to the income of her husband, and the income of each child under eighteen years of age to that of its parent or parents, when said wife or child is not living separately from said husband, parent, or parents." In Virginia the corresponding provision is that "only one deduction of one thousand dollars shall be made from the aggregate income of any family." In Hawaii, the act provides that "only one deduction of one thousand dollars shall be made from the aggregate annual income of all the members of one family composed of one or both parents and one or more minor children, or husband and wife." With the exception of Wisconsin, none of these statutes expressly requires a taxpayer who is a husband and head of a family to include in his own return the separate income of his wife and children. Yet such is their apparent intention. And it is difficult to see in what other way the provision could be made effective. It may be added that the constitutional validity of provisions of this kind has been sustained by the courts.[7]

On the other hand, the act of Congress of 1913 treats husband and wife as separate and distinct taxpayers, each of whom, without reference to the other, is required to make a return and pay the tax if he or she has a sufficient income. And the language of the statute shows that it was within the contemplation of Congress that both a husband and wife might be separately taxable, or that either, without the other, might be taxable. But as to the matter

[6] United States v. Smith, 1 Sawy. 277, Fed. Cas. No. 16,341.
[7] Robertson v. Pratt, 13 Hawaii, 590.

of exemptions, a married pair living together may claim an exemption greater by $1,000 that that allowed to an unmarried person, presumably on account of the greater expenses of family life. This additional exemption, however, cannot be claimed by both the husband and the wife. It may be claimed by a married man, living with and supporting his wife, provided that she herself has not a taxable income. Or it may be claimed by a married woman, with a husband living with her, where she has a taxable income and he has not. But if both have taxable incomes, apparently one only can claim the additional exemption. So far the statute is reasonably intelligible. But its meaning is much clouded by the addition of the provision that "only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together." Apparently the intention is that if either of the spouses (whether the husband or the wife) has an income large enough to be taxable, while the other has a separate and independent income not large enough to be taxable, both incomes shall be added together and included in the return to be made by the taxable person, and thereupon a total deduction of $4,000 may be made from the aggregate amount of income so included.

§ 111. Time for Filing Returns

The time for filing an income-tax return, under the federal statute, is the first day of March in each year, the return relating to the income of the preceding calendar year, that is, the year ending on the thirty-first of December preceding. This applies alike to individuals and corporations, except that the latter are permitted to designate a fiscal year of their own, which may not be coterminous with the calendar year, and be taxed upon the income of such fiscal year, and in this case the return is to be made within sixty days after the close of such fiscal year. It is

also provided that when the neglect of any taxpayer (individual or corporate) to file the return at the time prescribed is due to "sickness or absence," the collector of internal revenue "may allow such further time for making and delivering such list or return as he may deem necessary, not exceeding thirty days." The Wisconsin income tax law contains similar provisions as to allowing corporations to base their returns on the business of their own fiscal year, and as to an extension of time in case of the "sickness or absence of an officer of any corporation, joint stock company or association required to make said return, or for other sufficient reason." But the time for filing returns is not prescribed by the statute, but is left to the determination of the state tax commission, which has apparently designated the first of March in each year.[8] It was ruled by the treasury department, under the act of 1909, that where a corporation makes its return in due time, but it is returned for corrections, and a correct return is afterwards filed, though after the appointed day, the corporation is not to be regarded as delinquent, and the penalty for neglecting or refusing to make a return will not attach.[9]

§ 112. Where Returns are to be Filed

The federal statute requires the return of an individual taxpayer to be filed with the collector of internal revenue "for the district in which such person resides or has his principal place of business, or, in the case of a person residing in a foreign country, in the place where his principal business is carried on within the United States." In the case of a domestic corporation, the return is to be filed with the collector "for the district in which it has its principal place of business," and in the case of a foreign corpo-

[8] Wisconsin Income Tax Law, edition published by State Tax Commission, 1911, p. 32.

[9] Treasury Decisions, No. 1711.

ration, "in the place where its principal business is located within the United States." Under similar provisions in the corporation tax law of 1909, it was ruled that returns filed with a deputy collector of internal revenue are regarded as having been filed with the collector;[10] that the "principal place of business" means the principal office where a corporation keeps its books from which the required return is to be prepared, and not necessarily the place where the operating plant is located;[11] and that foreign corporations having several branch offices in the United States should each designate one of such branches as its principal office, and should also designate the proper officers to make the required return.[12] Under the law in Wisconsin an important distinction is made between the returns of corporations and those of individuals. The former are to be filed with the state tax commission, the latter with the assessor of incomes of the district. In the case of a guardian, trustee, executor, etc., the district is that in which he resides, rather than that in which the ward or beneficiary may reside. In the case of a non-resident, the income is to be "assessed and taxed in the town, city, or village from which such income is derived," where apparently also the return should be filed. In South Carolina, the return is to be rendered to the auditor of the county in which the taxpayer resides, whether he makes the return for himself or in the capacity of a guardian, trustee, or other fiduciary. But in the case of a non-resident, the return is to be filed with the auditor or auditors of the county or counties where his taxable income arises. In Oklahoma, the return is to be made to the local assessor of taxes, and forwarded by him to the state auditor; and in North Carolina, it is to be rendered to the

[10] Treasury Decisions, No. 1742, par. 40.
[11] Treasury Decisions, No. 1742, par. 13.
[12] Treasury Decisions, No. 1742, par. 11.

list-taker, and forwarded to the state corporation commission.

§ 113. Publicity or Inspection of Returns

The act of Congress of 1913, in so far as relates to corporations, provides that, when the assessment shall have been made, the returns shall be filed in the office of the Commissioner of Internal Revenue, "and shall constitute public records and be open to inspection as such: Provided, that any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President." It also contains a provision apparently intended to aid in the administration of the revenue laws of such states as may lay a tax on incomes, concurrently with the federal statute, by throwing open to their officers, under proper restrictions, the facts in the possession of the federal officers concerning taxable corporations. This provision is as follows: "That the proper officers of any state imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint stock company, association, or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe." The substantive part of this enactment was taken from the corporation tax law of 1909, and the proviso from an amendatory act of 1910. In pursuance thereof, regulations were prescribed by the Secretary of the Treasury November 25, 1910, and approved by the President, and the latter issued an executive order of the same date putting them in force. These regulations may be epitomized as follows: The returns of all corporations shall be open to the inspection of the proper officers and employés of the Treasury Department, and of the officers and employés of other departments of the government, but in the latter case only on a written application, signed by the head of the depart-

ment, setting forth the reasons for making it, and addressed to the Secretary of the Treasury. But if inspection of the return of any corporation is desired for the purpose of using the return (or information derived from it) in any legal proceeding, or if inspection is desired by any official of any state or territory, then the application must first be referred to the Attorney General, and, if recommended by him, transmitted to the Secretary of the Treasury. Any bona fide stockholder may be permitted to inspect the return made by his own corporation, on satisfactory proof of his ownership of stock in it, and on application to the Secretary of the Treasury showing good and sufficient cause. But the granting of such an application is in the discretion of the Secretary, and permission granted cannot be delegated or transferred to another person. The returns of certain corporations may be inspected by any person, on written application to the Secretary of the Treasury, setting forth briefly and succinctly the facts necessary to enable him to act upon the request. These are (a) companies whose stock is listed upon any duly organized and recognized stock exchange within the United States; (b) corporations whose stock is advertised in the press or offered to the public by the corporation itself for sale.[13] It will be observed that there is no similar provision in the statute concerning the returns made by individual taxpayers, and these apparently are not public records nor open to inspection by any one or on any conditions.

In the Wisconsin statute it is provided that "nothing herein shall be construed as preventing the assessment roll, the tax roll, and all proceedings had before the county board of review and all evidence taken at such hearing from being open to public inspection at such times and under such conditions as the state tax commission may direct." This, as construed by the

[13] These regulations may be seen in full in Treasury Decisions, No. 1665.

revenue officers of the state, authorizes inspection by the public of the roll or list of persons subject to the income tax and the amount of their taxable income, as prepared by the assessors of income, and also the proceedings before the board of review to such an extent as the tax commission may authorize.

To the limited extent to which statutes of this character authorize the publication or inspection of taxpayers' returns, it is held that they do not violate the constitutional prohibitions against unreasonable searches and seizures.[14] But aside from statutory authorization, the courts have shown great reluctance to force the disclosure of matters contained in such essentially confidential documents, even when desired in the interests of public justice. Thus, in England, it is held that a court will not compel the tax officers to produce or exhibit documents in their possession (such as a taxpayer's return) for use in litigation or for the use of a receiver, when it is stated that such a course would be prejudicial and injurious to the public service and interests.[15] And in the United States the rule is even more strict. For a collector of internal revenue cannot be compelled to testify, even in a criminal proceeding in a state court, concerning statements made to him by an applicant for a liquor dealer's tax-stamp, which statements were made for the purpose of being reduced to writing and embodied in the records of the internal revenue office; for, to divulge such statements, would be to divulge the contents of the records themselves, and this is forbidden by the internal revenue regulations.[16]

§ 114. Penalties for Divulging Information

To encourage frank and full disclosures by taxpayers, and to remove as far as possible the inquisitorial features of such

[14] Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389.

[15] In re Joseph Hargreaves, Ltd. [1900] 1 Ch. 347, 4 Tax Cas. 173.

[16] In re Huttman, 70 Fed. 699.

a law, the income tax statutes denounce very heavy penalties upon the officers charged with the assessment and collection of the tax if they shall divulge or make known (except to the limited extent authorized by the statute) the return of any taxpayer or its items or details. The act of Congress also forbids these officers to permit any person to see or examine any return or any copy thereof or any book containing any abstract or particulars thereof; and also provides that it shall be unlawful for any person to print or publish in any manner whatever not provided by law, any income return or any part thereof, or the amount or source of income, profits, losses, or expenditures appearing in any income return. Any violation of these provisions is declared a misdemeanor, and the punishment prescribed is a fine not exceeding $1,000, or imprisonment not exceeding one year, or both, and in addition, if the offender is an officer or employé of the United States, dismissal from office and perpetual incapacity for holding any office under the government.[17] In Wisconsin, the prohibition is substantially the same, except that the penalty, though of the same character, is not so severe, and except that it applies only to the officers and employés of the state or the assessment districts, so that, if they violate their duty and disclose the contents of returns, there is apparently nothing to forbid any person from printing and publishing such information.[18] In Oklahoma, on the other hand, the provision is that "it shall be unlawful for any person to print or publish in any manner whatever any income tax return, or any part thereof, or the taxes due thereon, unless the tax herein becomes delinquent, and any person violating the provisions of this section shall be deemed guilty of a misdemeanor and shall be fined not to exceed fifty dollars and imprisoned in the county jail not more than thirty

[17] Rev. Stat. U. S., § 3167 (U. S. Comp. St. 1901, p. 2058), as amended by Income Tax Act of 1913.

[18] Wisconsin Income Tax Law 1911, § 1087m, subsec. 24, pars. 1–3.

days for each offense." [19] And in North Carolina, the provision is substantially the same as in Oklahoma, except that no permission is given for the publication of the tax returns in case of delinquency.[20]

§ 115. Proceedings in Case of Refusal or Neglect to File Return

As a general rule, where a taxable person or corporation refuses or omits to make the required return, or makes a false and fraudulent return, it is made the duty of the assessor or collector to make and compile the return on the best information he can obtain. Thus, under the act of Congress, the return in such cases is to be made by the collector or deputy collector of internal revenue on the best information which he can obtain, including that elicited on his examination of witnesses and of books and papers, and "on his own view and information." In Wisconsin, while penalties are prescribed for the neglect or refusal to make a return, there is no provision for the making of the return by the taxing officers, except that, if it is discovered that any taxable person or corporation has failed to make a return in any one of the three next previous years, the proper officer may "make such additions or corrections to the assessment as is deemed true and just, such correction to be made in the next tax levy." In South Carolina, any person or corporation failing to make the required return "shall be assessed by the auditor on account of the income tax, in such amount as appears to him from the best information obtainable by him either by examination of the defaulting taxpayer or any other evidence, that such taxpayer is liable for." In Hawaii, the provision of the statute is that, in such cases, "the assessor may make such assessments as he may consider just, and the same shall be

[19] Oklahoma Income Tax Law, § 6; Laws Oklahoma 1907, p. 730.
[20] Acts North Carolina 1907, c. 256, § 23.

binding and conclusive upon all parties, and shall not be subject to appeal."

As a general principle of law, it is held, if the taxpayer refuses to give in his income to the assessor, it is the duty of the assessor to ascertain its amount by inquiry or otherwise, to the best of his information and judgment; and if, in discharging this duty, acting in good faith, the assessor fixes the amount of such income at a larger sum than it in fact amounted to, and assesses it at the sum thus ascertained by him, such assessment is legal, notwithstanding the mistake or overstatement, and the collection of the tax so assessed, by the tax collector, is also legal.[21] And in making his estimate of the value of property for the purpose of the income tax (as, for instance, in determining the rental value of the taxpayer's residence) the assessor is not bound to accept and follow the valuation placed on the same property by any other assessor for the purposes of any other tax.[22] It should also be observed that an assessment for the income tax cannot be impeached collaterally or re-examined in any collateral proceeding. It may be subject to appeal or review, but cannot be revised in any other mode than the special statutory mode provided for that purpose. Hence a proof in bankruptcy by a collector of taxes, in respect of arrears due under an assessment for the income tax, cannot be expunged on the ground that the debtor had not received the income or made the profits so assessed.[23]

§ 116. Same; Examination of Books, Papers, and Witnesses

It is provided in the Revised Statutes, as amended by the act of Congress of 1913, that if any person shall refuse or neglect to make the required return, on notice and demand,

[21] Lott v. Hubbard, 44 Ala. 593.
[22] Walker v. Brisley, 4 Tax Cas. 254.
[23] Calvert v. Walker [1899] 2 Q. B. 145, 4 Tax Cas. 79.

or shall render a return which, in the opinion of the collector, is false or fraudulent or contains any undervaluation or understatement, "it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person, or any other person he may deem proper, to appear before him and produce such books, at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects liable to tax or the returns thereof. The collector may summon any person residing or found within the state in which his district lies; and when the person intended to be summoned does not reside and cannot be found within such state, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end, he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned." And in another part of the statute, it is provided that "jurisdiction is hereby conferred upon the district courts of the United States for the district within which any person summoned under this section to appear to testify or to produce books shall reside, to compel such attendance, production of books, and testimony by appropriate process." [24] And another federal statute provides that "every collector, deputy collector, and inspector is authorized to administer oaths and to take evidence touching any part of the administration of the internal revenue laws with which he is charged, or where such oaths and evidence are authorized by law to be taken." [25]

In Wisconsin there are stringent provisions for requiring the delinquent taxpayer or corporation to furnish the information necessary to make or complete the return, but

[24] Rev. Stat. U. S., § 3173 (U. S. Comp. St. 1901, p. 2065), and Income Tax Act 1913, subdivisions "J" and "L," amending the same.

[25] Rev. Stat. U. S., § 3165 (U. S. Comp. St. 1901, p. 2057).

none for the examination of witnesses or of books and papers, except when an appeal is taken to the board of review. In South Carolina, the law seems to authorize an "examination of the defaulting taxpayer," though it makes no explicit provision for compelling his attendance. In Oklahoma the state auditor "may take such steps as he may deem necessary" to compel any delinquent to make a proper return of his income, and "to enable him to obtain such information, he or anyone designated by him to obtain such information shall have the power to summon witnesses within the county in which such persons live," and may invoke the aid of the courts to compel their attendance. In Hawaii, "it shall be lawful for the assessor to summon such person, or any of the officers of such corporation, or any person having possession, custody, or care of books of account containing entries relating to the business of such person or corporation, or any other person he may deem proper, wherever residing or found, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogatories under oath, respecting any income liable to tax or the returns thereof." [26] But as to the production of records or other documents by public officers, the law is not very clear, and the question has not often arisen. There is, however, a Scotch decision in reference to compelling the production of documents for the purpose of discovering taxable income, holding that a public department cannot be compelled by a court of law to produce confidential documents in its possession coming from third parties, if so to compel it would be to discourage similar communications being made in the future.[27] In the statute of Hawaii we find the following severe and extraordinary provision: "It shall be the duty of

[26] Session Laws Hawaii 1901, Act No. 20, § 6, p. 31.

[27] Brown's Trustees v. Hay, 35 Scotch Law Rep. 340, 3 Tax Cas. 598.

every person or corporation doing business for profit to keep full, regular, and accurate books of accounts upon which all its transactions shall be entered from day to day in regular order, which books shall be open to the inspection of the assessor of the division or any person authorized by him to inspect the same, during business hours." It is perhaps fortunate that no penalty for the violation of this provision has been prescribed.

§ 117. Assessment of the Tax

Under the act of Congress, returns are to be filed with the collector or deputy collector, and it is also the duty of these officers, as above stated, to require the making of returns, or to make returns for delinquent persons or corporations upon information. But the actual assessment of the tax is an act required to be performed by the Commissioner of Internal Revenue. And the statute also gives to this latter officer a power and duty which appear to overlap those intrusted to the collectors. For it is provided that, "in cases of refusal or neglect to make such return, and in cases of false and fraudulent returns, the Commissioner of Internal Revenue shall, upon discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law."

Under the Wisconsin statute, the assessment of the income tax upon corporations, joint stock companies, and associations is to be made by the state tax commission, but upon individual taxpayers by the county assessor of incomes. In South Carolina, the income tax "shall be assessed, levied, and collected in the same manner, at the same time, as other taxes, and by the same county officials as are now charged with the assessment, levy, and collection of state and county taxes." In Oklahoma, the returns are to be forwarded to the state auditor who "shall certify the amount of the tax due upon the in-

come so reported to the county clerk," and the latter shall extend the same on the tax rolls and deliver them to the county treasurer. In North Carolina, the lists are to be forwarded to the Corporation Commission, which "shall certify the amount of the tax due upon the income so reported to the chairman of the board of county commissioners of the county in which said taxpayer resides, and the same shall be paid to the sheriff of said county, together with other taxes for that year."

§ 118. Appeal and Review of Assessment

The federal income tax law provides that "if the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly." In order to understand the force of this provision, it is permissible to recur to the earlier acts of Congress on the same subject, where the idea was more clearly expressed. In the act of 1864, it was provided that "if the list or return of any party shall have been increased by the assistant assessor, such party may exhibit his books and accounts, and be permitted to prove and declare, under oath or affirmation, the amount of annual income liable to be assessed, but such oaths and evidence shall not be considered as conclusive of the facts." This was repeated in the act of 1870. Under these earlier statutes, the assessor (or collector) was to increase a return which, according to his information and judgment, was understated, after which the taxpayer might appear before him and prove the true amount of his income. But under the present act, the increase is not to be made until after a hearing. The collector is first to give notice to the taxpayer and summon him to show cause why his assessment should not be increased. But probably the rule of evidence remains as before, namely,

that the taxpayer may present his affidavit to the collector stating the amount of his assessable income, and exhibit his books and accounts in support thereof, but neither the affidavit nor the exhibits shall be so far conclusive as to prevent the collector from taking other evidence, if he is not convinced of their correctness. Provision for an appeal to a higher officer of the revenue department is made, as follows: "If dissatisfied with the decision of the collector, such person may submit the case, with all the papers, to the Commissioner of Internal Revenue for his decision, and may furnish sworn testimony of witnesses to prove any relevant facts."

Under the law in Wisconsin, the assessment of corporations, joint stock companies and associations is made by the state tax commission, and it is provided that any such company, "feeling aggrieved by the decision of said commission regarding the assessment of its income, shall be granted the same rights of hearing and appeal as are now granted corporations assessed by said commission." And the commission explains that the remedy here referred to is found in a statute which provides that any company claiming to be aggrieved by the levy of a tax, and alleging facts showing substantial injustice in the determination of the commission, may, within six months from the payment of the tax, bring an action against the state in the circuit court of Dane county to recover such part of the tax as shall exceed the amount the company should have paid.[28] But as to the review of assessments of income tax upon individuals, as distinguished from corporations, the provision is entirely different. For this purpose a board of review is created in each county, to hold stated meetings, of which notice is given, and having power to enforce the attendance of witnesses and the exhibition of books, to hear com-

[28] Wisconsin Income Tax Law 1911, edition published by State Tax Commission, p. 38, citing Laws Wis. 1903, c. 315, § 20, as amended by Laws Wis. 1905, c. 216, § 5.

plaints preferred by persons aggrieved or other persons, and to increase or lessen the amount of any assessment of income. Any person dissatisfied with the decision of the board of review may appeal to the state tax commission within twenty days. But, as is usually the case where statutes provide a special tribunal for the review of tax assessments, the taxpayer must exhaust his remedy thus provided before questioning the amount of the assessment in any proceeding in a court of justice.[29]

The only other income tax law making explicit provision for a review of the assessment is that of Hawaii. Herein it is provided that, if any person or corporation refuses or neglects to make the required return, or refuses to verify it, the assessor shall make such an assessment as he deems just, and there shall be no appeal therefrom. But any person or corporation which has made a legal return as required may appeal, in respect to the amount assessed, to the Tax Appeal Court, having first given the assessor written notice of his intention to appeal and of the grounds of appeal, and having deposited the costs of appeal.[30]

§ 119. Rate of Tax

In two states and one territory the laws levy a "flat" tax on incomes. That is, the rate of the tax remains the same whatever be the amount of the taxable income. In Virginia, the rate of the tax is one per cent, as it is also in North Carolina. In Hawaii, it is two per cent. The act of Congress of 1913 also imposes a flat tax of one per cent upon the income of corporations. But as concerns individuals, it is graded or progressive, the rate of taxation increasing as the amount of taxable income increases, within or beyond certain fixed limits. This progressive feature is also found in the income

[29] Wisconsin Income Tax Law 1911, § 1087m, subds. 14–19.
[30] Session Laws Hawaii 1901, Act No. 20, p. 31, §§ 8, 9.

tax laws of South Carolina, Wisconsin, and Oklahoma. The act of Congress (as to individuals only) first levies a "normal income tax" of one per cent on all incomes in excess of the statutory exemption, and then provides that there shall also be levied an "additional income tax" at the rate of "one per centum per annum upon the amount by which the total net income exceeds $20,000, and does not exceed $50,000, and two per centum per annum upon the amount by which the total net income exceeds $50,000 and does not exceed $75,000, and three per centum per annum upon the amount by which the total net income exceeds $75,000 and does not exceed $100,000, and four per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $250,000, and five per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $500,000, and six per centum per annum upon the amount by which the total net income exceeds $500,000." In Wisconsin, the rate for individuals is one per cent upon the first thousand dollars of taxable income or part thereof, and from this point the rate increases with each successive thousand dollars of taxable income, advancing first by quarters of one per cent and after the fifth thousand by halves of one per cent, to the twelfth thousand, on which the rate is five and one-half per cent, with a rate of six per cent on any sum in excess of twelve thousand dollars. As to corporations, under the Wisconsin statute, the rate is determined by the ratio between the taxable income of the company and the "assessed value of the property used and employed in the acquisition of such income." If this ratio is one per cent or less, the rate of the tax is one-half of one per cent of such income. From this point it advances "until the rate of profits equals twelve per cent of such assessed value of the property used and employed in the acquisition of such income, when such rate shall continue as a proportional rate

of six per cent of such taxable income. In South Carolina, the tax is at the rate of one per cent on incomes over and above $2,500 and up to $5,000; one and one-half per cent on $5,000 and over, up to $7,500; two per cent on $7,500 and over, up to $10,000; two and one-half per cent on $10,000 and over, up to $15,000; and three per cent on $15,000 and over. In Oklahoma, the rate is five mills on the dollar on the excess of income over $3,500 and less than $5,000; seven and one-half mills on the excess of $5,000 and less than $10,000; twelve mills on the excess over $10,000 and less than $20,000; fifteen mills on the excess over $20,000 and less than $50,000; twenty mills on the excess over $50,000 and less than $100,000; and thirty-three and one-third mills on all amounts over $100,000.

For purposes of comparison a table is appended, showing the amount of the tax payable by individuals and by corporations under the federal statute and also the amount of the tax under the progressive income tax laws of the three states mentioned. The reader will notice that the "amount of taxable income" in the first column does not mean gross income, but the net income on which the tax will be payable after deducting all exemptions and allowances. A glance at the table will show that the progressive feature of the tax is applied with the greatest severity under the act of Congress, but with Wisconsin a close second in its application to very large incomes. Attention may also be called to the striking disparity between the taxes payable by individuals and those payable by corporations under the federal statute, when the income reaches large figures, which is entirely due to the fact that the tax on corporations is flat, while that on individuals is progressive.

Amount of Taxable Income.	U. S. Am't of Tax on Individuals.	U. S. Am't of Tax on Corporations.	Wisconsin Am't of Tax.	S. Carolina Am't of Tax.	Oklahoma Am't of Tax.
$ 5,000.	$ 50.	$ 50.	$ 75.	$ 75.	$ 37.50.
10,000.	100.	100.	250.	250.	120.
15,000.	150.	150.	535.	450.	180.
20,000.	200.	200.	835.	600.	300.
25,000.	300.	250.	1,135.	750.	375.
50,000.	800.	500.	2,635.	1,500.	1,000.
100,000.	2,550.	1,000.	5,635.	3,000.	2,000.
200,000.	7,550.	2,000.	11,635.	6,000.	6,666.66.
500,000.	25,050.	5,000.	29,635.	15,000.	16,666.66.
1,000,000.	60,050.	10,000.	59,635.	30,000.	33,333.33.

§ 120. When Tax is Payable

The act of Congress provides that "all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June." But the penalty for delinquency applies only to "sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector." Under a similar provision in the corporation tax law of 1909, it was ruled that the taxes are due and payable ten days after the date of the actual mailing of the notice and demand. But where a notice so sent is not delivered in due time, by reason of delay in the mail, and satisfactory evidence of that fact is furnished, the penalty will not be collected, provided the full tax due is paid to the collector within ten days after the actual receipt of the notice.[31] But if a notice from the collector was mailed to a delinquent taxpayer in a franked envelope, properly addressed, bearing the return address of the collector, and was not returned by the post office department, the presumption is that it was duly received.[32] Where a check is tendered in payment of the tax, which is not accepted as payment by the collector, and he deposits it in a bank for collection, the penalty for non-payment must be exacted, unless the collection is made and the tax turned over to the collector within ten days after mailing notice to the taxpayer. It is immaterial that the check was deposited in due time for the collection to have been made if the bank had been diligent. And the fact that the particular bank is a government depository does not make it an agency for the collection of internal revenue taxes, and therefore laches on its part in the performance of business

[31] Treasury Decisions, No. 1659.
[32] United States v. General Inspection & Loading Co., 204 Fed. 657.

duties, outside of its functions as such depository, cannot be imputed to the government or affect its interests.[33]

Under the laws of the states, income taxes are generally made payable at the same time with the general taxes for the year on real and personal property.

§ 121. Penalties for Delinquency and False Returns

Analyzing and comparing the various provisions of the act of Congress of 1913 with reference to penalties, it appears that the following rules may be stated:

1. Failure to pay the tax when due, and for ten days after notice and demand thereof by the collector, will subject the taxpayer, whether an individual or a corporation, to a penalty of five per cent of the amount of the tax unpaid, which is to be added to that amount, together with interest at the rate of one per cent a month from the time the tax became due until it is paid. But an exception is made in favor of the estates of insane, deceased, and insolvent persons.

2. Neglect or refusal to make a return, or to verify a return, subjects the individual taxpayer to a fine of from $20 to $1,000, and the Commissioner of Internal Revenue will add fifty per cent to the amount of the tax as assessed by him. But if the omission to make a return at the proper time was due to the "sickness or absence" of the taxpayer, this addition to the assessment will not be made, provided a return is made within the further time allowed by the collector, not exceeding thirty days.

3. Certain persons and corporations, having the management of another person's property, or having fixed and determinable payments to make to such person at stated intervals, exceeding $3,000 for any taxable year, are required to make a return for such person and to withhold and pay over to the government the amount of the income tax thereon; as, for example mortgagors, employers paying salaries, testamentary

[33] Treasury Decisions, No. 1651.

and other trustees, executors, receivers, conservators, and disbursing officers of the United States. And if any one subject to this provision, whether it be a "person, corporation, joint stock company, association, or insurance company," shall refuse or neglect to make a return at the proper time, a penalty is imposed of not less than $20 nor more than $1,000.

4. If a corporation, joint stock company or association, or insurance company, liable to the tax, shall neglect or refuse to make its own return at the appointed time, it is liable to a penalty of not more than $10,000, and in addition is liable to have its assessment increased fifty per cent.

5. If an individual taxpayer "makes any false or fraudulent return or statement with intent to defeat or evade the assessment required" by the statute, he shall be guilty of a misdemeanor, and be punished by a fine not exceeding $2,000, or imprisonment for not more than one year, or both, in the discretion of the court, with the costs of prosecution. And in addition, the amount of the tax assessed upon him shall be increased by the addition of one hundred per cent.

6. If the return made by or on behalf of a corporation is false or fraudulent, as above defined, the officers of the corporation signing and verifying it are liable to the same punishment as above prescribed for individuals, and the assessment shall likewise be increased by the addition of one hundred per cent of its amount, and further, by the explicit language of the statute, the corporation itself shall be liable to a penalty of not more than $10,000.

Under the Wisconsin statute, any individual taxpayer who fails or refuses to make the required return, or who makes a false or fraudulent return, is liable to a fine of not more than $500, or imprisonment for not more than one year, or both. In the case of a corporation, a penalty is denounced of not less than $100 nor more than $5,000, at the discretion of the court, for either failing to make its return or for rendering a false or fraudulent return, and in the latter case, the officers

of the corporation signing and verifying the return are liable to the same penalty as above prescribed for individuals. Furthermore, both in the case of an individual and in that of a corporation, and whether there was a failure to make the return or a false or fraudulent return was filed, if the revenue officers discover an additional amount of taxable income, "the amount so discovered shall be subject to twice the original rate." In South Carolina, if the taxpayer neglects or refuses to make a return, the auditor is to add fifty per cent as a penalty to the amount of tax due, and one hundred per cent in the case of a false or fraudulent return having been made. In Oklahoma, non-payment of the income tax when due subjects the taxpayer to the same penalties as are provided in the case of ad valorem taxes, and false swearing in a return is declared to be perjury. In Hawaii, "in case of any false or fraudulent return or valuation by any taxpayer, the assessor shall add 200 per cent to the just valuation of the income of such taxpayer, and the amount of the tax assessed on such increase shall become part of the tax on the said income."

In regard to the validity of these various penalties, there can be little room for dispute. Courts have often sustained them in the case of general taxes, and, specifically with reference to an income tax, it has been held that the imposition of an addition of 100 per cent as a penalty for making a false or fraudulent return is not unconstitutional.[34] In regard to the manner of enforcing the penalties, it is ruled that the penalty imposed on a corporation for failing to make the required return is to be recovered by a civil action (not by indictment in a criminal proceeding), in which the amount of the penalty will be determined by the court, within the limits stated, after a verdict for the plaintiff.[35] But it is not within the jurisdiction of a court to modify a penalty

[34] Doll v. Evans, 9 Phila. 364, Fed. Cas. No. 3,969.
[35] Treasury Decisions, No. 1740.

prescribed for making a false return, its discretion being confined to the limits marked out for it by the law.[36] It has also been held that an assessor of internal revenue, on ascertaining that the return made by a taxpayer was false and fraudulent, has power to reassess the tax and add the penalty, notwithstanding that the taxpayer has already paid the amount first assessed against him on his original return.[37]

§ 122. Lien of Tax

In Oklahoma, it is expressly provided by statute that the amount due for income tax shall be a lien upon the real and personal property of the taxpayer. Elsewhere the matter is left to be regulated by the laws relating to taxes in general. As to the federal income tax, there is an act of Congress, applicable to internal revenue taxes in general, which provides that "if any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights belonging to such person." [38] And the opinion was given by the Attorney General that this statute was applicable to the special tax on corporations imposed by the act of 1909, and if so, it would, for the same reasons, be applicable under the act of 1913. He ruled that the assets of a corporation are subject to a lien for the payment of the tax, provided that the corporation has not been dissolved and all its assets distributed prior to the time the list of assessments came into the hands of the collector.

[36] Lord Advocate v. McLaren, 42 Scotch Law Rep. 762, 5 Tax Cas. 110.

[37] Doll v. Evans, 9 Phila. 364, Fed. Cas. No. 3,969.

[38] Rev. Stat. U. S., § 3186 (U. S. Comp. St. 1901, p. 2073), as amended by Act Cong. March 1, 1879, 20 Stat. 331.

And even if a corporation is dissolved before the tax falls due, so that the government cannot claim a lien on its assets, still the tax imposed may be collected by the government by pursuing the assets into the hands of the stockholders, in the same manner as any other creditor might obtain satisfaction of his debt.[39]

§ 123. Process for Recovery of Tax

The federal income tax law of 1913 provides that "all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this section, are hereby extended and made applicable to all the provisions of this section and to the tax herein imposed." The laws relating to the recovery or collection of internal revenue taxes in general are elaborate and detailed, and cannot be here set out in full. But it may be stated that the duty of collecting these taxes is imposed upon the several collectors of internal revenue, and that, if the taxes are not paid after proper demand, they may proceed by distraint, by seizure and sale of real property, or by suit against the delinquent in the name of the United States, according to the circumstances of the case.[40]

§ 124. Compromise of Litigation

An unrepealed act of Congress provides that "the Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and with the advice and consent of the said Secretary and the recommendation of the

[39] 28 Opin. Atty. Gen. 241.

[40] See Rev. Stat. U. S., §§ 3183–3219 (U. S. Comp. St. 1901, pp. 2072–2086), and particularly §§ 3187, 3196, 3213.

Attorney General, he may compromise any such case after a suit thereon has been commenced." [41] This was held applicable to the penalties imposed by the corporation tax law of 1909 for failure to file the return required of corporations. But the Commissioner of Internal Revenue instructed the collectors on this point as follows: "Particular attention is called to the fact that no solicitation of an offer should be made, and no delinquent should be induced by threats to invoke the power of the commissioner to compromise, and no assurance should be given of the probable action of the commissioner if an offer is made. But where the officers of a corporation are ignorant of a provision of law providing for a compromise of offenses against the revenues, and they desire to make an appeal for clemency in the manner provided, it is the duty of the collector to give them suitable instructions. The amount to be offered in each such case must be left to the discretion of the corporation making the offer, and in nowise should be suggested by the collector or any other revenue officer. In connection with the corporation tax law, this right of compromise extends only to the penalty prescribed under paragraph 8, and not to the tax itself, nor to the addition of fifty per cent assessed." [42] And on the application of this subject to the tax imposed by an earlier statute, the Supreme Court of the United States said: "The power intrusted by law to the Secretary was not a judicial one, but one of mercy, to mitigate the severity of the law. It admitted of no appeal to the Court of Claims, or to any other court. It was the exercise of his discretion in a matter intrusted to him alone, and from which there could be no appeal." [43]

[41] Rev. Stat. U. S., § 3229 (U. S. Comp. St. 1901, p. 2089).
[42] Treasury Decisions, No. 1692.
[43] Dorsheimer v. United States, 7 Wall. 166, 174.

§ 125. Collection at the Source

This feature of the federal income tax law of 1913, copied in part from the English statute, presents many complexities and many provisions difficult to interpret in such a manner as to make them practically effective. The subject cannot be understood without a careful reading of the statute itself, which is printed in full in the appendix to this volume. But for the guidance of the reader, the following conclusions may be stated as deducible from an analysis and comparison of the various paragraphs of the act bearing upon it:

First. The provision for collection at the source applies only to the "normal" income tax, that is, the tax of one per cent imposed upon all incomes above the exempted amount, and not to the super-tax or "additional tax" on incomes exceeding $20,000. Hence the "source"—for instance, an employer paying a salary, a mortgagor paying interest, or a testamentary trustee paying over the annual income of an estate—is required and authorized to withhold only one per cent on the amount, no matter how great the income may be.

Second. Persons or corporations having the management or control of another person's property, or having fixed and determinable payments to make to such person at stated intervals, exceeding $3,000 for any taxable year, are required to make a return for such person, which shall include his name and address, or state that his name and address are unknown, if such is the case, and also to deduct and withhold from payments so to be made a sum sufficient to pay the normal income tax, and pay over the same to the proper federal officer, and they are moreover made personally liable for the tax.[44] Those subject to this provision include "lessees or

[44] If official liquidators, such as receivers, trustees in bankruptcy, or assignees for creditors, pay away all the assets of the corporation without making provision for a debt due the government in respect of income tax, they are guilty of misapplying the assets, and are personally responsible for the debt, and payment of it may be enforced by attachment. In re Watchmakers' Alliance, 5 Tax Cas. 117.

mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers, and all officers and employés of the United States" having to do with the disbursement of funds. They may be either "persons, firms, copartnerships, companies, corporations, joint-stock companies or associations, or insurance companies." And the payments which they have to make to the third person may be in the nature of "interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual" or periodical "gains, profits, and income." [45] But this does not apply to dividends on the capital stock, or paid out of the net earnings, of corporations or other associations subject to the tax, since the corporation pays the tax on its own profits, and the stockholder is allowed to deduct from his income for taxation what he receives in the way of dividends.[46]

Third. Corporations, joint stock companies, and insurance companies which pay interest on their bonds, mortgages, deeds of trust, or other obligations are required to deduct and withhold from such payments a sum sufficient to pay the normal income tax assessable against the several payees, whether such payments are made annually or at shorter or longer periods, and although such interest, receivable by any one payee, does not amount to $3,000 per annum. In the latter case, the recipient of the income should clearly be entitled to the exemption provided by the statute. But the act omits to prescribe

[45] In England, in respect to dealings between merchants, discounting bills and the like, and in loans made for short periods, the income tax is not deducted by the one having to make the payment. Mosse v. Salt, 32 Beav. 269.

[46] So in England, in paying dividends on its stock, a corporation is bound to account to the Crown for the income tax which it deducts from the dividends, only so far as the dividends are not paid out of its income which has already been charged with the income tax. London County Council v. Attorney General [1901] App. Cas. 26.

any method of claiming or securing the benefit of the exemption in this instance, since the only provision under which a taxpayer whose tax has been collected at the source can secure the benefit of the exemptions and deductions to which he may be entitled is expressly confined to the case of a "person receiving such payment of more than $3,000 per annum."

Fourth. Whereas various obligations, and particularly bonds of corporations, are often issued under a contract by which they are made "tax free," that is, a contract by which the obligor undertakes to pay all taxes which may be assessed on the bonds, the act of Congress provides that no such contract entered into after the taking effect of the act shall be valid in regard to any federal income tax imposed upon a person liable to such payment.

Fifth. Where the whole or part of a person's income consists in interest on bonds of foreign countries, or interest upon foreign mortgages or other like obligations, not payable in the United States, or dividends upon the stock (or interest upon the obligations) of foreign corporations engaged in business in foreign countries, and where the payment of such interest or dividends is made in the form of coupons, checks, or bills of exchange, the amount of the income tax is to be deducted and withheld therefrom by any banker or other person who shall sell or otherwise realize such coupons, etc., the same not being payable in the United States, or any person who shall obtain payment, not in the United States, of such interest or dividends in behalf of another person by means of coupons, etc., or by "any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States) otherwise than from a banker or another dealer in such coupons." Persons, firms, and corporations "undertaking as a matter of business or for profit the collection of foreign payments by means of coupons, checks, or bills of exchange" are required, under heavy penalties, to obtain a license from the Commissioner of Internal

Revenue, and are made subject to regulations to be prescribed by him. This part of the statute applies although the interest or dividends so collected do not amount to more than $3,000, but in each case the benefit of the exemption and of the deductions allowed under the act may be obtained as hereinafter mentioned.

Sixth. If the person whose income is thus taxed at the source is entitled to the various deductions specified in the act, or any of them, and the effect of deducting such items would be to entitle him to exemption from the normal income tax, or to reduce the amount subject to the tax, he may receive the benefit of such exemption or reduction either by filing with the person required to withhold the tax and pay it to the government, not less than thirty days prior to the day on which the return of his income is due, a signed notice claiming the benefit of such exemption, and a true and correct statement of his annual income from all other sources, and of the deductions claimed, which notice and statement shall become a part of the return to be made in his behalf by the person required to withhold and pay the tax, or by making the application for the exemption to the collector of the district in which return is made or to be made for him, and proving to the satisfaction of the collector that he is entitled to the same. Provision is also made for the case where the person is a minor, insane, absent from the United States, or incapacitated by "serious illness" from making the return and application. In either of these cases, the return and application may be made for him by the person required to withhold and pay the tax; but the latter must then make oath that he has sufficient knowledge of the affairs and property of his beneficiary to enable him to make a full and complete return for him, and that the return and application so made are full and complete.

Seventh. Each taxable person, making his own return, is entitled to deduct from his total income as shown thereon "the

amount of income, the tax upon which has been paid or withheld from payment at the source; provided, that whenever the tax upon the income of a person is required to be withheld and paid at the source as herein required, if such annual income does not exceed the sum of $3,000, or is not fixed or certain, or is indefinite, or irregular as to amount or time of accrual, the same shall not be deducted in the personal return of such person."

Eighth. The provision requiring the normal tax of individuals to be withheld at the source of the income shall not be construed to require any of such tax to be withheld prior to the first day of November, 1913.

CHAPTER X

REFUNDING AND RECOVERY OF TAXES ILLEGALLY EXACTED

§ 126. Statutory Provisions

As a general rule, the income tax laws make no specific provision for the refund or recovery of taxes illegally exacted or assessed to an excessive amount, the rights and remedies of the taxpayer in these cases being governed by the ordinary rules of law applicable in matters of taxation. In Wisconsin, however, there is a provision applicable to corporations only, which permits a company which is dissatisfied with the assessment of its income by the state tax commission to bring an action against the state for the recovery of so much of the tax paid by it as is in excess of the amount which it admits to have been legally chargeable upon it. This action must be brought in the circuit court of Dane county, within six months after the payment of the tax, and must be based on a petition alleging facts showing substantial injustice in the determination of the tax commission.[1] The act of Congress of 1913 likewise provides that "all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal revenue taxes not heretofore specifically repealed and not inconsistent

[1] Wisconsin Income Tax Law 1911, § 1087m, subd. 13; Laws Wis. 1903, c. 315, § 20, as amended by Laws Wis. 1905, c. 216, § 5.

with the provisions of this section, are hereby extended and made applicable to all the provisions of this section and to the tax herein imposed." [2]

§ 127. Payment of Tax Under Protest

It is a general principle of law, applicable to income taxes as well as to any others, that after a taxpayer has exhausted his lawful remedies to induce the administrative officers to cancel or reduce an assessment which he considers illegal or unjust in whole or in part, he must then pay the tax, but may save his right to bring an action for its recovery by accompanying his payment with a protest, addressed to the officer charged with the collection of the tax. This rule was held applicable to the corporation excise tax law of 1909, and a ruling was made that, no particular form of protest having been prescribed, any form would be sufficient if filed before the payment of the tax, and the collectors of internal revenue were specially warned that the right of protest must not be denied. In a case arising under this statute, it appeared that, the plaintiff corporation having failed to pay the tax assessed against it, a writ of distraint was issued by the collector, and, the corporation having been notified that the tax would be collected by levy, the deputy collector took from a representative of the corporation the amount of the tax, against the verbal protest of the corporate officer at the time, and a written notice of protest then served, in which the corporation denied that it was liable to the tax. It was held that the protest was sufficient to entitle the corporation to recover the amount from the collector, on its being determined that the corporation was not within the law. The court said: "Where the tax is paid under such circumstances that the terms of protest are understood and sufficiently expressed to be brought to the notice of the government, and where the levy is used

[2] Federal Income Tax Law 1913, § 2, subd. "M."

merely to protect the government officer in acting under the statute, an action may be maintained to recover the tax." [3]

§ 128. Refund by Commissioner of Internal Revenue

The general laws applicable to the collection of United States internal revenue taxes contain a provision (not repealed by the act of Congress of 1913) under which a taxpayer may obtain a refund of taxes which he should not have been required to pay, without the necessity of an action at law. This section reads as follows: "The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized, on appeal to him made, to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected. Provided, that where a second assessment is made in case of a list, statement, or return which, in the opinion of the collector or deputy collector, was false or fraudulent, or contained any understatement or undervaluation, such assessment shall not be remitted, nor shall taxes collected under such assessment be refunded or paid back, unless it is proved that said list, statement, or return was not false or fraudulent, and did not contain any understatement or undervaluation." [4]

§ 129. Suit to Enjoin Collection or Payment

As a general rule, if the assessment of a tax upon a person's income is not made in legal form, or is otherwise disputed, the remedy of the person aggrieved is at law, and not in equity.[5] And the laws of the United States expressly provide that "no suit for the purpose of restraining the assess-

[3] Abrast Realty Co. v. Maxwell, 206 Fed. 333. And see Treasury Decisions, No. 1742, par. 41.

[4] Rev. Stat. U. S., § 3220 (U. S. Comp. St. 1901, p. 2086).

[5] Magee v. Denton, 5 Blatchf. 130, Fed. Cas. No. 8,943.

ment or collection of any tax shall be maintained in any court." [6] Notwithstanding this, in the case in which the constitutionality of the income tax act of Congress of 1894 was assailed, the Supreme Court held that a federal court, as a court of equity, may restrain a corporation, at the suit of one of its stockholders, from voluntarily making returns for the imposition of, and paying, an unconstitutional tax levied under an act of Congress, on the ground of the breach of trust or duty in such misapplication or diversion of the corporate funds, and on allegations of threatened multiplicity of suits and irreparable injury, where the objection of adequate remedy at law is not raised, and the question of jurisdiction is waived, so far as it is within the power of the government to do so.[7] But since then it has been held, and apparently with better reason, that a corporation had an adequate remedy at law to recover an internal revenue tax assessed against its income under the act of 1909, by paying the tax under protest and then suing for its recovery, and hence a stockholder could not maintain a suit to restrain the corporation from paying the tax, on the ground that the corporation was not subject to assessment.[8] A similar question was raised before the Supreme Court of Wisconsin, in the case in which the validity of the income tax law of that state of 1911 was tested. But it was held that where a state statute, creating an income tax, works an important change in the general taxation policy of the state, and is intended to supersede the taxation of personal property previously existing and to provide an income tax in its stead, and such act is claimed to be unconstitutional, this claim involves the interests of the whole people of the state, so as to authorize the Supreme Court, at the instance of

[6] Rev. Stat. U. S., § 3224 (U. S. Comp. St. 1901, p. 2088).

[7] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759. But on this point there was an emphatic dissent by Mr. Justice White, now Chief Justice, and Mr. Justice Harlan.

[8] Straus v. Abrast Realty Co., 200 Fed. 327.

a private relator, to take original jurisdiction to restrain the officers of the state, charged with the enforcement of such law, from taking steps to enforce the same, and from expending the public funds in such enforcement, until the question of the constitutionality of the statute shall have been determined.[9]

§ 130. Suit for Recovery of Taxes Paid

The general provisions of the United States internal revenue laws do not explicitly authorize the maintenance of a suit for the recovery back of such taxes when illegally or improperly exacted, but they do so by clear and necessary implication, since they provide for the reimbursement of a collector for "sums of money recovered against him in any court for any internal taxes collected by him;" prescribed the burden of proof in suits for the recovery of taxes assessed after the rendering of an alleged false return; forbid the maintenance of such a suit until after an appeal shall have been taken to the Commissioner of Internal Revenue; and set up a limitation of two years against "any suit or proceeding for the recovery of any internal tax."[10] And in accordance with these general provisions, it is held that a United States district court has jurisdiction of an action to recover money paid to the United States under an erroneous assessment as an internal revenue tax and penalty.[11] Besides which, the Federal Judicial Code of 1911 (§ 24) provides that district courts of the United States shall have original jurisdiction of "all cases arising under any law providing for internal revenue." And under recent legislation of Congress,

[9] State v. Frear, 148 Wis. 456, 134 N. W. 673, 26 Am. & Eng. Ann. Cas. 1147.

[10] Rev. Stat. U. S., §§ 3220, 3225, 3226, 3227 (U. S. Comp. St. 1901, pp. 2086, 2088, 2089). And see Hastings v. Herold, 184 Fed. 759; United States v. Barnes, 222 U. S. 513, 32 Sup. Ct. 117, 56 L. Ed. 291.

[11] Dooley v. United States, 182 U. S. 222, 21 Sup. Ct. 762, 45 L. Ed. 1074; United States v. Finch, 201 Fed. 95.

a suit to recover taxes alleged to have been wrongfully assessed and collected under the internal revenue laws may be brought directly against the United States, instead of against the collector,[12] though the latter is more usually made the defendant. In this case, if judgment goes against a collector of internal revenue for taxes paid under protest, costs incurred before judgment and before any certificate of probable cause was granted are properly awarded against him and also the judgment may properly include interest.[13]

§ 131. Same; Appeal to Commissioner as Pre-requisite

The internal revenue laws provide that "no suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until appeal shall have been duly made to the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the Commissioner has been had therein: Provided, that if such decision is delayed more than six months from the date of such appeal, then the said suit may be brought, without first having a decision of the Commissioner, at any time within the period limited in the next section," that is to say, "within two years next after the cause of action accrued" or within one year after a decision rendered by the Commissioner.[14] This statute is mandatory, and the party aggrieved must pursue the remedy

[12] Emery, Bird, Thayer Realty Co. v. United States, 198 Fed. 242; Christie-Street Commission Co. v. United States, 136 Fed. 326, 69 C. C. A. 464.

[13] Treat v. Farmers' Loan & Trust Co., 185 Fed. 760, 108 C. C. A. 98.

[14] Rev. Stat. U. S., §§ 3226, 3227 (U. S. Comp. St. 1901, pp. 2088, 2089).

here prescribed before he can resort to a court either of law or equity for relief.[15] It was at one time held in Connecticut that this statute did not operate to prevent the maintenance of such suits in the courts of the state.[16] But the Supreme Court of the United States decided that it was applicable to all courts, state as well as federal.[17] Where, after the assessment of an internal revenue tax, alleged to be illegal, application is made to the Commissioner of Internal Revenue for review, and he overrules the application and refuses to abate the tax, it is held that this is a sufficient compliance with the statute, and the plaintiff is not bound, after paying the tax, to appeal again to the Commissioner as a condition precedent to his right to sue the collector for the recovery of the tax.[18]

§ 132. Remission of Penalties

The corporation excise tax law of 1909 was amended by an act of Congress, March 3, 1913, providing that a corporation which had been charged with an additional tax imposed as a penalty for neglect to file its return in due season, might apply to the Commissioner of Internal Revenue for a refund of such additional tax, within a year after the passage of the act or within a year after date of notice of the assessment. "And the Commissioner of Internal Revenue, with the advice and consent of the Solicitor of Internal Revenue, is hereby directed to remit, abate, and pay back all such additional taxes, in excess of $100 for any single year, whenever in any case it appears to his satisfaction that the additional tax was assessed or imposed solely because of a neglect to make a return at the time or times specified in said act, and without any intention or design on the part of any officer of such corporation to hinder or delay the United States in the collection of the tax originally assessed."

[15] Magee v. Denton, 5 Blatchf. 130, Fed. Cas. No. 8,943.
[16] Hubbard v. Brainard, 35 Conn. 563.
[17] Collector v. Hubbard, 12 Wall. 1, 20 L. Ed. 272.
[18] Weaver v. Ewers, 195 Fed. 247, 115 C. C. A. 219.

It is doubtful whether or not this supplementary or amendatory act is repealed by the act of 1913. But if it should be so held, still the taxpayer has his remedy under the general provisions of the internal revenue laws, which authorizes the refund by the Commissioner (or the recovery by suit), not only of the tax collected, but also of "all penalties collected without authority." [19]

[19] Rev. Stat. U. S., §§ 3220, 3226, 3227 (U. S. Comp. St. 1901, pp. 2086, 2088, 2089).

APPENDIX

UNITED STATES INCOME TAX LAW OF 1913

[This enactment constitutes the second section of the Tariff Act of 1913, the title of the whole statute being "An Act to Reduce Tariff Duties and to Provide Revenue for the Government, and For Other Purposes."]

Section II

Rate of normal tax.

A. Subdivision 1. That there shall be levied, assessed, collected, and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income except as hereinafter provided; and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere.

Rates of additional tax on individuals.

Subdivision 2. In addition to the income tax provided under this section (herein referred to as the normal income tax) there shall be levied, assessed, and collected upon the net income of every individual an additional income tax (herein referred to as the additional tax) of 1 per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000, and 2 per centum per annum upon the amount by which the total net income exceeds $50,000 and does not exceed $75,000, 3 per centum per annum upon the amount by which the total net income exceeds $75,000 and does not exceed $100,000, 4 per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $250,000, 5 per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $500,000, and 6 per centum per annum upon the amount by which the total net income exceeds

$500,000. All the provisions of this section relating to individuals who are to be chargeable with the normal income tax, so far as they are applicable and are not inconsistent with this subdivision of paragraph A, shall apply to the levy, assessment, and collection of the additional tax imposed under this section. Every person subject to this additional tax shall, for the purpose of its assessment and collection, make a personal return of his total net income from all sources, corporate or otherwise for the preceding calendar year under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. For the purpose of this additional tax the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint stock companies, or corporations however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint stock company, or association is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint stock company, or association shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same if distributed.

Returns for additional tax.

Income subject to additional tax.

B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person

Sources of taxable income.

shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent: *Provided,* That the proceeds of life insurance policies paid upon the death of the person insured or payments made by or credited to the insured, on life insurance, endowment, or annuity contracts, upon the return thereof to the insured at the maturity of the term mentioned in the contract, or upon surrender of the contract, shall not be included as income.

Deductions for normal tax.

That in computing net income for the purpose of the normal tax there shall be allowed as deductions: First, the necessary expenses actually paid in carrying on any business, not including personal, living, or family expenses; second, all interest paid within the year by a taxable person on indebtedness; third, all national, State, county, school, and municipal taxes paid within the year, not including those assessed against local benefits; fourth, losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise; fifth, debts due to the taxpayer actually ascertained to be worthless and charged off within the year; sixth, a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the computation is made: But no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for

which an allowance is or has been made: *Provided,* that no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate; seventh, the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association, or insurance company which is taxable upon its net income as hereinafter provided; eighth, the amount of income, the tax upon which has been paid or withheld for payment at the source of the income, under the provisions of this section, provided that whenever the tax upon the income of a person is required to be withheld and paid at the source as hereinafter required, if such annual income does not exceed the sum of $3,000 or is not fixed or certain, or is indefinite, or irregular as to amount or time of accrual, the same shall not be deducted in the personal return of such person.

Income from property of nonresidents.

The net income from property owned and business carried on in the United States by persons residing elsewhere shall be computed upon the basis prescribed in this paragraph and that part of paragraph G of this section relating to the computation of the net income of corporations, joint-stock and insurance companies, organized, created, or existing under the laws of foreign countries, in so far as applicable.

Exemptions.

That in computing net income under this section there shall be excluded the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States; also the compensation of the present President of the United States during the term for which he has been elected, and of the judges of the supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State or any political subdivision thereof except when such compensation is paid by the United States Government.

Deductions from amount of net income.

C. That there shall be deducted from the amount of the net income of each of said persons, ascertained as provided

herein, the sum of $3,000, plus $1,000 additional if the person making the return be a married man with a wife living with him, or plus the sum of $1,000 additional if the person making the return be a married woman with a husband living with her; but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife: *Provided*, That only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together.

Period for computation of tax.

D. The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first; Provided, however, that for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions herein provided for. On or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, a true and accurate return, under oath or affirmation, shall be made by each person of lawful age, except as hereinafter provided, subject to the tax imposed by this section, and having a net income of $3,000 or over for the taxable year, to the collector of internal revenue for the district in which such person resides or has his principal place of business, or, in the case of a person residing in a foreign country, in the place where his principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources and from the total thereof, deducting the aggregate items or expenses and allowance herein authorized; guardians, trustees, executors, administrators, agents, receivers, conservators, and all

Time and place for return.

Form and contents of return.

Returns by guardians, trustees, etc.

persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals; *Provided*, that a return made by one of two or more joint guardians, trustees, executors, administrators, agents, receivers, and conservators, or other persons acting in a fiduciary capacity, filed in the district where such person resides, or in the district where the will or other instrument under which he acts is recorded, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph; and also all persons, firms, companies, copartnerships, corporations, joint stock companies or associations, and insurance companies, except as hereinafter provided, in whatever capacity acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income of another person subject to tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal income tax upon the same and make and render a return, as aforesaid, but separate and distinct, of the portion of the income of each person from which the normal tax has been thus withheld, and containing also the name and address of such person or stating that the name and address or the address, as the case may be, are unknown; *Provided*, that the provision requiring the normal tax of individuals to be withheld at the source of the income shall not be construed to require any of such tax to be withheld prior to the first day of November, 1913: Provided further, that in either case above mentioned no return of income not exceeding $3,000 shall be required: Provided further, that any persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of

Returns by persons, etc., having control, etc., of income of another.

Returns by partners.

a partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid, under the provisions of this section, and any such firm, when requested by the Commissioner of Internal Revenue, or any district collector, shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same, if distributed: Provided further, that persons liable for the normal income tax only, on their own account or in behalf of another, shall not be required to make return of the income derived from dividends on the capital stock or from the net earnings of corporations, joint-stock companies or associations, and insurance companies taxable upon their net income as hereinafter provided. Any person for whom return has been made and the tax paid, or to be paid as aforesaid, shall not be required to make a return unless such person has other net income, but only one deduction of $3,000 shall be made in the case of any such person. The collector or deputy collector shall require every list to be verified by the oath or affirmation of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly. If dissatisfied with the decision of the collector, such person may submit the case, with all the papers, to the Commissioner of Internal Revenue for his decision, and may furnish sworn testimony of witnesses to prove any relevant facts.

Returns of certain dividends, etc., not required.

Returns to be verified.

Returns understating income.

E. That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of

Assessment and payment.

June, except in cases of refusal or neglect to make such return and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid, and interest at the rate of 1 per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

Penalty and interest on non-payment.

Payment of normal tax at source.

All persons, firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual gains, profits, and income of another person, exceeding $3,000 for any taxable year, other than dividends on capital stock, or from the net earnings of corporations and joint-stock companies or associations subject to like tax, who are required to make and render a return in behalf of another, as provided herein, to the collector of his, her, or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits and income such sum as will be sufficient to pay the normal tax imposed thereon by this section, and shall pay

to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax.

Deduction from amount of income, where tax paid at source.

In all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source, as aforesaid, such person shall not receive the deduction and benefit of the exemption allowed in paragraph C of this section except by an application for refund of the tax unless he shall, not less than thirty days prior to the day on which the return of his income is due, file with the person who is required to withhold and pay tax for him, a signed notice in writing claiming the benefit of such exemption and thereupon no tax shall be withheld upon the amount of such exemption: *Provided,* That if any person for the purpose of obtaining any allowance or reduction by virtue of a claim for such exemption, either for himself or for any other person, knowingly makes any false statement or false or fraudulent representation, he shall be liable to a penalty of $300; nor shall any person under the foregoing conditions be allowed the benefit of any deduction provided for in subsection B of this section unless he shall, not less than thirty days prior to the day on which the return of his income is due, either file with the person who is required to withhold and pay tax for him a true and correct return of his annual gains, profits, and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the person required to withhold and pay the tax, likewise make application for deductions to the collector of the district in which return is made or to be made for him: *Provided further,* That if such person is a minor or an insane person, or is absent from the United States, or is unable owing to serious illness to make the return and application above provided for, the return and application may be made for him or her by the person required to withhold and pay the tax, he making

Penalty for false statement for deduction.

Deduction for exempt income, where tax paid at source.

oath under the penalties of this act that he has sufficient knowledge of the affairs and property of his beneficiary to enable him to make a full and complete return for him or her, and that the return and application made by him are full and complete: *Provided further,* That the amount of the normal tax hereinbefore imposed shall be deducted and withheld from fixed and determinable annual gains, profits, and income derived from interest upon bonds, and mortgages, or deeds of trust, or other similar obligations of corporations, joint-stock companies or associations, insurance companies, whether payable annually or at shorter or longer periods, although such interest does not amount to $3,000, subject to the provisions of this section requiring the tax to be withheld at the source and deducted from annual income and paid to the Government; and likewise the amount of such tax shall be deducted and withheld from coupons, checks, or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations, and insurance companies engaged in business in foreign countries; and the tax in each case shall be withheld and deducted for and in behalf of any person subject to the tax hereinbefore imposed, although such interest, dividends, or other compensation does not exceed $3,000, by any banker or person who shall sell or otherwise realize coupons, checks, or bills of exchange drawn or made in payment of any such interest or dividends (not payable in the United States), and any person who shall obtain payment (not in the United States), in behalf of another of such dividends and interest by means of coupons, checks, or bills of exchange, and also any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States), otherwise than

Withholding amount of normal tax at source, on interest, etc., less than $3,000.

from a banker or another dealer in such coupons; but in each case the benefit of the exemption and the deduction allowable under this section may be had by complying with the foregoing provisions of this paragraph.

License and regulation of collection of foreign payments of interest, etc.

All persons, firms, or corporations undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to ascertain and verify the due withholding and payment of the income tax required to be withheld and paid as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and any person who shall undertake to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding $5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

Person taxable not to be released.

Nothing in this section shall be construed to release a taxable person from liability from income tax nor shall any contract entered into after this Act takes effect be valid in regard to any Federal income tax imposed upon a person liable to such payment.

Assessment not falling under foregoing provisions.

The tax herein imposed upon annual gains, profits and income not falling under the foregoing and not returned and paid by virtue of the foregoing shall be assessed by personal return under rules and regulations prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury.

Payment at source, of normal tax, only.

The provisions of this section relating to the deduction and payment of the tax at the source of income shall only apply to the normal tax hereinbefore imposed upon individuals.

Failure to make return; penalty.

F. That if any person, corporation, joint-stock company, association, or insurance company liable to make the return or pay the tax aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, such person shall be liable to a penalty of not less than $20 nor more than $1,000. Any person or any officer of any corporation required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this section to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

False, etc., return; punishment.

Normal tax on corporations, etc.

G. (a) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, but not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income arising or accruing by it from business transacted and capital invested within the United States during such year: *Provided, however,* That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations operating under the lodge system, or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members, nor to domestic building and loan associations, nor to cemetery companies, organized and operated

Exceptions of certain organizations, etc.

exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, nor to business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare: *Provided further*, That there shall not be taxed under this section any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of the State, Territory, or the District of Columbia, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of the State or Territory, has, prior to the passage of this Act, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this Act upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this section upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

Exemption of income from public utility, etc.

Deductions by corporations, etc.

(*b*) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and

Expenses.

necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the

Losses.

continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts:

Mutual fire insurance companies; premium deposits.

Provided further, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further,* That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include

Mutual marine insurance companies; premiums.

as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year: *Provided,* That in case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation, joint stock company, or association, the total interest secured and paid by such company, corporation, or association within the year on any such indebtedness may be deducted as a part of its expense of doing business: *Provided further,* That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; and in the case of a bank, banking association, loan, or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country: *Provided,* That in the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income accrued within the year from business

Interest on indebtedness.

Taxes.

Foreign corporations, etc.

transacted and capital invested within the United States, (first)
Expenses. all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use of possession of property; (second) all
Losses. losses actually sustained within the year in business conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear or property, if any, and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*
Mutual fire insurance companies; premium deposits. *further,* That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment
Mutual marine insurance companies; premiums. of losses and expenses and reinsurance reserves: *Provided further,* That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any indi-

vidual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding the proportion of one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital employed in the business at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided,* that in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State, or Territory thereof, or the District of Columbia. In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

Interest on indebtedness.

Taxes.

Assessment insurance companies.

The tax herein imposed shall be computed upon its entire net income accruing during each preceding calendar year ending December thirty-first: *Provided,* however, that for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be imposed upon its entire net income accruing during that portion of said year from March first to December thirty-first, both dates inclusive, to be ascertained by taking five-sixths of its entire net income for said calendar year: *Provided* further, that any corporation, joint-stock company or association, or insurance company subject to this tax may designate the last day of any month in the year as

Period for computation of tax on corporation, etc.

Computation based on fiscal year of corporation, etc.

the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the date upon which its annual return shall be filed. All corporations, joint-stock companies or associations, and insurance companies subject to the tax herein imposed, computing taxes upon the income of the calendar year, shall, on or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, and all corporations, joint-stock companies or associations, and insurance companies, computing taxes upon the income of a fiscal year which it may designate in the manner hereinbefore provided, shall render a like return within sixty days after the close of its said fiscal year, and within sixty days after the close of its fiscal year in each year thereafter, or in the case of a corporation, joint-stock company or association, or insurance company, organized or existing under the laws of a foreign country, in the place where its principal business is located within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, shall render a true and accurate return under oath or affirmation of its president, vice president, or other principal officer, and its treasurer or assistant treasurer, to the collector of internal revenue for the district in which it has its principal place of business, setting forth (first) the total amount of its paid-up capital stock outstanding, or if no capital stock, its capital employed in business, at the close of the year; (second) the total amount of its bonded and other indebted-

Time and place of returns by corporations, etc.

Form and contents of returns by corporations, etc.

Capital.

Indebtedness.

ness at the close of the year; (third) the gross amount of its income, received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and capital invested within the United States; (fourth) the total amount of all its ordinary and necessary expenses paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint-stock company or association, or insurance company within the year, stating separately all rentals or other payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States; (fifth) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further,* That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further,* That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in the deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between

Gross income.

Expenses.

Losses.

Mutual fire insurance companies.

Mutual marine insurance companies.

the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; and in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States, not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further,* That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further,* That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of

Life insurance companies.

Foreign corporations, etc.

Mutual fire insurance companies.

Mutual marine insurance companies.

Life insurance companies.

such individual policyholder, within such year; (sixth) the amount of interest accrued and paid within the year on its bonded or other indebtedness not exceeding one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock, outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of indebtedness not exceeding the amount of capital employed in the business at the close of the year, and in the case of a bank, banking association, or trust company, stating separately all interest paid by it within the year on deposits; or in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, interest so paid on its bonded or other indebtedness to an amount of such bonded or other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of capital employed in the business at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States; (seventh) the amount paid by it within the year for taxes imposed under the authority of the United States and separately the amount so paid by it for taxes imposed by the Government of any foreign country; (eighth) the net income of such corporation, joint-stock company or association, or insurance company, after making the deductions in this subsection authorized. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue.

Interest.

Foreign corporations, etc.

Taxes.

Net income.

All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on

Assessment and payment.

Computation based on fiscal year of corporation, etc.

or before the thirtieth day of June: *Provided,* That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and twenty days after the date upon which it is required to file its list or return of income for assessment; except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, or after one hundred and twenty days from the date on which the return of income is required to be made by the taxpayer, and for ten days after notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid and interest at the rate of 1 per centum per month upon said tax from the time the same becomes due.

Penalty and interest on tax unpaid.

Returns filed as records.

(d) When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided,* That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: *Provided* further, that the proper officers of any State im-

Inspection of or access to returns.

posing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint-stock company, association or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe.

Failure to make return, false, etc., return; penalty.

If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000.

Words "State" "United States," construed.

H. That the word "State" or "United States" when used in this section shall be construed to include any Territory, Alaska, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions.

R. S. §§ 3167, 3172, 3173, 3176, amended.

J. That sections thirty-one hundred and sixty-seven, thirty-one hundred and seventy-two, thirty-one hundred and seventy-three, and thirty-one hundred and seventy-six of the Revised Statutes of the United States as amended are hereby amended so as to read as follows:

Revenue officers disclosing operations of manufacturers, income tax returns, etc., punishable.

"Sec. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return by any person or corporation, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any

person to print or publish in any manner whatever not provided by law any income return or any part thereof or the amount or source of income profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office and be incapable thereafter of holding any office under the Government.

Canvass of districts for objects of taxation.

"Sec. 3172. Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects.

Annual returns of persons liable to tax.

"Sec. 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, in case of a special tax, on or before the thirty-first day of July in each year, in case of income tax on or before the first day of March in each year, and in other cases before the day on which the taxes accrue, to make a list or return, verified by oath or affirmation, to the collector or a deputy collector of the district where located, of the articles or objects, including the amount of annual income charged with a duty or tax, the quantity of goods, wares, and merchandise made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, association, or corporation is liable: *Provided,* That if any person liable to pay any duty or tax, or owning, possessing, or hav-

ing the care or management of property, goods, wares, and merchandise, articles or objects liable to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being distinctly read, consented to, and signed and verified by oath or affirmation by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such person: *Provided further,* That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath or affirmation. And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector, is false or fraudulent, or contains any undervaluation or understatement, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person, or any other

person he may deem proper, to appear before him and produce such books, at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects liable to tax or the returns thereof. The collector may summon any person residing or found within the State in which his district lies; and when the person intended to be summoned does not reside and can not be found within such State, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned.

When collector may enter premises and make returns.

"Sec. 3176. When any person, corporation, company or association refuses or neglects to render any return or list required by law, or renders a false or fraudulent return or list, the collector or any deputy collector shall make, according to the best information which he can obtain, including that derived from the evidence elicited by the examination of the collector, and on his own view and information, such list or return, according to the form prescribed, of the income, property, and objects liable to tax owned or possessed or under the care or management of such person or corporation, company or association, and the Commissioner of Internal Revenue shall assess all taxes not paid by stamps, including the amount, if any, due for special tax, income or other tax, and in case of any return of a false or fraudulent list or valuation intentionally he shall add 100 per centum to such tax; and in case of a refusal or neglect, except in cases of sickness or absence, to make a list or return, or to verify the same as aforesaid, he shall add 50 per centum to such tax. In case of neglect occasioned by sickness or absence as aforesaid the collector may allow such further time for making and delivering such list or return as he may deem necessary, not exceeding thirty days. The amount so added to the tax shall be collected at the same time and in the same manner

as the tax unless the neglect or falsity is discovered after the tax has been paid, in which case the amount so added shall be collected in the same manner as the tax; and the list or return so made and subscribed by such collector or deputy collector shall be held prima facie good and sufficient for all legal purposes."

Collectors' receipts for taxes; effect as evidence, etc.

K. That it shall be the duty of every collector of internal revenue, to whom any payment of any taxes other than the tax represented by an adhesive stamp or other engraved stamp is made under the provisions of this section, to give to the person making such payment a full written or printed receipt, expressing the amount paid and the particular account for which such payment was made; and whenever such payment is made such collector shall, if required, give a separate receipt for each tax paid by any debtor, on account of payments made to or to be made by him to separate creditors in such form that such debtor can conveniently produce the same separately to his several creditors in satisfaction of their respective demands to the amounts specified in such receipts; and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding the amount therein expressed from his next payment to his creditor; but such creditor may, upon giving to his debtor a full written receipt, acknowledging the payment to him of whatever sum may be actually paid, and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

Jurisdiction of district courts.

L. That jurisdiction is hereby conferred upon the district courts of the United States for the district within which any person summoned under this section to appear to testify or to produce books shall reside, to compel such attendance, production of books, and testimony by appropriate process.

Administrative, etc., provisions applicable.

M. That all administrative, special, and general provisions of law, including the laws in relation to the assessment,

remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this section, are hereby extended and made applicable to all the provisions of this section and to the tax herein imposed.

Provisions extended to Porto Rico and Philippine Islands.

N. That the provisions of this section shall extend to Porto Rico and the Philippine Islands: *Provided,* That the administration of the law and the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal-revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general governments, thereof, respectively: *And provided further,* That the jurisdiction in this section conferred upon the district courts of the United States shall, so far as the Philippine Islands are concerned, be vested in the courts of the first instance of said islands: *And provided further,* that nothing in this section shall be held to exclude from the computation of the net income the compensation paid any official by the governments of the District of Columbia, Porto Rico, and the Philippine Islands or the political subdivisions thereof.

Appropriation for carrying provisions into effect.

O. That for the purpose of carrying into effect the provisions of Section II of this Act, and to pay the expenses of assessing and collecting the income tax therein imposed, and to pay such sums as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may deem necessary, for information, detection, and bringing to trial and punishment persons guilty of violating the provisions of this section, or conniving at the same, in cases where such expenses are not otherwise provided for by law, there is hereby appropriated out of any money in the Treasury not otherwise appropriated for the fiscal year ending June thirtieth, nineteen hundred and fourteen, the sum of $800,000, and the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized to ap-

point and pay from this appropriation all necessary officers, agents, inspectors, deputy collectors, clerks, messengers and janitors, and to rent such quarters, purchase such supplies, equipment, mechanical devices, and other articles as may be necessary for employment or use in the District of Columbia or any collection district in the United States, or any of the Territories thereof: *Provided,* That no agent paid from this appropriation shall receive compensation at a rate higher than that now received by traveling agents on accounts in the Internal Revenue Service, and no inspector shall receive a compensation higher than $5 a day and $3 additional in lieu of subsistence, and no deputy collector, clerk, messenger, or other employé shall be paid at a rate of compensation higher than the rate now being paid for the same or similar work in the Internal Revenue Service.

Compensation of agents, officers, etc., limited.

In the office of the Commissioner of Internal Revenue at Washington, District of Columbia, there shall be appointed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, one additional deputy commissioner, at a salary of $4,000 per annum; two heads of divisions, whose compensation shall not exceed $2,500 per annum; and such other clerks, messengers, and employés, and to rent such quarters and to purchase such supplies as may be necessary: *Provided,* That for a period of two years from and after the passage of this Act the force of agents, deputy collectors, inspectors, and other employés not including the clerical force below the grade of chief of division employed in the Bureau of Internal Revenue in the city of Washington, District of Columbia, authorized by this section of this Act shall be appointed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, under such rules and regulations as may be fixed by the Secretary of the Treasury to insure faithful and competent service, and with such compensation as the Commissioner of Internal Revenue may fix, with the approval of the

Additional officers, clerks, etc., in office of Commissioner of Internal Revenue.

Appointment of agents, officers, etc.

Secretary of the Treasury, within the limitations herein prescribed: *Provided further,* That the force authorized to carry out the provisions of Section II of this Act, when not employed as herein provided, shall be employed on general internal-revenue work.

Employment of authorized force.

Inconsistent provisions repealed.

T. That, except as hereinafter provided, sections one to forty-two, both inclusive, of an Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August fifth, nineteen hundred and nine, and all Acts and parts of Acts inconsistent with the provisions of this Act, are hereby repealed: *Provided* * * * that all excise taxes upon corporations imposed by section thirty-eight [of the Act of August 5, 1909] that have accrued or have been imposed for the year ending December thirty-first, nineteen hundred and twelve, shall be returned, assessed, and collected in the same manner, and under the same provisions, liens, and penalties as if section thirty-eight continued in full force and effect: *And provided further,* that a special excise tax with respect to the carrying on or doing of business, equivalent to 1 per centum upon their entire net income, shall be levied, assessed, and collected upon corporations, joint stock companies or associations, and insurance companies, of the character described in section thirty-eight of the Act of August fifth, nineteen hundred and nine, for the period from January first to February twenty-eighth, nineteen hundred and thirteen, both dates inclusive, which said tax shall be computed upon one-sixth of the entire net income of said corporations, joint stock companies or associations, and insurance companies, for said year, said net income to be ascertained in accordance with the provisions of subsection G of section two of this Act: *Provided further,* That the provisions of said section thirty-eight of the Act of August fifth, nineteen hundred and nine, relative to the collection of the tax therein

Taxes on corporations accrued not affected.

Special excise tax on corporations, etc., for period Jan. 1 to Feb. 28, 1913.

Provisions of special excise tax law applicable.

imposed shall remain in force for the collection of the excise tax herein provided, but for the year nineteen hundred and thirteen it shall not be necessary to make more than one return and assessment for all the taxes imposed herein upon said corporations, joint stock companies or associations, and insurance companies, either by way of income or excise, which return and assessment shall be made at the times and in the manner provided in this Act; but the repeal of existing laws or modifications thereof embraced in this Act shall not affect any act done, or any right accruing or accrued, or any suit or proceeding had or commenced in any civil case before the said repeal or modification; but all rights and liabilities under said laws shall continue and may be enforced in the same manner as if said repeal or modifications had not been made. Any offenses committed and all penalties or forfeitures or liabilities incurred prior to the passage of this Act under any statute embraced in or changed, modified, or repealed by this Act may be prosecuted or punished in the same manner and with the same effect as if this Act had not been passed. No Acts of limitation now in force, whether applicable to civil causes or to the prosecution of offenses or for the recovery of penalties or forfeitures embraced in or modified, changed, or repealed by this Act shall be affected thereby, so far as they affect any suits, proceedings, or prosecutions, whether civil or criminal, for causes arising or acts done or committed prior to the passage of this Act, which may be commenced and prosecuted within the same time and with the same effect as if this Act had not been passed.

Limitation of effect of repeal, etc., of existing laws.

UNITED STATES CORPORATION EXCISE TAX LAW OF 1909

Act of Congress, August 5, 1909, 36 Stat. 112, U. S. Comp. Stat. Supp. 1909, p. 844

§ 38. "That every corporation, joint stock company, or association organized for profit and having a capital stock represented by shares, and every insurance company now or hereafter organized under the laws of the United States or of any state or territory of the United States, or under the acts of Congress applicable to Alaska or the District of Columbia, or now or hereafter organized under the laws of any foreign country, and engaged in business in any state or territory of the United States or in Alaska or in the District of Columbia, shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint stock company, or association, or insurance company, equivalent to one per centum upon the entire net income over and above five thousand dollars, received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies subject to the tax hereby imposed; or, if organized under the laws of any foreign country, upon the amount of net income over and above five thousand dollars received by it from business transacted and capital invested within the United States and its territories, Alaska, and the District of Columbia, during such year, exclusive of amounts so received by it as dividends upon stock of other corporations, joint stock companies or associations or insurance companies subject to the tax hereby imposed: Provided, however, that nothing in this section contained shall apply to labor, agricultural or horticultural organizations, or to fraternal beneficiary societies,

orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders or associations, and dependents of such members, nor to domestic building and loan associations, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association, or trust company, all interest actually paid by it within the year on deposits; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any state or territory thereof, or imposed by the government of any foreign country

as a condition to carry on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed: Provided, that in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the District of Columbia, (first) all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States and its territories, Alaska, and the District of Columbia, including all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year in business conducted by it within the United States or its territories, Alaska, or the District of Columbia not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness, not exceeding the proportion of its paid-up capital stock outstanding at the close of the year which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the District of Columbia bears to the gross amount of its income derived from all sources within and without the United States; (fourth) the sums paid by it within the year for taxes imposed under the authority of the United States or of any state

or territory thereof; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, and insurance companies, subject to the tax hereby imposed. In the case of assessment insurance companies the actual deposit of sums with state or territorial officers, pursuant to law, as additions to guaranty or reserve funds shall be treated as being payments required by law to reserve funds.

Third. There shall be deducted from the amount of the net income of each of such corporations, joint stock companies or associations, or insurance companies, ascertained as provided in the foregoing paragraphs of this section, the sum of five thousand dollars, and said tax shall be computed upon the remainder of said net income of such corporation, joint stock company or association, or insurance company, for the year ending December thirty-first, nineteen hundred and nine, and for each calendar year thereafter; and on or before the first day of March, nineteen hundred and ten, and the first day of March in each year thereafter, a true and accurate return under oath or affirmation of its president, vice-president, or other principal officer, and its treasurer or assistant treasurer, shall be made by each of the corporations, joint stock companies or associations, and insurance companies, subject to the tax imposed by this section, to the collector of internal revenue for the district in which such corporation, joint stock company or association, or insurance company has its principal place of business, or, in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, in the place where its principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth (first) the total amount of the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year;

(second) the total amount of the bonded and other indebtedness of such corporation, joint stock company or association, or insurance company at the close of the year; (third) the gross amount of the income of such corporation, joint stock company or association, or insurance company, received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the District of Columbia; also the amount received by such corporation, joint stock company or association, or insurance company within the year by way of dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax imposed by this section; (fourth) the total amount of all the ordinary and necessary expenses actually paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint stock company or association, or insurance company within the year, stating separately all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States and its territories, Alaska, and the District of Columbia; (fifth) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the case of insurance companies the sums other than dividends paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; and in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States

or its territories, Alaska, and the District of Columbia, not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the case of insurance companies the sums other than dividends paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve fund; (sixth) the amount of interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association, or trust company, stating separately all interest paid by it within the year on deposits; or in case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, interest so paid on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the District of Columbia, bears to the gross amount of its income derived from all sources within and without the United States; (seventh) the amount paid by it within the year for taxes imposed under the authority of the United States or any state or territory thereof, and separately the amount so paid by it for taxes imposed by the government of any foreign country as a condition to carrying on business therein; (eighth) the net income of such corporation, joint stock company or association, or insurance company, after making the deductions in this section authorized. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue.

Fourth. Whenever evidence shall be produced before the

Commissioner of Internal Revenue which in the opinion of the Commissioner justifies the belief that the return made by any corporation, joint stock company or association, or insurance company is incorrect, or whenever any collector shall report to the Commissioner of Internal Revenue that any corporation, joint stock company or association, or insurance company has failed to make a return as required by law, the Commissioner of Internal Revenue may require from the corporation, joint stock company or association, or insurance company making such return, such further information with reference to its capital, income, losses, and expenditures as he may deem expedient; and the Commissioner of Internal Revenue, for the purpose of ascertaining the correctness of such return or for the purpose of making a return where none has been made, is hereby authorized, by any regularly appointed revenue agent specially designated by him for that purpose, to examine any books and papers bearing upon the matters required to be included in the return of such corporation, joint stock company or association, or insurance company, and to require the attendance of any officer or employee of such corporation, joint stock company or association, or insurance company, and to take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons; and the Commissioner of Internal Revenue may also invoke the aid of any court of the United States having jurisdiction to require the attendance of such officers or employees and the production of such books and papers. Upon the information so acquired the Commissioner of Internal Revenue may amend any return or make a return where none has been made. All proceedings taken by the Commissioner of Internal Revenue under the provisions of this section shall be subject to the approval of the Secretary of the Treasury.

Fifth. All returns shall be retained by the Commissioner of Internal Revenue, who shall make assessments thereon;

and in case of any return made with false or fraudulent intent, he shall add one hundred per centum of such tax, and in case of a refusal or neglect to make a return or to verify the same as aforesaid he shall add fifty per centum of such tax. In case of neglect occasioned by the sickness or absence of an officer of such corporation, joint stock company or association, or insurance company, required to make said return, or for other sufficient reason, the collector may allow such further time for making and delivering such return as he may deem necessary, not exceeding thirty days. The amount so added to the tax shall be collected at the same time and in the same manner as the tax originally assessed, unless the refusal, neglect, or falsity is discovered after the date for payment of said taxes, in which case the amount so added shall be paid by the delinquent corporation, joint stock company or association, or insurance company, immediately upon notice given by the collector. All assessments shall be made and the several corporations, joint stock companies or associations, or insurance companies, shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as above provided for, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the

rate of one per centum per month upon said tax from the time the same becomes due.

[NOTE. This subdivision of the section was amended by Act of Congress, March 3, 1913, by providing as follows: "Any corporation, joint stock company, association, or any insurance company subject to the special excise tax provided by section thirty-eight of the act of August fifth, nineteen hundred and nine, known as the special excise corporation-tax law, which has been or may be compelled to pay or become liable for any additional tax within the provisions of subsection five of said section thirty-eight, which additional tax has been or may hereafter be imposed for a neglect to file a return as provided in said corporation-tax law on or before the first of March of any year, may, within one year after the passage of this act, or within one year after the date of notice of assessment where such notice is given after the passage of this act, make application to the Commissioner of Internal Revenue for a refund of such additional tax. And the Commissioner of Internal Revenue, with the advice and consent of the Solicitor of Internal Revenue, is hereby directed to remit, abate, or pay back all such additional taxes in excess of $100 for any single year whenever in any case it appears to his satisfaction that the additional tax was assessed or imposed solely because of a neglect to make a return at the time or times specified in said act, and without any intention or design on the part of any officer of such corporation, joint-stock company, association, or insurance company to hinder or delay the United States in the collection of the tax originally assessed."]

Sixth. When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue, and shall constitute public records and be open to public inspection as such.

[NOTE. This subdivision of the section was amended by Act of Congress of June 17, 1910, Stat. at L., 2d Sess. 61st Cong. 494, chap. 297, by adding the following words "That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President."]

Seventh. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or make known in any manner whatever not provided by law to any person any information obtained by him in the discharge of his official duty, or to divulge or make known in any manner not provided by law any document received, evidence taken, or report made under this section except upon the special direction of the President; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding one thousand dollars, or by imprisonment not exceeding one year, or both, at the discretion of the court.

Eighth. If any of the corporations, joint stock companies or associations, or insurance companies aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint stock company or association, or insurance company shall be liable to a penalty of not less than one thousand dollars and not exceeding ten thousand dollars.

Any person authorized by law to make, render, sign, or verify any return, who makes any false or fraudulent return, or statement, with intent to defeat or evade the assessment required by this section to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding one thousand dollars or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

All laws relating to the collection, remission, and refund

of internal-revenue taxes, so far as applicable to and not inconsistent with the provisions of this section, are hereby extended and made applicable to the tax imposed by this section.

Jurisdiction is hereby conferred upon the circuit and district courts of the United States for the district within which any person summoned under this section to appear to testify or to produce books as aforesaid, shall reside, to compel such attendance, production of books, and testimony by appropriate process.

FEDERAL INCOME TAX LAW OF 1894

Act of Congress, August 27, 1894, 28 Stat. 509, c. 349

Section 27. That from and after the first day of January, eighteen hundred and ninety-five, and until the first day of January, nineteen hundred, there shall be assessed, levied, collected and paid annually upon the gains, profits, and income received in the preceding calendar year by every citizen of the United States, whether residing at home or abroad, and every person residing therein, whether said gains, profits, or income be derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever, a tax of two per centum on the amount so derived over and above four thousand dollars, and a like tax shall be levied, collected, and paid annually upon the gains, profits, and income from all property owned and of every business, trade, or profession carried on in the United States by persons residing without the United States. And the tax herein provided for shall be assessed by the Commissioner of Internal Revenue, and collected and paid, upon the gains, profits, and income for the year ending the thirty-first day of December next preceding the time for levying, collecting, and paying said tax.

Section 28. That in estimating the gains, profits, and income of any person there shall be included all income derived from interest upon notes, bonds, and other securities, except such bonds of the United States the principal and interest of which are by the law of their issuance exempt from all federal taxation; profits realized within the year from sales of real estate purchased within two years previous to the close of the year for which income is estimated; interest received or accrued upon all notes, bonds, mortgages, and other forms of indebtedness bearing interest, whether paid or not, if good and collectible, less the interest which has become due from said person or which has been paid by him during the year; the amount of all premium on all bonds, notes, or coupons; the amount of sales of live stock, sugar, cotton, wool, butter, cheese, pork, beef, mutton, or other meats, hay, and grain, or other vegetable or other productions, being the growth or produce of the estate of such person, less the amount expended in the purchase or production of said stock or produce, and not including any part thereof consumed directly by the family; money and the value of all personal property acquired by gift or inheritance; all other gains, profits, and income derived from any source whatever, except that portion of the salary, compensation or pay received for services in the civil, military, naval, or other service of the United States, including senators, representatives, and delegates in Congress, from which the tax has been deducted, and except that portion of any salary upon which the employer is required by law to withhold, and does withhold, the tax and pays the same to the officer authorized to receive it. In computing incomes the necessary expenses actually incurred in carrying on any business, occupation, or profession shall be deducted and also all interest due or paid within the year by such person on existing indebtedness. And all national, state, county, school, and municipal taxes, not in-

cluding those assessed against local benefits, paid within the year shall be deducted from the gains, profits, or income of the person who has actually paid the same, whether such person be owner, tenant, or mortgagor; also losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise, and debts ascertained to be worthless, but excluding all estimated depreciation of values and losses within the year on sales of real estate purchased within two years previous to the year for which income is estimated: Provided, that no deduction shall be made for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate: Provided, further, that only one deduction of four thousand dollars shall be made from the aggregate income of all the members of any family, composed of one or both parents, and one or more minor children, or husband and wife; that guardians shall be allowed to make a deduction in favor of each and every ward, except that in case where two or more wards are comprised in one family, and have joint property interests, the aggregate deduction in their favor shall not exceed four thousand dollars: and provided further, that in case where the salary or other compensation paid to any person in the employment or service of the United States shall not exceed the rate of four thousand dollars per annum, or shall be by fees, or uncertain or irregular in the amount or in the time during which the same shall have accrued or been earned, such salary or other compensation shall be included in estimating the annual gains, profits, or income of the person to whom the same shall have been paid, and shall include that portion of any income or salary upon which a tax has not been paid by the employer, where the employer is required by law to pay on the excess over four thousand dollars: Provided also, that in computing the income of any person, corpora-

tion, company, or association, there shall not be included the amount received from any corporation, company, or association as dividends upon the stock of such corporation, company, or association, if the tax of two per centum has been paid upon its net profits by said corporation, company, or association as required by this act.

Section 29. That it shall be the duty of all persons of lawful age having an income of more than three thousand five hundred dollars for the taxable year, computed on the basis herein prescribed, to make and render a list or return, on or before the day provided by law, in such form and manner as may be directed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to the collector or a deputy collector of the district in which they reside, of the amount of their income, gains, and profits, as aforesaid; and all guardians and trustees, executors, administrators, agents, receivers, and all persons or corporations acting in any fiduciary capacity shall make and render a list or return, as aforesaid, to the collector or a deputy collector of the district in which such person or corporation acting in a fiduciary capacity resides or does business, of the amount of income, gains, and profits of any minor or person for whom they act, but persons having less than three thousand five hundred dollars income are not required to make such report; and the collector or deputy collector shall require every list or return to be verified by the oath or affirmation of the party rendering it, and may increase the amount of any list or return if he has reason to believe that the same is understated; and in case any such person having a taxable income shall neglect or refuse to make and render such list and return, or shall render a wilfully false or fraudulent list or return, it shall be the duty of the collector or deputy collector to make such list according to the best information he can obtain, by the examination of such person, or any other evidence, and to add fifty per centum as a penalty to

the amount of the tax due on such list in all cases of wilfull neglect or refusal to make and render a list or return; and in all cases of a wilfully false or fraudulent list or return having been rendered to add one hundred per centum as a penalty to the amount of tax ascertained to be due, the tax and the additions thereto as a penalty to be assessed and collected in the manner provided for in other cases of willful neglect or refusal to render a list or return, or of rendering a false or fraudulent return. Provided, that any person or corporation in his, her, or its own behalf, or as such fiduciary, shall be permitted to declare, under oath or affirmation, the form and manner of which shall be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, that he, she, or his or her, or its ward or beneficiary, was not possessed of an income of four thousand dollars, liable to be assessed according to the provisions of this act; or may declare that he, she, or it, or his, her, or its ward or beneficiary has been assessed and has paid an income tax elsewhere in the same year, under authority of the United States, upon all his, her, or its income, gains, or profits, and upon all the income, gains, or profits for which he, she, or it is liable as such fiduciary, as prescribed by law; and if the collector or deputy collector shall be satisfied of the truth of the declaration, such person or corporation shall thereupon be exempt from income tax in the said district for that year; or if the list or return of any person or corporation, company, or association shall have been increased by the collector or deputy collector, such person or corporation, company, or association may be permitted to prove the amount of income liable to be assessed; but such proof shall not be considered conclusive of the facts, and no deductions claimed in such cases shall be made or allowed until approved by the collector or deputy collector. Any person or company, corporation, or association feeling aggrieved by the decision

of the deputy collector, in such cases, may appeal to the collector of the district, and his decision thereon, unless reversed by the Commissioner of Internal Revenue, shall be final. If dissatisfied with the decision of the collector, such person or corporation, company, or association may submit the case, with all the papers, to the Commissioner of Internal Revenue for his decision, and may furnish the testimony of witnesses to prove any relevant facts, having served notice to that effect upon the Commissioner of Internal Revenue, as herein prescribed.

Such notice shall state the time and place at which, and the officer before whom, the testimony will be taken; the name, age, residence, and business of the proposed witness, with the questions to be propounded to the witness, or a brief statement of the substance of the testimony he is expected to give: Provided, that the Government may at the same time and place take testimony upon like notice to rebut the testimony of the witnesses examined by the person taxed.

The notice shall be delivered or mailed to the Commissioner of Internal Revenue a sufficient number of days previous to the day fixed for taking the testimony, to allow him, after its receipt, at least five days, exclusive of the period required for mail communication with the place at which the testimony is to be taken, in which to give, should he so desire, instructions as to the cross-examination of the proposed witness.

Whenever practicable, the affidavit or deposition shall be taken before a collector or deputy collector of internal revenue, in which case reasonable notice shall be given to the collector or deputy collector of the time fixed for taking the deposition or affidavit: Provided further, that no penalty shall be assessed upon any person or corporation, company, or association for such neglect or refusal or for making or rendering a willfully false or fraudulent return,

except after reasonable notice of the time and place of hearing, to be prescribed by the Commissioner of Internal Revenue, so as to give the person charged an opportunity to be heard.

Section 30. The taxes on incomes herein imposed shall be due and payable on or before the first day of July in each year; and to any sum or sums annually due and unpaid after the first day of July as aforesaid, and for ten days after notice and demand thereof by the collector, there shall be levied, in addition thereto, the sum of five per centum on the amount of taxes unpaid, and interest at the rate of one per centum per month upon said tax from the time the same becomes due, as a penalty, except from the estates of deceased, insane, or insolvent persons.

Section 31. Any non-resident may receive the benefit of the exemptions hereinbefore provided for by filing with the deputy collector of any district a true list of all his property and sources of income in the United States and complying with the provisions of section twenty-nine of this act as if a resident. In computing income, he shall include all income from every source, but unless he be a citizen of the United States, he shall only pay on that part of the income which is derived from any source in the United States. In case such non-resident fails to file such statement, the collector of each district shall collect the tax on the income derived from property situate in his district, subject to income tax, making no allowance for exemptions, and all property belonging to such non-resident shall be liable to distraint for tax: Provided, that non-resident corporations shall be subject to the same laws as to tax as resident corporations, and the collection of the tax shall be made in the same manner as provided for collections of taxes against non-resident persons.

Section 32. That there shall be assessed, levied, and collected, except as herein otherwise provided, a tax of

two per centum annually on the net profits or income above actual operating and business expenses, including expenses for materials purchased for manufacture or bought for resale, losses, and interest on bonded and other indebtedness, of all banks, banking institutions, trust companies, savings institutions, fire, marine, life, and other insurance companies, railroad, canal, turnpike, canal navigation, slack water, telephone, telegraph, express, electric light, gas, water, street railway companies, and all other corporations, companies, or associations doing business for profit in the United States, no matter how created and organized, but not including partnerships.

That said tax shall be paid on or before the first day of July in each year; and if the president or other chief officer of any corporation, company, or association, or in the case of any foreign corporation, company, or association, the resident manager or agent, shall neglect or refuse to file with the collector of the internal revenue district in which said corporation, company, or association shall be located or be engaged in business, a statement verified by his oath or affirmation, in such form as shall be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, showing the amount of net profits or income received by said corporation, company, or association during the whole calendar year last preceding the date of filing said statement as hereinafter required, the corporation, company, or association making default shall forfeit as a penalty the sum of one thousand dollars and two per centum on the amount of taxes due, for each month until the same is paid, the payment of said penalty to be enforced as provided in other cases of neglect and refusal to make return of taxes under the internal revenue laws.

The net profits or income of all corporations, companies, or associations shall include the amounts paid to shareholders, or carried to the account of any fund, or used for

construction, enlargement of plant, or any other expenditure or investment paid from the net annual profits made or acquired by said corporations, companies, or associations.

That nothing herein contained shall apply to states, counties, or municipalities; nor to corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes, including fraternal beneficiary societies, orders, or associations operating upon the lodge system and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members; nor to the stocks, shares, funds, or securities held by any fiduciary or trustee for charitable, religious, or educational purposes; nor to building and loan associations or companies which make loans only to their shareholders; nor to such savings banks, savings institutions or societies as shall, first, have no stockholders or members except depositors and no capital except deposits; secondly, shall not receive deposits to an aggregate amount, in any one year, of more than one thousand dollars from the same depositor; thirdly, shall not allow an accumulation or total of deposits, by any one depositor, exceeding ten thousand dollars; fourthly, shall actually divide and distribute to its depositors, ratably to deposits, all the earnings over the necessary and proper expenses of such bank, institution, or society, except such as shall be applied to surplus; fifthly, shall not possess, in any form, a surplus fund exceeding ten per centum of its aggregate deposits; nor to such savings banks, savings institutions, or societies composed of members who do not participate in the profits thereof and which pay interest or dividends only to their depositors; nor to that part of the business of any savings bank, institution, or other similar association having a capital stock that is conducted on the mutual

plan solely for the benefit of its depositors on such plan, and which shall keep its accounts or its business conducted on such mutual plan separate and apart from its other accounts.

Nor to any insurance company or association which conducts all its business solely upon the mutual plan, and only for the benefit of its policy holders or members, and having no capital stock and no stock or shareholders, and holding all its property in trust and in reserve for its policy holders or members; nor to that part of the business of any insurance company having a capital stock and stock and shareholders, which is conducted on the mutual plan, separate from its stock plan of insurance, and solely for the benefit of the policy holders and members insured on said mutual plan, and holding all the property belonging to and derived from said mutual part of its business in trust and reserve for the benefit of its policy holders and members insured on said mutual plan.

That all state, county, municipal, and town taxes paid by corporations, companies, or associations, shall be included in the operating and business expenses of such corporations, companies, or associations.

Section 33. That there shall be levied, collected, and paid on all salaries of officers, or payments for services to persons in the civil, military, naval, or other employment or service of the United States, including senators and representatives and delegates in congress, when exceeding the rate of four thousand dollars per annum, a tax of two per centum on the excess above the said four thousand dollars; and it shall be the duty of all paymasters and all disbursing officers under the government of the United States, or persons in the employ thereof, when making any payment to any officers or persons as aforesaid, whose compensation is determined by a fixed salary, or upon the settling or adjusting the accounts of such officers or persons, to deduct

and withhold the aforesaid tax of two per centum; and the pay roll, receipts, or account of officers or persons paying such tax as aforesaid shall be made to exhibit the fact of such payment. And it shall be the duty of the accounting officers of the treasury department, when auditing the accounts of any paymaster or disbursing officer, or any officer withholding his salary from moneys received by him, or when settling or adjusting the accounts of any such officer, to require evidence that the taxes mentioned in this section have been deducted and paid over to the Treasurer of the United States, or other officer authorized to receive the same. Every corporation which pays to any employé a salary or compensation exceeding four thousand dollars per annum shall report the same to the collector or deputy collector of his district and said employé shall pay thereon, subject to the exemptions herein provided for, the tax of two per centum on the excess of his salary over four thousand dollars; Provided that salaries due to state, county, or municipal officers shall be exempt from the income tax herein levied.

Section 34. That sections thirty-one hundred and sixty-seven, thirty-one hundred and seventy-two, thirty-one hundred and seventy-three, and thirty-one hundred and seventy-six of the Revised Statutes of the United States as amended are hereby amended so as to read as follows:

Section 3167. That it shall be unlawful for any collector, deputy collector, agent, clerk or other officer or employé of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return by any person or corporation, or to permit any income return or copy thereof or any book containing any abstract or

particulars thereof, to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return or any part thereof or the amount or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding one thousand dollars or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employé of the United States he shall be dismissed from office and be incapable thereafter of holding any office under the Government.

Section 3172. That every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects.

Section 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, in case of a special tax, on or before the thirty-first day of July in each year, in case of income tax on or before the first Monday of March in each year, and in other cases before the day on which the taxes accrue, to make a list or return, verified by oath or affirmation, to the collector or a deputy collector of the district where located, of the articles or objects, including the amount of annual income charged with a duty or tax, the quantity of goods, wares, and merchandise made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury,

for which such person, partnership, firm, association, or corporation is liable: Provided that if any person liable to pay any duty or tax, or owning, possessing, or having the care or management of property, goods, wares, and merchandise, articles or objects liable to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being distinctly read, consented to, and signed and verified by oath or affirmation by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such person: Provided further, that in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath or affirmation. And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector is false or fraudulent, or contains any undervaluation or understatement, it shall be lawful

for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person, or any other person he may deem proper, to appear before him and produce such books, at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects liable to tax or the returns thereof. The collector may summon any person residing or found within the state in which his district lies; and when the person intended to be summoned does not reside and cannot be found within such state, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned.

Section 3176. When any person, corporation, company, or association refuses or neglects to render any return or list required by law, or renders a false or fraudulent return or list, the collector or any deputy collector shall make, according to the best information which he can obtain, including that derived from the evidence elicited by the examination of the collector, and on his own view and information, such list or return, according to the form prescribed, of the income, property, and objects liable to tax owned or possessed or under the care or management of such person or corporation, company or association, and the Commissioner of Internal Revenue shall assess all taxes not paid by stamps, including the amount, if any, due for special tax, income or other tax, and in case of any return of a false or fraudulent list or valuation intentionally he shall add one hundred per centum to such tax; and in case of a refusal or neglect, except in cases of sickness or absence, to make a list or return, or to verify the same as aforesaid, he shall add fifty per centum to such tax. In case of neglect occasioned by sickness or absence as aforesaid the collector may allow such further time for making and deliver-

ing such list or return as he may deem necessary, not exceeding thirty days. The amount so added to the tax shall be collected at the same time and in the same manner as the tax, unless the neglect or falsity is discovered after the tax has been paid, in which case the amount so added shall be collected in the same manner as the tax; and the list or return so made and subscribed by such collector or deputy collector shall be held prima facie good and sufficient for all legal purposes.

Section 35. That every corporation, company, or association doing business for a profit shall make and render to the collector of its collection district, on or before the first Monday of March in every year, beginning with the year eighteen hundred and ninety-five, a full return, verified by oath or affirmation, in such form as the Commissioner of Internal Revenue shall prescribe, of all the following matters for the whole calendar year last preceding the date of such return:

First. The gross profits of such corporation, company, or association from all kinds of business of every name and nature.

Second. The expenses of such corporation, company, or association, exclusive of interest, annuities, and dividends.

Third. The net profits of such corporation, company, or association, without allowance for interest, annuities, or dividends.

Fourth. The amount paid on account of interest, annuities, and dividends, stated separately.

Fifth. The amount paid in salaries of four thousand dollars or less to each person employed.

Sixth. The amount paid in salaries of more than four thousand dollars to each person employed and the name and address of each of such persons and the amount paid to each.

Section 36. That it shall be the duty of every corporation, company, or association doing business for profit to keep full, regular, and accurate books of account, upon which all its

transactions shall be entered from day to day, in regular order, and whenever a collector or deputy collector of the district in which any corporation, company, or association is assessable shall believe that a true and correct return of the income of such corporation, company, or association has not been made, he shall make an affidavit of such belief and of the grounds upon which it is founded, and file the same with the Commissioner of Internal Revenue, and if said Commissioner shall, on examination thereof, and after full hearing upon notice given to all parties, conclude there is good ground for such belief, he shall issue a request in writing to such corporation, company, or association to permit an inspection of the books of such corporation, company, or association to be made; and if such corporation, company, or association shall refuse to comply with such request, then the collector or deputy collector of the district shall make from such information as he can obtain an estimate of the amount of such income, and then add fifty per centum thereto, which said assessment so made shall then be the lawful assessment of such income.

Section 37. That it shall be the duty of every collector of internal revenue, to whom any payment of any tax other than the tax represented by an adhesive stamp or other engraved stamp is made under the provisions of this act, to give to the person making such payment a full written or printed receipt, expressing the amount paid and the particular account for which such payment was made; and whenever such payment is made such collector shall, if required, give a separate receipt for each tax paid by any debtor, on account of payments made to or to be made by him to separate creditors in such form that such debtor can conveniently produce the same separately to his several creditors in satisfaction of their respective demands to the amounts specified in such receipts; and such receipts shall be sufficient evidence in favor of such debtor, to justify him in withholding the amount therein ex-

pressed from his next payment to his creditor; but such creditor may, upon giving to his debtor a full written receipt, acknowledging the payment to him of whatever sum may be actually paid, and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

[NOTE. By a joint resolution of February 21, 1895 (28 Stat. 971), the time for making returns of income for the year 1894 was extended, and it was provided that, "in computing incomes under said act the amounts necessarily paid for fire insurance premiums and for ordinary repairs shall be deducted;" and that "in computing incomes under said act the amounts received as dividends upon the stock of any corporation, company, or association shall not be included in case such dividends are also liable to the tax of two per centum upon the net profits of said corporation, company, or association, although such tax may not have been actually paid by said corporation, company, or association at the time of making returns by the person, corporation, or association receiving such dividends, and returns or reports of the names and salaries of employés shall not be required from employers unless called for by the collector in order to verify the returns of employés."]

CIVIL WAR INCOME TAX ACTS OF CONGRESS

Act of Congress August 5, 1861, ch. 45, §§ 49–51, 12 Stat. 309

Section 49. From and after the first day of January next, there shall be levied, collected, and paid, upon the annual income of every person residing within 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, if such annual income exceeds the sum of eight hundred dollars, a tax of three per centum on the amount of such excess of such income above eight hundred dollars: Provided, that upon such portion of said income as shall be derived from interest upon treasury notes or other securities of the United States, there shall be levied, collected, and paid a tax of one and one-half per centum. Upon the income, rents, or dividends accruing upon any property, securities, or stocks owned in the United States by any citizen of the United States residing abroad, there shall be levied, collected, and paid a tax of five per centum, excepting that portion of said income derived from interest on treasury notes or other securities of the Government of the United States, which shall pay one and one-half per centum. The tax herein provided shall be assessed upon the annual income of the persons hereinafter named for the year next preceding the time for assessing said tax, to wit, the year next preceding the first of January, eighteen hundred and sixty-two, and the said taxes, when so assessed and made public, shall become a lien on the property or other sources of said income for the amount of the same, with the interest and other expenses of collection until paid: Provided, that, in estimating said income, all national, state, or

local taxes assessed upon the property, from which the income is derived, shall be first deducted.

Section 50. It shall be the duty of the President of the United States, and he is hereby authorized, by and with the advice and consent of the Senate, to appoint one principal assessor and one principal collector in each of the States and Territories of the United States, and in the District of Columbia, to assess and collect the internal duties or income tax imposed by this act, with authority in each of said officers to appoint so many assistants as the public service may require, to be approved by the Secretary of the Treasury. The said taxes to be assessed and collected under such regulations as the Secretary of the Treasury may prescribe. The said collectors, herein authorized to be appointed, shall give bonds, to the satisfaction of the Secretary of the Treasury, in such sums as he may prescribe, for the faithful performance of their respective duties. And the Secretary of the Treasury shall prescribe such reasonable compensation for the assessment and collection of said internal duties or income tax as may appear to him just and proper; not, however, to exceed in any case the sum of two thousand five hundred dollars per annum for the principal officers herein referred to, and twelve hundred dollars per annum for an assistant. The assistant collectors herein provided shall give bonds to the satisfaction of the principal collector for the faithful performance of their duties. The Secretary of the Treasury is further authorized to select and appoint one or more depositaries in each State for the deposit and safe-keeping of the moneys arising from the taxes herein imposed when collected, and the receipt of the proper officer of such depository to the collector for the moneys deposited by him shall be the proper voucher for such collector in the settlement of his account at the Treasury Department. And he is further authorized and empowered to make such officer or depositary the disbursing agent of the Treasury for the payment of all interest due to the citizens

of such State upon the treasury notes or other government securities issued by authority of law. And he shall also prescribe the forms of returns to be made to the department by all assessors and collectors appointed under the authority of this act. He shall also prescribe the form of oath or obligation to be taken by the several officers authorized or directed to be appointed and commissioned by the President under this act, before a competent magistrate duly authorized to administer oaths, and the form of the return to be made thereon to the Treasury Department.

Section 51. The tax herein imposed by the forty-ninth section of this act shall be due and payable on or before the thirtieth day of June in the year 1862, and all sums due and unpaid at that day shall draw interest thereafter at the rate of six per centum per annum; and if any person or persons shall neglect or refuse to pay after due notice said tax assessed against him, her, or them, for the space of more than thirty days after the same is due and payable, it shall be lawful for any collector or assistant collector charged with the duty of collecting said tax, and they are hereby authorized, to levy the same on the visible property of any such person, or so much thereof as may be sufficient to pay such tax with the interest due thereon and the expenses incident to such levy and sale, first giving thirty days' public notice of the time and place of the sale thereof; and in case of the failure of any person or persons authorized to act as agent or agents for the collection of the rents or other income of any person residing abroad shall neglect or refuse to pay the tax assessed thereon (having had due notice) for more than thirty days after the thirtieth of June, 1862, the collector or his assistant, for the district where such property is located, or rents or income is payable, shall be and is hereby authorized to levy upon the property itself, and to sell the same, or so much thereof as may be necessary to pay the tax assessed, together with the interest and expenses incident to such levy and sale, first giv-

ing thirty days' public notice of the time and place of sale. And in all cases of the sale of property herein authorized, the conveyance by the officer authorized to make the sale, duly executed, shall give a valid title to the purchaser, whether the property sold shall be real or personal. And the several collectors and assistants appointed under the authority of this act may, if they find no property to satisfy the taxes assessed upon any person by authority of the forty-ninth section of this act, and which such person neglects to pay as hereinbefore provided, shall have power, and it shall be their duty, to examine under oath the person assessed under this act, or any other person, and may sell at public auction, after ten days' notice, any stock, bonds, or choses in action, belonging to said person, or so much thereof as will pay such tax and the expenses of such sale; and in case he refuses to testify, the said several collectors and assistants shall have power to arrest such person and commit him to prison, to be held in custody until the same shall be paid, with interest thereon at the rate of six per centum per annum, from the time when the same was payable as aforesaid, and all fees and charges of such commitment and custody. And the place of custody shall in all cases be the same provided by law for the custody of persons committed for any cause by the authority of the United States, and the warrant of the collector, stating the cause of commitment, shall be sufficient authority to the proper officer for receiving and keeping such person in custody until the amount of said tax and interest, and all fees and the expense of such custody, shall have been fully paid and discharged; which fees and expenses shall be the same as are chargeable under the laws of the United States in other cases of commitment and custody. And it shall be the duty of such collector to pay the expenses of such custody, and the same, with his fees, shall be allowed on settlement of his accounts. And the person so committed shall have the same right to be discharged from such custody as may be allowed by the laws of the State

or Territory, or the District of Columbia, where he is so held in custody, to persons committed under the laws of such State or Territory, or District of Columbia, for the non-payment of taxes, and in the manner provided by such laws; or he may be discharged at any time by order of the Secretary of the Treasury.

Act of Congress July 1, 1862, ch. 119, §§ 89–93, 12 Stat. 432, 473

Sec. 89. And be it further enacted, that for the purpose of modifying and re-enacting, as hereinafter provided, so much of an act, entitled "An act to provide increased revenue from imports to pay interest on the public debt, and for other purposes," approved fifth of August, eighteen hundred and sixty-one, as relates to income tax; that is to say, sections forty-nine, fifty (except so much as relates to the selection and appointment of depositaries) and fifty-one, be, and the same are hereby, repealed.

Sec. 90. And be it further enacted, That there shall be levied, collected, and paid annually, upon the annual gains, profits, or income of every person residing within the United States, whether derived from any kind of property, rents, interest, dividends, salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever, except as hereinafter mentioned, if such annual gains, profits, or income exceed the sum of six hundred dollars, and do not exceed the sum of ten thousand dollars, a duty of three per centum on the amount of such annual gains, profits, or income over and above the said sum of six hundred dollars; if said income exceeds the sum of ten thousand dollars, a duty of five per centum upon the amount thereof exceeding six hundred dollars; and upon the annual gains, profits, or income, rents, and dividends accruing upon any property, securities, and stocks owned in the United States by any

citizen of the United States residing abroad, except as hereinafter mentioned, and not in the employment of the government of the United States, there shall be levied, collected, and paid a duty of five per centum.

Sec. 91. And be it further enacted that in estimating said annual gains, profits, or income, whether subject to a duty, as provided in this act, of three per centum or of five per centum, all other national, state, and local taxes, lawfully assessed upon the property or other sources of income of any person as aforesaid, from which said annual gains, profits, or income of such person is or should be derived, shall be first deducted from the gains, profits, or income of the person or persons, who actually pay the same, whether owner or tenant, and all gains, profits, or income derived from salaries of officers, or payments to persons in the civil, military, naval, or other service of the United States, including senators, representatives, and delegates in Congress, above six hundred dollars, or derived from interest or dividends on stock, capital, or deposits in any bank, trust company, or savings institution, insurance, gas, bridge, express, telegraph, steamboat, ferry-boat, or railroad company or corporation, or on any bonds or other evidences of indebtedness of any railroad company or other corporation, which shall have been assessed and paid by said banks, trust companies, savings institutions, insurance, gas, bridge, telegraph, steamboat, ferry-boat, express, or railroad companies, as aforesaid, or derived from advertisements, or on any articles manufactured, upon which specific, stamp or ad valorem duties shall have been directly assessed or paid, shall also be deducted; and the duty hereinbefore provided for shall be assessed and collected upon the income for the year ending the thirty-first day of December next preceding the time for levying and collecting said duty, that is to say, on the first day of May, eighteen hundred and sixty-three, and in each year thereafter: Provided, that upon such portion of said gains,

profits, or income, whether subject to a duty as provided in this act of three per centum or of five per centum, which shall be derived from interest upon notes, bonds, or other securities of the United States, there shall be levied, collected, and paid a duty not exceeding one and one-half of one per centum, anything in this act to the contrary notwithstanding.

Sec. 92. And be it further enacted, That the duties on incomes herein imposed shall be due and payable on or before the thirtieth day of June, in the year eighteen hundred and sixty-three, and in each year thereafter until and including the year eighteen hundred and sixty-six and no longer; and to any sum or sums annually due and unpaid for thirty days after the thirtieth of June as aforesaid, and for ten days after demand thereof by the collector, there shall be levied in addition thereto the sum of five per centum on the amount of duties unpaid, as a penalty, except from the estates of deceased and insolvent persons; and if any person or persons, or party, liable to pay such duty, shall neglect or refuse to pay the same, the amount due shall be a lien in favor of the United States from the time it was so due until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all the property, and rights to property, stocks, securities, and debts of every description from which the income upon which said duty is assessed or levied shall have accrued, or may or should accrue; and in default of the payment of said duty for the space of thirty days, after the same shall have become due, and be demanded, as aforesaid, said lien may be enforced by distraint upon such property, rights to property, stocks, securities, and evidences of debt, by whomsoever holden; and for this purpose the Commissioner of Internal Revenue, upon the certificate of the collector or deputy collector that said duty is due and unpaid for the space of ten days after notice duly given of the levy of such duty, shall issue a warrant in form and manner to be pre-

scribed by said Commissioner of Internal Revenue, under the directions of the Secretary of the Treasury, and by virtue of such warrant there may be levied on such property, rights to property, stocks, securities, and evidences of debt, a further sum, to be fixed and stated in such warrant, over and above the said annual duty, interest, and penalty for non-payment, sufficient for the fees and expenses of such levy. And in all cases of sale, as aforesaid, the certificate of such sale by the collector or deputy collector of the sale, shall give title to the purchaser, of all right, title, and interest of such delinquent in and to such property, whether the property shall be real or personal; and where the subject of sale shall be stocks, the certificate of said sale shall be lawful authority and notice to the proper corporation, company, or association, to record the same on the books or records, in the same manner as if transferred or assigned by the person or party holding the same, to issue new certificates of stock therefor in lieu of any original or prior certificates, which shall be void whether cancelled or not; and said certificate of sale of the collector or deputy collector, where the subject of sale shall be securities or other evidences of debt, shall be good and valid receipts to the person or party holding the same, as against any person or persons, or other party holding or claiming to hold possession of such securities or other evidences of debt.

Sec. 93. And be it further enacted, That it shall be the duty of all persons of lawful age, and of all guardians and trustees, whether such trustees are so by virtue of their office as executors, administrators, or other fiduciary capacity, to make return in the list or schedule, as provided in this act, to the proper officer of internal revenue, of the amount of his or her income, or the income of such minors or persons as may be held in trust, as aforesaid, according to the requirements hereinbefore stated, and in case of neglect or refusal to make such return, the assessor or assistant asses-

sor shall assess the amount of his or her income, and proceed thereafter to collect the duty thereon in the same manner as is provided for in other cases of neglect and refusal to furnish lists or schedules in the general provisions of this act, where not otherwise incompatible, and the assistant assessor may increase the amount of the list or return of any party making such return, if he shall be satisfied that the same is understated: Provided, that any party, in his or her own behalf, or as guardian or trustee, as aforesaid, shall be permitted to declare, under oath or affirmation, the form and manner of which shall be prescribed by the Commissioner of Internal Revenue, that he or she was not possessed of an income of six hundred dollars, liable to be assessed according to the provisions of this act, or that he or she has been assessed elsewhere and the same year for an income duty, under authority of the United States, and shall thereupon be exempt from an income duty; or, if the list or return of any party shall have been increased by the assistant assessor, in manner as aforesaid, he or she may be permitted to declare, as aforesaid, the amount of his or her annual income, or the amount held in trust, as aforesaid, liable to be assessed, as aforesaid, and the same so declared shall be received as the sum upon which duties are to be assessed and collected.

[NOTE. This act was amended by Act Cong. March 3, 1863, 12 Stat. 713, 723, by adding the following: "In estimating the annual gains, profits, or income of any person, under the act to which this act is an amendment, the amount actually paid by such person for the rent of the dwelling house or estate on which he resides shall be first deducted from the gains, profits, or income of such person."]

Act of Congress June 30, 1864, 13 Stat. 223, 281, as amended by Act of Congress March 3, 1865, 13 Stat. 469, 479

Section 116. There shall be levied, collected, and paid annually upon the annual gains, profits, and income of every person residing in the United States, or of any citizen of the United States residing abroad, and whether derived from any kind of property, rents, interests, dividends, or salaries, or from any profession, trade, employment, or vocation, carried on in the United States or elsewhere, or from any other source whatever, a duty of five per centum on the excess over six hundred dollars and not exceeding five thousand dollars, and a duty of ten per centum on the excess over five thousand dollars; and in ascertaining the income of any person liable to an income tax, the amount of income received from institutions whose officers, as required by law, withhold a per centum of the dividends made by such institutions and pay the same to the Commissioner of Internal Revenue or other officer authorized to receive the same, shall be included, and the amount so withheld shall be deducted from the tax which otherwise would be assessed upon such person. And the duty herein provided for shall be assessed, collected, and paid upon the gains, profits, and income for the year ending on the thirty-first day of December next preceding the time for levying, collecting, and paying said duty: Provided, that incomes derived from interest upon notes, bonds, and other securities of the United States, and also all premiums on gold and coupons shall be included in estimating incomes under this act. Provided further, that only one deduction of six hundred dollars shall be made from the aggregate incomes of all the members of any family composed of parents and minor children, or husband and wife: And provided further, that net profits realized by sales of real estate purchased within the year for which income is estimated, shall be chargeable as income; and losses on sales

of real estate purchased within the year for which income is estimated shall be deducted from the income of such year.

Section 117. In estimating the annual gains, profits, and income of any person, all national, state, county, and municipal taxes paid within the year shall be deducted from the gains, profits, or income of the person who has actually paid the same, whether owner, tenant, or mortgagor; also the salary or pay received for services in the civil, military, naval, or other service of the United States, including senators, representatives, and delegates in Congress, above the rate of six hundred dollars per annum; also the amount paid by any person for the rent of the homestead used or occupied by himself or his family, and the rental value of any homestead used or occupied by any person or by his family, in his own right or in the right of his wife, shall not be included and assessed as part of the income of such person. In estimating the annual gains, profits, or income of any person, the interest received or accrued upon all notes, bonds, and mortgages, or other forms of indebtedness bearing interest, whether paid or not, if good and collectable, less the interest paid by or due from such person, shall be included and assessed as part of the income of such person for each year; and also all income or gains derived from the purchase and sale of stocks or other property, real or personal, and of live stock, and the amount of live stock, sugar, wool, butter, cheese, pork, beef, mutton, or other meats, hay or grain, or other vegetable or other productions, being the growth or produce of the estate of such person sold, not including any part thereof unsold or on hand during the year next preceding the thirty-first of December, until the same shall be sold, shall be included and assessed as part of the income of such person for each year, and his share of the gains and profits of all companies, whether incorporated or partnership, shall be included in estimating the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise. In estimating deductions from income, as afore-

said, when any person rents buildings, lands, or other property, or hires labor to cultivate land, or to conduct any other business from which such income is actually derived, or pays interest upon any actual incumbrance thereon, the amount actually paid for such rent, labor, or interest shall be deducted; and also the amount paid out for usual or ordinary repairs, not exceeding the average paid out for such purposes for the preceding five years shall be deducted, but no deduction shall be made for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate: Provided, that in cases where the salary or other compensation paid to any person in the employment or service of the United States shall not exceed the rate of six hundred dollars per annum, or shall be by fees, or uncertain or irregular in the amount or in the time during which the same shall have accrued or been earned, such salary or other compensation shall be included in estimating the annual gains, profits, or income of the person to whom the same shall have been paid, in such manner as the commissioner of internal revenue, under the direction of the Secretary of the Treasury, may prescribe.

Section 118. It shall be the duty of all persons of lawful age to make and render a list or return, in such form and manner as may be prescribed by the commissioner of internal revenue, to the assistant assessor of the district in which they reside, of the amount of their income, gains, and profits as aforesaid; and all guardians and trustees, whether as executors, administrators, or in any other fiduciary capacity, shall make and render a list or return, as aforesaid, to the assistant assessor of the district in which such guardian or trustee resides, of the amount of income, gains, and profits of any minor or person for whom they act as guardian or trustee; and the assistant assessor shall require every list or return to be verified by the oath or affirmation of the party rendering it, and may increase the amount of any list or return,

if he has reason to believe that the same is understated; and in case any person, guardian, or trustee shall neglect or refuse to make and render such list or return, or shall render a false or fraudulent list or return, it shall be the duty of the assessor or assistant assessor to make such list, according to the best information he can obtain, by the examination of such person, and his books and accounts, or any other evidence, and to add twenty-five per centum as a penalty to the amount of the duty due on such list in all cases of wilful neglect or refusal to make and render a list or return, and, in all cases of a false or fraudulent return having been rendered, to add one hundred per centum, as a penalty, to the amount of duty ascertained to be due, the duty and the additions thereto as penalty to be assessed and collected in the manner provided for in other cases of wilful neglect or refusal to render a list or return, or of rendering a false or fraudulent return: Provided, that any party, in his or her own behalf, or as guardian or trustee, shall be permitted to declare, under oath or affirmation, the form and manner of which shall be prescribed by the commissioner of internal revenue, that he or she, or his or her ward or beneficiary, was not possessed of an income of six hundred dollars, liable to be assessed according to the provisions of this act; or may declare that he or she has been assessed and paid an income duty elsewhere in the same year, under the authority of the United States, upon his or her gains and profits, as prescribed by law, and if the assistant assessor shall be satisfied of the truth of the declaration, shall thereupon be exempt from income duty in said district; or if the list or return of any party shall have been increased by the assistant assessor, such party may exhibit his books and accounts, and be permitted to prove and declare, under oath or affirmation, the amount of annual income liable to be assessed; but such oaths and evidence shall not be considered as conclusive of the facts, and no deductions claimed in such cases shall be made or allowed

until approved by the assistant assessor. Any person feeling aggrieved by the decision of the assistant assessor in such cases may appeal to the assessor of the district, and his decision thereon, unless reversed by the commissioner of internal revenue, shall be final, and the form, time, and manner of proceedings shall be subject to rules and regulations to be prescribed by the commissioner of internal revenue.

Section 119. The duties on incomes herein imposed shall be levied on the first day of May, and be due and payable on or before the thirtieth day of June, in each year, until and including the year eighteen hundred and seventy, and no longer; and to any sum or sums annually due and unpaid after the thirtieth of June, as aforesaid, and for ten days after notice and demand thereof by the collector, there shall be levied in addition thereto the sum of ten per centum on the amount of duties unpaid, as a penalty, except from the estates of deceased and insolvent persons. And if any person liable to pay such duty shall neglect or refuse to pay the same, after such demand, the amount due shall be a lien in favor of the United States from the time it was due until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all the property and rights to property belonging to such person; and in default of the payment of the said duty aforesaid, such lien may be enforced by distraint upon such property, rights to property, stocks, securities, and evidences of debt, by whomsoever holden; and for this purpose, the collector, after demands duly given, as aforesaid, shall issue a warrant, in form and manner to be prescribed by the commissioner of internal revenue, under the directions of the Secretary of the Treasury, and by virtue of such warrant there may be levied on such property, rights to property, stocks, securities, and evidences of debt, a further sum, to be fixed and stated in such warrant, over and above the said annual duty, interest, and penalty for non-payment, sufficient for the fees, costs, and expenses of

such levy. And in all cases of sale, as aforesaid, the certificate of such sale by the collector shall vest in the purchaser all right, title, and interest of such delinquent in and to such property, whether the property be real or personal; and where the subject of sale shall be stocks, the certificate of said sale shall be lawful authority and notice to the proper corporation, company, or association, to record the same on the books or records, in the same manner as if transferred or assigned by the person or party holding the same, to issue new certificates of stock therefor in lieu of any original or prior certificates, which shall be void whether cancelled or not. And said certificates of sale of the collector, when the subject of sale shall be securities or other evidences of debt, shall be good and valid receipts to the person holding the same, as against any person holding, or claiming to hold, possession of such securities or other evidences of debt.

Sections 120 and 121. (These sections imposed a tax of five per cent on dividends declared by banks, trust companies, savings institutions, and insurance companies, and also the same tax on any undivided profits of such companies carried during the year to surplus or contingent funds.)

Section 122. (This section made a similar provision as to "railroad, canal, turnpike, canal navigation,. and slackwater companies," in addition to taxing at the same rate the annual payments of interest on their bonds.)

Section 123. There shall be levied, collected, and paid on all salaries of officers, or payments for services to persons in the civil, military, naval, or other employment or service of the United States, including senators and representatives and delegates in Congress, when exceeding the rate of six hundred dollars per annum, a duty of five per centum on the excess above the said six hundred dollars; and it shall be the duty of all paymasters, and all disbursing officers, under the government of the United States, or in the employ thereof, when making any payments to officers and persons

as aforesaid, or upon settling and adjusting the accounts of such officers and persons, to deduct and withhold the aforesaid duty of five per centum, and [they] shall, at the same time, make a certificate stating the name of the officer or person from whom such deduction was made, and the amount thereof, which shall be transmitted to the office of the commissioner of internal revenue, and entered as part of the internal duties; and the pay-roll, receipts, or account of officers or persons paying such duty, as aforesaid, shall be made to exhibit the fact of such payment. And it shall be the duty of the several auditors of the Treasury Department, when auditing the accounts of any paymaster or disbursing officer, or when settling or adjusting the accounts of any such officer, to require evidence that the duties or taxes mentioned in this section have been deducted or paid over to the commissioner of internal revenue: Provided, that payments of prize money shall be regarded as income from salaries, and the duty thereon shall be adjusted and collected in like manner.

[NOTE. For various amendments to the foregoing statute, see Act Cong. March 10, 1866, 14 Stat. 4; Act Cong. July 13, 1866, 14 Stat. 98, 137–139; Act Cong. March 2, 1867, 14 Stat. 471, 477–480.]

Act of Congress, July 14, 1870, c. 255, 16 Stat. 256

Section 6. There shall be levied and collected annually, as hereinafter provided, for the years eighteen hundred and seventy and eighteen hundred and seventy-one, and no longer, a tax of two and one-half per centum upon the gains, profits, and income of every person residing within the United States, and of every citizen of the United States residing abroad, derived from any source whatever, whether within or without the United States, except as hereafter provided, and a like tax annually upon the gains, profits, and income de-

rived from any business, trade, or profession carried on in the United States by any person residing without the United States, and not a citizen thereof, or from rents of real estate within the United States owned by any person residing without the United States, and not a citizen thereof.

Section 7. In estimating the gains, profits, and income of any person, there shall be included all income derived from any kind of property, rents, interest received or accrued upon all notes, bonds, and mortgages, or other forms of indebtedness bearing interest, whether paid or not, if good and collectable, interest upon notes, bonds, or other securities of the United States; and the amount of all premium on gold and coupons; the gains, profits, and income of any business, profession, trade, employment, office, or vocation, including any amount received as salary or pay for services in the civil, military, naval, or other service of the United States, or as senator, representative, or delegate in Congress, except that portion thereof from which, under authority of acts of Congress previous hereto, a tax of five per centum shall have been withheld; the share of any person of the gains and profits, whether divided or not, of all companies or partnerships, but not including the amount received from any corporations whose officers, as authorized by law, withhold and pay as taxes a per centum of the dividends made, and of interest or coupons paid by such corporations; profits realized within the year from sales of real estate purchased within two years previous to the year for which income is estimated; the amount of sales of live stock, sugar, wool, butter, cheese, pork, beef, mutton, or other meats, hay and grain, fruits, vegetables, or other productions, being the growth or produce of the estate of such person, but not including any part thereof consumed directly by the family; and all other gains, profits, and income drawn from any source whatever, but not including the rental value of the homestead used or occupied by any person or by his family.

Section 8. Military or naval pensions allowed to any person under the laws of the United States, and the sum of two thousand dollars of the gains, profits, and income of any person, shall be exempt from said income tax, in the manner hereinafter provided. Only one deduction of two thousand dollars shall be made from the aggregate income of all members of any family composed of one or both parents and one or more minor children, or of husband and wife; but when a wife has by law a separate income, beyond the control of her husband, and is living separate and apart from him, such deduction shall then be made from her income, gains, and profits; and guardians and trustees shall be allowed to make the deduction in favor of each ward or beneficiary, except that in a case of two or more wards or beneficiaries comprised in one family, having joint property interest, only one deduction shall be made in their favor. For the purpose of allowing such deduction from the income of any religious or social community holding all their property and the income thereof jointly and in common, each five of the persons composing such society, and any remaining fractional number of such persons less than five over such groups of five, shall be held to constitute a family, and a deduction of two thousand dollars shall be allowed for each of such families. Any taxes on the incomes, gains, and profits of such societies now due and unpaid, shall be assessed and collected according to this provision, except that the deduction shall be only one thousand dollars for any year prior to eighteen hundred and seventy.

Section 9. In addition to the exemptions provided in the preceding section, there shall be deducted from the gains, profits, and income of any person all national, state, county, and municipal taxes paid by him within the year, whether such person be owner, tenant, or mortgager; all his losses actually sustained during the year arising from fires, floods, shipwreck,

or incurred in trade, and debts ascertained to be worthless, but excluding all estimated depreciation of values; the amount of interest paid during the year, and the amount paid for rent or labor to cultivate land, or to conduct any other business from which income is derived; the amount paid for the rent of the house or premises occupied as a residence for himself or his family, and the amount paid out for usual and ordinary repairs. No deduction shall be made for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate.

Section 10. The tax hereinbefore provided shall be assessed upon the gains, profits, and income for the year ending on the thirty-first day of December next preceding the time for levying and collecting said tax, and shall be levied on the first day of March, eighteen hundred and seventy-one, and eighteen hundred and seventy-two, and be due and payable on or before the thirtieth day of April in each of said years. And in addition to any sum annually due and unpaid after the thirtieth day of April, and for ten days after notice and demand therefor by the collector, there shall be levied and collected, as a penalty, the sum of five per centum on the amount unpaid, and interest on said amount at the rate of one per centum per month from the time the same became due, except from the estates of deceased, insane, or insolvent persons.

Section 11. It shall be the duty of every person of lawful age, whose gross income during the preceding year exceeded two thousand dollars, to make and render a return on or before the day designated by law, to the assistant assessor of the district in which he resides of the gross amount of his income, gains, and profits as aforesaid; but not including the amount received from any corporation whose officers, as authorized by law, withhold and pay as taxes a per centum of the dividends made and of the interest or coupons paid by such corporations, nor that portion of the salary or pay received for services in

the civil, military, naval, or other service of the United States, or as senator, representative, or delegate in Congress, from which tax has been deducted, nor the wages of minor children not received; and every guardian and trustee, executor or administrator, and any person acting in any other fiduciary capacity, or as resident agent for, or copartner of, any non-resident alien, deriving income, gains, and profits from any business, trade, or profession carried on in the United States, or from rents of real estate situated therein, shall make and render a return as aforesaid to the assistant assessor of the district in which he resides of the amount of income, gains, and profits of any minor or person for whom he acts. The assistant assessor shall require every such return to be verified by the oath of the party rendering it, and may increase the amount of any return, after notice to such party, if he has reason to believe that the same is understated. In case any person having a gross income as above, of two thousand dollars or more, shall neglect or refuse to make and render such return, or shall render a false or fraudulent return, the assessor or the assistant assessor shall make such return, according to the best information he can obtain by the examination of said person, or of his books or accounts, or by any other evidence, and shall add, as a penalty, to the amount of the tax due thereon, fifty per centum in all cases of willful neglect or refusal to make and render a return, and one hundred per centum in all cases of a false or fraudulent return having been rendered. The tax and the addition thereto as penalty shall be assessed and collected in the manner provided for in cases of willful neglect or refusal to render a return, or of rendering a false or fraudulent return. But no penalty shall be assessed upon any person for such neglect or refusal, or for making or rendering a false or fraudulent return, except after reasonable notice of the time and place of hearing, to be regulated by the commissioner of internal revenue, so as to give the person

charged an opportunity to be heard: Provided that no collector, deputy collector, assessor, or assistant assessor shall permit to be published in any manner such income returns, or any part thereof, except such general statistics, not specifying the names of individuals or firms, as he may make public, under such rules and regulations as the commissioner of internal revenue shall prescribe.

Section 12. When the return of any person is increased by the assistant assessor, such person may exhibit his books and accounts and be permitted to prove and declare, under oath, the amount of income liable to be assessed; but such oath and evidence shall not be conclusive of the facts, and no deductions claimed in such case shall be allowed until approved by the assistant assessor. Any person may appeal from the decision of the assistant assessor, in such cases, to the assessor of the district, and his decision thereon, unless reversed by the commissioner of internal revenue, shall be final. The form, time, and manner of proceedings shall be subject to regulations to be prescribed by the commissioner of internal revenue.

Section 13. Any person in his own behalf, or as such fiduciary or agent, shall be permitted to declare, under oath, that he, or his ward, beneficiary, or principal, was not possessed of an income of two thousand dollars, liable to be assessed according to the provisions of this act; or may declare that an income tax has been assessed and paid elsewhere in the same year, under authority of the United States, upon his income, gains, and profits, or those of his ward, beneficiary, or principal, as required by law; and if the assistant assessor shall be satisfied of the truth of the declaration, such person shall thereupon be exempt from income tax in said district.

Section 14. Consuls of foreign governments who are not citizens of the United States shall be exempt from any income tax imposed by this act which may be derived from their official emoluments, or from property in foreign countries: Pro-

vided that the governments which such consuls may represent shall extend similar exemptions to consuls of the United States.

Section 15. There shall be levied and collected for and during the year eighteen hundred and seventy-one a tax of two and one-half per centum on the amount of all interest or coupons paid on bonds or other evidences of debt issued and payable in one or more years after date, by any of the corporations in this section hereinafter enumerated, and on the amount of all dividends of earnings, income, or gains hereafter declared, by any bank, trust company, savings institution, insurance company, railroad company, canal company, turnpike company, canal navigation company, and slack-water company, whenever and wherever the same shall be payable, and to whatsoever person the same may be due, including non-residents, whether citizens or aliens, and on all undivided profits of any such corporation which have accrued and been earned and added to any surplus, contingent, or other fund, and every such corporation having paid the tax as aforesaid, is hereby authorized to deduct and withhold from any payment on account of interest, coupons, and dividends an amount equal to the tax of two and one-half per centum on the same; and the payment to the United States, as provided by law, of the amount of tax so deducted from the interest, coupons, and dividends aforesaid, shall discharge the corporation from any liability for that amount of said interest, coupons, or dividends, claimed as due to any person, except in cases where said corporations have provided otherwise by an express contract: Provided, that the tax upon the dividends of insurance companies shall not be deemed due until such dividends are payable, either in money or otherwise; and that the money returned by mutual insurance companies to their policy holders, and the annual or semi-annual interest allowed or paid to the depositors in savings banks and savings institutions, shall not be considered as dividends; and that when any dividend is made, or interest as aforesaid is paid, which includes

any part of the surplus or contingent fund of any corporation which has been assessed and the tax paid thereon, or which includes any part of the dividends, interest, or coupons received from other corporations whose officers are authorized by law to withhold a per centum on the same, the amount of tax so paid on that portion of the surplus or contingent fund, and the amount of tax which has been withheld and paid on dividends, interest, or coupons so received, may be deducted from the tax on such dividend or interest.

Section 16. Every person having the care or management of any corporation liable to be taxed under the last preceding section shall make and render to the assessor or assistant assessor of the district in which such person has his office for conducting the business of such corporation, on or before the tenth day of the month following that in which any dividends or sums of money become due or payable as aforesaid, a true and complete return in such form as the commissioner of internal revenue may prescribe, of the amount of income and profits and of taxes as aforesaid; and there shall be annexed thereto a declaration of the president, cashier, or treasurer of the corporation, under oath, that the same contains a true and complete account of the income and profits and of taxes as aforesaid. And for any default in the making or rendering of such return, with such declaration annexed, the corporation so in default shall forfeit, as a penalty, the sum of one thousand dollars; and in case of any default in making or rendering said return, or of any default in the payment of the tax as required, or of any part thereof, the assessment and collection of the tax and penalty shall be in accordance with the general provisions of law in other cases of neglect and refusal.

THE WISCONSIN INCOME-TAX LAW OF 1911

Laws of Wisconsin 1911, c. 658, page 984, July 15, 1911

Section 1. There are added to the statutes thirty new sections to read: Section 1087m—1. There shall be assessed, levied, collected, and paid a tax upon incomes received during the year ending December 31, 1911, and upon incomes received annually thereafter, by such persons and from such sources as hereinafter described; provided, that firms, copartnerships, corporations, joint stock companies and associations which customarily close their annual accounts on a date other than December 31, or which customarily estimate their income or profits on a basis other than that of actual cash receipts and disbursements, may, with the consent and approval of the tax commission, return for assessment and taxation the income or profits earned during the business year for which the accounts of such person are customarily made up.

Section 1087m—2. 1. The term "person," as used in this act, shall mean and include any individual, firm, copartnership, and every corporation, joint stock company or association organized for profit and having a capital stock represented by shares, unless otherwise expressly stated.

2. The term "income," as used in this act, shall include:

(a) All rent of real estate, including the estimated rental of residence property occupied by the owner thereof.

(b) All interest derived from money loaned or invested in notes, mortgages, bonds or other evidences of debt of any kind whatsoever.

(c) All wages, salaries or fees derived from services; provided that compensation to public officers for public service shall not be computed as a part of the taxable income in such cases where the taxation thereof would be repugnant to the constitution.

(d) All dividends or profits derived from stock or from the purchase and sale of any property or other valuable acquired within three years previous or from any business whatever.

(e) All royalties derived from the possession or use of franchises or legalized privileges of any kind.

(f) And all other income of any kind derived from any source whatever except such as is hereinafter exempted.

3. The tax shall be assessed, levied, and collected upon all income, not hereinafter exempted, received by every person residing within the state, and by every non-resident of the state upon such income as is derived from sources within the state or within its jurisdiction. So much of the income of any person residing within the state as is derived from rentals, stocks, bonds, securities or evidences of indebtedness shall be assessed and taxed, whether such income is derived from sources within or without the state; provided, that any person engaged in business within and without the state shall, with respect to income other than that derived from rentals, stocks, bonds, securities or evidences of indebtedness, be taxed only upon that proportion of such income as is derived from business transactions and property located within [the] state, which shall be determined in the manner specified is [in] subdivision (e) of section 1770b, as far as applicable.

Section 1087m—3. Every corporation, joint stock company or association shall be allowed to make from its gross income the following deductions:

(a) Payments made within the year for personal services of officers and employés actually employed in the production of such income; provided, there be reported the name, address, and amount paid each such officer or employé to whom a compensation of seven hundred dollars or more shall have been paid during the assessment year.

(b) Other ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and property, including a reasonable allow-

ance for depreciation of property from which the income is derived. All bonds issued by a corporation shall be deemed an interest in the property and business of such corporation; and so much of the interest payable on such bonds as is represented by the ratio between the property located and business transacted within this state to he [the] total property and business of such corporation as provided in subdivision 3, of section 1087m—2, shall be subject to taxation under this act at the same rate as the income of such corporation. Such tax shall be assessed to the bondholders under the general designation "The Bondholders of ....." (inserting the name of the corporation), but shall be a lien upon the property and business of such corporation prior to all other liens, and unless paid by the bondholders shall be enforced against the corporation. When paid by the corporation the amount of such tax may be deducted from the next interest payment on such bonds, unless otherwise provided by contract.

(c) Losses actually sustained within the year and not compensated for by insurance or otherwise.

(d) Sums paid by such person within the year for taxes imposed by any state of this union or subdivision thereof, or any territory or possession of the United States, upon the source from which the income taxed by this act is derived.

(e) Dividends or income received within the year from stocks or interest in any firm, copartnership or corporation, joint stock company or association, the income of which shall have been assessed under the provisions of this act; provided, such firm, copartnership, corporation, joint stock company or association report at the time of assessment the name and address of each such person owning stocks or interest in the same and the amount of dividends or income paid such person during the assessment year.

(f) Interest received from bonds or other securities exempt from taxation under the laws of the United States.

Section 1087m—4. Persons other than corporations, joint stock companies or associations, in reporting incomes for purposes of taxation shall be allowed the following deductions:

(a) The ordinary and necessary expenses actually paid within the year in carrying on the profession, occupation, or business from which the income is derived, including a reasonable allowance for depreciation of the property from which the income is derived. But no deductions shall be made for any amount paid for personal services unless these be reported, the name, address, and the amount paid each such employé to whom a compensation of seven hundred dollars or more shall have been paid during the assessment year.

(b) Losses during the year and not compensated for by insurance or otherwise.

(c) Dividends or incomes received by any person from stocks, or interest in any firm, copartnership, corporation, joint stock company or association, the income of which shall have been assessed under the provisions of this act; provided, such firm, copartnership, corporation, joint stock company or association report at the time of assessment the name and address of each such person owning stock or interest in the same and the amount of dividends or income paid such person during the assessment year.

(d) Interest paid within the year on existing indebtedness; provided, the debtor reports the amount so paid, the form of the indebtedness, together with the name and address of the creditor.

(e) Interest received from bonds or other securities exempt from taxation under the laws of the United States.

(f) Salaries or other compensation received from the United States by officials thereof.

(g) Pensions received from the United States.

(h) Taxes paid by such persons during the year other than inheritance taxes upon the property or business from which the income hereby taxed is derived.

(i) All inheritances, devises and bequests received during the year upon which an inheritance tax shall have been paid to this state.

(j) Insurance to the total amount of ten thousand dollars received by any person or persons legally dependent upon the decedent, in payment of a death claim by any insurance company, fraternal benefit society or other insurer.

Section 1087m—5. 1. There shall be exempt from taxation under this act income as follows, to-wit:

(a) To an individual, income up to and including eight hundred dollars.

(b) To husband and wife, twelve hundred dollars.

(c) For each child under the age of eighteen years, two hundred dollars.

(d) For each additional person, for whose support the taxpayer is legally liable and who is entirely dependent upon the taxpayer for his support, two hundred dollars.

(e) The aforesaid exemptions shall not apply to incomes derived from sources within the state by non-residents thereof, nor to firms, copartnerships, corporations, joint stock companies nor associations. In computing said exemptions and the amount of taxes payable under section 1087m—7 of this act, the income of a wife shall be added to the income of her husband, and the income of each child under eighteen years of age to that of its parent or parents, when said wife or child is not living separately from said husband, parent or parents.

(2) Income of any mutual savings or loan and building association, or of any religious, scientific, educational, benevolent, or other association of individuals not organized or conducted for pecuniary profit.

(3) Incomes derived from property and privileges by persons now required by law to pay taxes or license fees directly into the treasury of the state in lieu of taxes, and

such persons shall continue to pay taxes and license fees as heretofore.

(4) Incomes received by the United States, the state, and all counties, cities, villages, school districts or other political units of the state.

Section 1087m—6. 1. The tax to be assessed, levied, and collected upon the incomes of all persons, except as otherwise provided by law, after making such deductions and exemptions as are hereinbefore allowed, shall be computed at the following rates, to-wit:

(a) On the first one thousand dollars of taxable income or any part thereof, at the rate of one per cent.

(b) On the second one thousand dollars or any part thereof, one and one-fourth per cent.

(c) On the third one thousand dollars or any part thereof, one and one-half per cent.

(d) On the fourth one thousand dollars or any part thereof, one and three-fourths per cent.

(e) On the fifth one thousand dollars or any part thereof, two per cent.

(f) On the sixth one thousand dollars or any part thereof, two and one-half per cent.

(g) On the seventh one thousand dollars or any part thereof, three per cent.

(h) On the eighth one thousand dollars or any part thereof, three and one-half per cent.

(i) On the ninth one thousand dollars or any part thereof, four per cent.

(j) On the tenth one thousand dollars or any part thereof, four and one-half per cent.

(k) On the eleventh one thousand dollars or any part thereof, five per cent.

(l) On the twelfth one thousand dollars or any part thereof, five and one-half per cent.

(m) On any sum of taxable income in excess of twelve thousand dollars, six per cent.

2. Providing, however, that the tax to be assessed, levied, and collected upon the incomes of corporations, joint stock companies or associations, after making due allowance for deductions as hereinbefore provided, shall be computed at the following rates to-wit:

(a) If the taxable income equals one per cent or less of the assessed value of the property used and employed in the acquisition of such income, the rate of tax shall be one half of one per cent of such income.

(b) If the taxable income equals more than one, but does not exceed two per cent of the assessed value of the property used and employed in the acquisition of such income, the rate of tax shall be one per cent of such income.

(c) If the taxable income equals more than two, but does not exceed three per cent of the assessed value of the property used and employed in the acquisition of such income, the rate of tax shall be one and one-half per cent of such income.

(d) If the taxable income equals more than three, but does not exceed four per cent of the assessed value of the property used and employed in the acquisition of such income, the rate of the tax shall be two per cent of such income.

(e) If the taxable income equals more than four, but does not exceed five per cent of the assessed value of the property used and employed in the acquisition of such income, the rate of the tax shall be two and one-half per cent of such income.

(f) If the taxable income equals more than five, but does not exceed six per cent of the assessed value of the property used and employed in the acquisition of such income, the rate of the tax shall be three per cent of such income.

(g) And in like manner the tax upon the taxable income shall continue to increase at the rate of one-half of one per cent for each additional one per cent or fractional part thereof that the taxable income bears to the assessed value of the property used and employed in the acquisition of such income, until the rate of profits equals twelve per cent of such assessed value of the property used and employed in the acquisition of such income, when such rate shall continue as a proportional rate of six per cent of such taxable income.

Section 1087m—7. The legislature intends subsection 2, of section 1087m—6 of this act, to be a separable part thereof, so that said subsection may fail or be declared invalid without adversely affecting any other part of the act: provided that in event of its failing or being declared invalid the incomes of corporations, joint stock companies and associations shall be subject and shall be construed to have been subject to taxation at the rates specified in subsection 1, of section 1087m—6, and said incomes shall be reassessed by the tax commission and taxed for the years for which the rates provided in subsection 2 of section 1087m—6, shall have failed.

Section 1087m—8. 1. The state shall be divided into assessment districts by the state tax commission, but in no instance shall a county be divided.

2. Not less than thirty days prior to the first of March, 1912, there shall be selected and appointed by the state tax commission an assessor of incomes for each assessment district in the state, who shall hold office for the term of three years unless sooner removed as hereinafter provided. Such assessor shall be a citizen and an elector of this state, but need not be a resident of the district in which he is appointed to serve; provided, however, that so far as practicable preference shall be given in making such appointments to residents of the districts.

3. The tax commission may in its discretion transfer any assessor of incomes from one district to another and may remove any assessor of incomes or his deputy from office.

4. Before entering upon his duties such assessor of incomes shall subscribe to the constitutional oath and file the same in the office of the secretary of state.

5. The state tax commission may authorize any assessor of incomes to appoint such deputies and other assistants as may be required for the proper performance of his duties. Such deputies shall qualify in like manner and possess the same powers as the assessor.

Section 1087m—9. The salaries of the assessors of incomes and their deputies and assistants shall be fixed by the state tax commission, but such salaries, together with the expenses of such assessors and their deputies and assistants shall not in any year exceed in amount five cents for every thousand dollars of the valuation of all property as fixed by the tax commission in the state assessment of the preceding year. The assessor shall be furnished all necessary printing, stationery and postage, and he and his deputies shall be entitled to receive their actual necessary expenses while traveling in the performance of their duties. The salaries of the assessor and his assistants, and all such expenditures shall be audited and paid out of the state treasury in the same manner as other similar salaries and state expenses are audited and paid.

Section 1087m—10. 1. The state tax commission and the assessors of incomes shall annually on the first day of January, or as soon thereafter as practicable, proceed to assess as hereinafter provided every income received during the preceding calendar year liable to taxation under the provisions of this act. The assessment of corporations, joint stock companies and associations shall be made by the state tax commission, and the assessment of persons, other than

corporations, joint stock companies and associations shall be by the county assessor of incomes.

2. In the performance of such duty the state tax commission and the county assessors of incomes shall respectively possess all powers now or hereafter granted by law to the state tax commission or assessors in the assessment of personal property and also the power to estimate incomes.

3. Every corporation, joint stock company or association, whether taxable under this act or not, shall furnish to the tax commission a true and accurate statement at such time, in such manner and form and setting forth such facts as said commission shall deem necessary to enforce the provisions of this act. Such statement shall be made upon the oath or affirmation of the president, vice-president or other principal officer and the treasurer of said corporation, joint stock company or association.

4. Whenever in the judgment of the assessor of incomes any person in his district other than a corporation, joint stock company or association shall be subject to an income tax under the provisions of this act, he shall require such person to make report in such manner and form as the tax commission may prescribe, specifying particularly among other items the amount of income received from services, unsecured notes, mortgages, bonds, stocks, real estate and other such information as the commission may deem necessary to enforce the provisions of this act.

5. Every guardian, trustee, executor, administrator, agent or receiver, and every other person or corporation acting in a fiduciary capacity, shall make and render to the assessor of incomes of the district in which such representative resides, a verified list or return as aforesaid of the amount of income of any such person, ward, or beneficiary. The return so made shall be signed by the person rendering it, and by the president or secretary thereof, if a corporation.

6. For each question unanswered, the assessor or deputy

assessor, failing to present satisfactory cause for such omission to the state tax commission, shall be subject to a penalty of five dollars, and said penalty shall be deducted from the compensation of said assessor or deputy assessor at the time such compensation is paid.

Section 1087m—11. 1. Whenever evidence shall be produced before the state tax commission, which in the opinion of the commission, justifies the belief that in any one or more of the three next previous years the returns made by any corporation, joint stock company or association are incorrect, or are made with false or fraudulent intent, or when any corporation, joint stock company or association has failed or refused to make a return as required by law the state tax commission may require from every such corporation, joint stock company or association such further information with reference to its capital, income, losses, expenditures and business transactions as is deemed expedient. Upon the information so required the state tax commission may make such additions or corrections to the assessment as is deemed true and just, such corrections to be made in the next tax levy. Whenever the state tax commission shall so increase or make subject to tax any income, it shall give notice in writing to the person liable for the payment of the tax on said income of the amount of the assessment. Such notice may be served by registered mail.

2. In case any return made by any corporation, joint stock company or association is made with false or fraudulent intent or in case of a refusal or neglect to make a return as required by law, and an additional amount is discovered, the amount so discovered shall be subject to twice the original rate. The amount so added to the tax shall be collected at such time and in such manner as may be designated by the state tax commission.

3. In case of neglect occasioned by the sickness or absence of an officer of any corporation, joint stock company

or association required to make said return, or for other sufficient reason, the state tax commission may allow such further time for making and delivering such return as it may deem necessary, not to exceed thirty days.

4. If any of the corporations, joint stock companies or associations aforesaid shall fail or refuse to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint stock company or association shall be liable to a penalty of not less than one hundred dollars and not to exceed five thousand dollars at the discretion of the court.

5. Any officer of a corporation, joint stock company or association required by law to make, render, sign or verify any return who makes any false or fraudulent return or statement, with intent to defeat or evade the assessment required by this act to be made, shall upon conviction be fined not to exceed five hundred dollars or be imprisoned not to exceed one year, or both, at the discretion of the court, with the cost of prosecution.

Section 1087m—12. 1. Whenever the assessor of incomes or the county board of review herein provided for shall have reason to believe that in any one or more of the three next previous years the returns made by any person other than a corporation, joint stock company or association are incorrect or are made with false or fraudulent intent, or when any such person has failed or refused to make a return as required by law, the assessor or county board of review shall make such additions or corrections to the next assessment as he or they shall deem true and just. Whenever the assessor or the county board of review shall so increase or make subject to tax any income he or they shall give notice in writing to the person liable for the payment of the tax on said income of the amount of the assessment. Such notice may be served by registered mail.

2. In case any return made by any person other than a

corporation, joint stock company or association is made with false or fraudulent intent, or in case of a refusal or neglect to make a return as required by law, and an additional amount is discovered, the amount so discovered shall be subject to twice the original rate.

3. Any person other than a corporation, joint stock company or association who fails or refuses to make a return at the time hereinbefore specified in each year or shall render a false or fraudulent return shall upon conviction be fined not to exceed five hundred dollars, or be imprisoned not to exceed one year, or both, at the discretion of the court, together with the cost of prosecution.

Section 1087m—13. Any corporation, joint stock company or association subject to assessment by the state tax commission, feeling aggrieved by the decision of said commission regarding the assessment of its income, shall be granted the same rights of hearing and appeal as are now granted corporations assessed by said commission.

Section 1087m—14. The state tax commission shall appoint three resident tax payers of each county to serve as a county board of review, and shall fix their compensation, which shall not be more than ten dollars per day, and shall be audited and paid in the same manner as the salary of assessors under this act is paid.

Section 1087m—15. The county clerk shall be clerk of such board, and shall keep an accurate record of all proceedings thereof, including a correct record of all changes in the assessment rolls made by the board. The county clerk shall take full minutes of all evidence given before the board; provided, however, that the board, with the approval of the assessor of incomes, may in cases where they deem it advisable, employ a stenographic reporter to take such evidence in shorthand, and extend the same in typewritten form. The county clerk shall preserve in his office a record of all such proceedings, minutes and evidence tak-

en, and all documentary evidence offered. The stenographer shall be paid by the state, but the board may, in its discretion, charge the expenses to the complaining party or parties appearing before the board.

Section 1087m—16. 1. The county board of review of each county, constituting an assessment district, shall meet annually on the last Monday of July at ten o'clock a. m. at the court house in said county to hear complaints and to review the assessments of income made by the assessor. A majority shall constitute a quorum.

2. In assessment districts composed of more than one county the board of review of the county designated by the assessor of incomes shall meet as provided above and the board of review of each remaining county of the district shall meet as soon thereafter as is possible for the assessor of incomes to be present. The date of such meeting shall be fixed by the assessor of incomes.

3. Notice of the annual meeting of each county board of review shall be published in a newspaper of the county at least one week previous to such meeting.

4. The board may adjourn from day to day, and from time to time, until its business is completed, but no adjournment other than from day to day shall be had except upon written request and for satisfactory cause shown.

5. Attendance of witnesses and the production of books and papers before said board may be compelled by subpœna, issued by the clerk thereof, a justice of the peace or a court commissioner.

Section 1087m—17. 1. The board shall hear and examine, and permit the assessor to examine, any aggrieved or other person upon oath who shall appear before it in relation to any assessment or commission [sic] of income, and may increase or lessen the amount of any income assessed, if satisfied from the evidence submitted and the statements of the assessor, that such change should be made.

2. The board shall not increase any assessments, nor assess any income not on the roll without notice in writing to the person liable for payment of the tax thereon, or his agent, if either be resident of the county, of such intention in time to appear and be heard before the board in relation thereof.

Section 1087m—18. No person subject to assessment by the county assessor shall be allowed in any action or proceeding to question any assessment of income, unless objections thereto shall first have been presented to the county board of review in good faith and full disclosure made under oath of any and all income of such party liable to assessment.

Section 1087m—19. 1. Any person dissatisfied with any determination of the county board of review may appeal within twenty days to the state tax commission, to whom a copy of the record of the board shall be certified, together with all evidence or a copy thereof, relating to such assessment.

2. The tax commission shall review such assessments from the record thus submitted and shall make necessary corrections and certify its conclusion to the county clerk, who shall duly notify the person liable for the tax and enter upon the assessment roll any change made by the commission.

Section 1087m—20. 1. The state tax commission shall complete the assessment of income for each corporation, joint stock company, and association on or before the fifteenth day of October in each year and compute the tax thereon, and shall thereupon forthwith certify to each county clerk a statement of the assessment of each corporation, joint stock company and association in his county and the amount of tax levied against each.

2. The state tax commission shall submit in their biennial report the amount of income tax collected for each county

in the state, and shall designate the several general classes of property from which the incomes were received, the cost to the state and each county for the administration of the law, and all such facts as shall be required to give a definite understanding of the financial operations of the law.

Section 1087m—21. The tax upon the income of persons other than corporations, joint stock companies and associations shall be computed by the county clerk, assisted by the assessor of incomes, and said clerk shall on or before November first, certify to each town, city and village clerk the names of all persons whose incomes are assessed in his own town, city or village, and the amount of tax levied against each such person, and such amount shall be entered by the town, city and village clerks in a separate column designated "income tax" upon the tax roll of the year, and shall be collected and paid as personal property taxes are now collected and paid.

Section 1087m—22. The place at which the income tax herein provided for shall be assessed, levied and collected shall be determined as follows:

1. In their return for purposes of assessment persons deriving incomes from within and without the state, or from more than one political subdivision of the state, shall make a separate accounting of the income derived from without the state and from each political subdivision of the state in such form and manner as the tax commission may prescribe.

2. The entire taxable income of every person deriving income from within and without the state or from within different political subdivisions of the state, when such person resides within the state, shall be combined and aggregated for the purpose of determining the proper exemptions and proper rate of taxation. The taxable income so computed shall be assessed, and taxes at such rate shall be paid, in the several towns, cities and villages in proportion to the

respective amounts of income derived from each, counting that part of income derived from without the state when taxable as having been derived from the town, city or village in which said person resides.

3. Income derived by non-residents of the state from sources within the state or within its jurisdiction, shall be separately assessed and taxed in the town, city or village from which such income is derived, at a rate determined by the total income derived from within any single town, city or village.

4. All laws not in conflict with the provisions of this act regulating the time, place and manner of payment of taxes on personal property, the collection thereof by action, distress or otherwise and the return of personal property taxes unpaid, shall apply to the income tax herein provided for.

Section 1087m—23. The revenue derived from such income tax shall be divided as follows, to-wit: Ten per cent to the state, twenty per cent to the county and seventy per cent to the town, city or village in which the tax was assessed, levied and collected, which shall be remitted and accounted for in the same manner as the state and county taxes collected from property are remitted and paid.

Section 1087m—24. 1. No commissioner, assessor of incomes, deputy, member of a county board of review, or any other officer, agent, clerk or employé shall divulge or make known to any person in any manner except as provided by law any information whatsoever obtained directly or indirectly by him in the discharge of his duties or permit any income return or copy thereof or any paper or book so obtained to be seen or examined by any person except as provided by law.

2. Any officer, clerk, agent or employé violating any of the provisions of this section shall upon conviction thereof be punished by fine of not less than one hundred dollars nor

more than five hundred dollars, or by imprisonment in the county jail for not less than one month nor more than six months, or by imprisonment in the state prison for not more than two years, at the discretion of the court.

3. Such officer, agent, clerk or employé upon such conviction shall also forfeit his office or employment and shall be incapable of holding any public office in this state for a period of three years thereafter.

4. Nothing herein shall be construed as preventing the assessment roll, the tax roll and all proceedings had before the county board of review and all evidence taken at such hearing from being open to public inspection at such times and under such conditions as the state tax commission may direct.

Section 1087m—25. 1. On and after the first Monday in January, 1912, the office of county supervisor of assessment is hereby abolished.

2. The assessor of incomes shall on and after the first Monday of January, 1912, in addition to the duties and powers herein imposed and conferred upon him, perform all the duties and possess all the powers heretofore imposed and conferred by law upon the said county supervisor of assessment. The assessor of incomes shall be under the direction and control of the state tax commission, and shall make such reports to the commission, to the county board of review and the county board of supervisors, and perform such other duties as the commission shall direct.

Section 1087m—26. Any person who shall have paid a tax upon his personal property during any year shall be permitted to present the receipt therefor to, and have the same accepted by, the tax collector to its full amount in the payment of taxes due upon the income of such person during said year. Any bank which has paid taxes during any year upon its shares assessed to the individual stockholders thereof shall be entitled, under the provisions of this sec-

tion, to present the receipt therefor, and have the same accepted by the tax collector to its full amount in the payment of taxes upon the income of such bank during said year.

Section 1087m—27. Nothing contained in this act shall be construed to affect the assessment or collection of taxes assessed in the year 1911 or prior thereto, under present laws, nor to limit the power of assessors and boards of review relative to correcting assessment rolls, placing omitted property thereon, and reassessing property whenever such correction, insertion of omitted property, or reassessment might be made under the laws as they now exist.

Section 1087m—28. The state tax commission is hereby empowered to make such rules and regulations as it shall deem necessary in order to carry out the foregoing provisions.

Section 1087m—29. The state tax commission is hereby authorized to employ such clerks and specialists as are necessary to carry into effective operation this act.

Section 1087m—30. There is hereby appropriated from the general fund of the state, out of any money in the state treasury not otherwise appropriated, a sum sufficient to carry out the provisions of this act.

SOUTH CAROLINA INCOME TAX LAW

Civil Code South Carolina, 1902, Sections 325–331

Section 325. There shall be annually assessed, levied and collected upon the gains, gross profits and income received during the preceding calendar year by every citizen of this state, whether such gains, profits or income be derived from any kind of property, rents, interests, dividends, or salaries, or from any profession, trade, employment, or vocation carried on in this state, or from any other source whatever, a tax of one per centum on the amount so derived over and above $2,500 and up to $5,000; one and one-half per centum on $5,000 and over, up to $7,500; two per centum on $7,500 and over, up to $10,000; two and one-half per centum on $10,000 and over, up to $15,000; three per centum on $15,000 and over; and a like tax shall be assessed, levied and collected annually upon the gains, profits and income from all property owned, and every business, trade or profession carried on in this state by persons residing without this state, excepting such corporations as are hereinafter excepted: Provided that, in estimating the gains, profits and income there shall not be included interest upon such bonds or securities of this state, or of the United States, the principal and interest of which are, by the law of their issue, exempt from taxation.

Section 326. In computing incomes, the necessary expenses actually incurred in carrying on any business, occupation or profession, not including remuneration to the taxpayer for personal supervision or the support and maintenance of his or her family, shall be deducted from the gross income or revenue; and the word "income," as used in this article, shall be deemed and taken to mean "gross profits:" Provided, that no deduction shall be made or allowed for

any amount paid or contracted for permanent improvements or betterments made to increase the value of any property or estate, or for the increase of capital, capital stock or assets.

Section 327. The words "citizen" and "person," as used in this article, shall be deemed to include all natural persons, all copartnerships, and all members of any incorporated association, and to exclude, except as hereinafter included, all corporations duly chartered by the laws of the United States or of this or any other state.

Section 328. The tax herein provided for shall be assessed, levied, and collected in the same manner, at the same time, as other taxes, and by the same county officials as are now charged with the assessment, levy, and collection of state and county taxes, and shall be paid into the state treasury as other general state taxes.

Section 329. All persons liable for the payment of any of the tax herein provided for shall, at the time now or hereafter provided for the making of returns of personal property make, under oath, a full and complete list or return, in such form and manner as may be directed by the Comptroller General, to the auditor of the county in which they reside; or, in case of nonresidents, of the county or counties where said gains, profits, or income arise, of the amount of their income, gains, and profits as aforesaid, and the property or investment, if any, upon which the same are computed, and such other particulars as may be required by the Comptroller General. All persons, whether natural or corporations created by charter, acting as guardians, trustees, executors, administrators, agents, receivers, or in any other fiduciary capacity, shall make and render a list or return as aforesaid to the auditor of the county in which such persons or corporations acting in a fiduciary capacity reside or do business, of the income, gains and profits of any minor or person for whom they act.

Section 330. Any person or corporation failing or refusing to make the list or return required by this act, or rendering a willfully false or fraudulent list or return, shall be assessed by the auditor on account of said income tax, in such amount as appears to him from the best information obtainable by him either by examination of the defaulting taxpayer or any other evidence, that such taxpayer is liable for; and in case of failure or neglect to make said list or return, the said auditor shall add fifty per centum as a penalty to the amount of tax due; and in case of a willfully false or fraudulent return or list having been rendered, the auditor shall add one hundred per centum as a penalty to said tax; the tax and the additions thereto as a penalty to be assessed and collected in the manner provided for in the case of failure to make returns or lists of personal property.

Section 331. In every respect not herein specified, the returns for and the levy and collection of the tax provided in this act shall be subject to all the provisions of law relative to the assessment and collection of taxes on personal property.

VIRGINIA INCOME TAX LAW

Acts Virginia 1903, c. 148, p. 155, as amended by Acts 1908, c. 10, p. 20

Section 3. The taxable subjects shall be classified by schedules, as follows:

Section 10. The classification under schedule D shall be as follows, to wit: The aggregate amount of income in excess of one thousand dollars, whether received or due but not received, within the year next preceding the first of February in each year.

Income shall include:

First. All rents, except ground rents or rents charge, salaries, interest upon notes, bonds, or other evidences of

debt, of whatever description, of the United States, or any other state or country, or any corporation, company, partnership, firm, or individual, collected or received during the year, less the interest due and paid during the year.

Second. The amount of all premiums on gold, silver, or coupons.

Third. The amount of sales of live stock and meat of all kinds, less the value assessed thereon the previous year by the commissioner of the revenue.

Fourth. The amount of sales of wood, butter, cheese, hay, tobacco, grain and other vegetable and agricultural productions during the preceding year, whether the same was grown during the preceding year or not, less all sums paid for taxes and for labor, fences, fertilizers, clover or other seed purchased and used upon the land upon which the vegetable and agricultural productions were grown or produced, and the rent of said land paid by said person, if he be not the owner thereof.

Fifth. All other gains and profits derived from any source whatever.

In addition to the sum of one thousand dollars as aforesaid, there shall be deducted from the income of the person assessed, all losses sustained during the year: provided further, that only one deduction of one thousand dollars shall be made from the aggregate income of any family, except that guardians may make a separate deduction of one thousand dollars, in favor of each ward, out of income coming to said ward.

Section 11. On income, as defined in this schedule, the tax shall be one per centum.

OKLAHOMA INCOME TAX LAW

Laws Oklahoma 1907, p. 730

Section 1. At the time of making the assessment of real and personal property for taxation in this state, the assessor shall demand of each person a list of his income for the year ending June thirtieth last preceding, in excess of three thousand five hundred dollars. The blank for listing taxes shall contain the question: "Was your gross income from salaries, fees, trade, profession and property upon which a gross receipt or excise tax has not been paid, any and all of them, for the year ending June thirtieth last preceding, in excess of three thousand five hundred dollars?"

Section 2. If the person answers the question in the affirmative, he shall be furnished by the assessor with a blank in the following form, to-wit:

"To the Auditor of the State of Oklahoma: I hereby certify that my income from salaries, fees, trade, profession and property upon which a gross receipt or excise tax has not been paid, any and all of them, for the year ending June thirtieth, in excess of three thousand five hundred dollars was $....."

"I, ... being duly sworn, do certify that the foregoing certificate is true to the best of my knowledge and belief.

" .....

"Subscribed and sworn to before me this ..... day of .....

" .....

"Assessor."

Said person shall fill out, sign, and swear to said certificate before the assessor or other officer authorized by law to administer oaths, and such assessor shall forward the same

to the state auditor not later than July first of that year, and said state auditor shall certify the amount of the tax due upon the income so reported to the county clerk of the county in which said person resides, who shall extend the same on the tax rolls and shall at the same time and in the same manner as is now, or may hereafter be, provided by law relative to the tax lists of the real and personal property, deliver the same to the county treasurer.

Section 3. It shall be the duty of the assessor of each township to furnish the state auditor a list of all persons whom he may find who are subject to the above tax and who have filled out the list above required, together with the names of other persons in his township not appearing thereon, who, in his opinion, may be liable for an income tax hereunder, and said state auditor may take such steps as he may deem necessary to require any such person whose name is added to make proper return of his said income, and to enable him to obtain such information he or anyone designated by him to obtain such information shall have the power to summon witnesses within the county in which such persons live. Provided, however, if any witness so subpœnaed fails and refuses to appear and give information as provided by this section, the state auditor shall certify such fact to any court and said court shall thereupon issue a subpœna requiring the person subpœnaed to appear and give testimony as required by this section, and if any such person subpœnaed shall fail or refuse to obey said subpœna, such person shall be punished as provided by law in cases of contempt.

Section 4. There is hereby levied, for the benefit of the available common school fund of the state, a tax of five mills on the dollar on the excess over the amount of three thousand five hundred dollars and less than five thousand, and seven and one-half mills on the dollar on the excess of five thousand dollars and less than ten thousand dollars,

and twelve mills on the dollar on the excess over the amount of ten thousand dollars and less than twenty thousand dollars, and fifteen mills on the dollar on the excess over the amount of twenty thousand dollars and less than fifty thousand dollars, and twenty mills on the dollar on the excess over the amount of fifty thousand dollars and less than one hundred thousand dollars, and thirty-three and one-third mills on the dollar upon all amounts over one hundred thousand dollars of all gross incomes.

Section 5. The above tax shall not be levied upon the income derived from property upon which a gross receipt or excise tax has been paid.

Section 6. It shall be unlawful for any person to print or publish in any manner whatever any income tax return or any part thereof, or the taxes due thereon unless the tax herein becomes delinquent, and any person violating the provisions of this section shall be deemed guilty of a misdemeanor and shall be fined not to exceed fifty dollars and imprisoned in the county jail not more than thirty days for each offense.

Section 7. If any of the taxes herein levied become delinquent they shall become a lien on all the property, personal and real, of such delinquent person and shall be subject to the same penalties and provisions as are all ad valorem taxes.

Section 8. Any person making the affidavits required herein, who shall knowingly swear falsely shall be guilty of perjury.

Section 9. Any assessor who shall fail or refuse to perform the duties herein imposed shall be guilty of malfeasance in office and shall forfeit the amount of taxes lost by the state by such failure or refusal, to be collected in a civil action in the name of the state against the assessor.

Section 10. All acts and parts of acts in conflict herewith are hereby repealed.

Section 11. An emergency is hereby declared to exist by reason whereof this act shall take effect and be in force from and after its passage and approval.

Approved May 26, 1908.

NORTH CAROLINA INCOME TAX LAW

Acts North Carolina, 1907, c. 256, §§ 22–25, p. 298

Section 22. The tax payer shall list his income for the year ending June first from any and all sources in excess of one thousand dollars.

Section 23. The blank for listing taxes shall contain the following question: "Was your gross income from salaries, fees, trade, profession and property not taxed, any or all of them, for the year ending June first, in excess of one thousand dollars?" If the tax payer answers this question in the affirmative, he shall be furnished by the list-taker with a blank in the following form, to wit:

"To the Corporation Commission of the State of North Carolina: I hereby certify that my income from salaries, fees, trade, profession and property not taxed, any or all of them, for the year ending June first, in excess of one thousand dollars was $.....

".....

"..... being duly sworn, says that the foregoing certificate is true to the best of his knowledge and belief.

"Subscribed and sworn to before me this .... day of ....."

Said tax payer shall fill out, sign, and swear to said certificate before the list-taker or other officer authorized by law to administer oaths, and the list-taker shall forward the same to the Corporation Commission of the State not later

than July first of that year; and said Corporation Commission shall certify the amount of the tax due upon the income so reported to the chairman of the Board of County Commissioners of the county in which said tax payer resides, and the same shall be paid to the sheriff of said county, together with other taxes for that year; and it shall be unlawful for any person to print or publish in any manner whatever any income, tax return or any part thereof, or the amount or source of income appearing in any such return, or the taxes due thereunder, and any person offending against the provisions of this section shall be guilty of a misdemeanor and be punished by a fine not exceeding fifty dollars, or be imprisoned not more than thirty days for each offense.

At the time said tax payer states to the list-taker that he is liable for a tax upon his income, as herein provided, said list-taker shall note the same on a list to be kept by him for that purpose, and on or before July fifth next he shall return such list to the chairman of the Board of Commissioners of that county, and said chairman shall within five days thereafter furnish to said Corporation Commission a copy of such list, and the names of any other persons in his county not appearing thereon, who in his opinion may be liable for an income tax hereunder, and said Corporation Commission may take such steps as he may deem necessary to require any such person whose name is so added to make proper return of his said income.

Section 24. On all gross incomes as provided in the preceding section hereof, a tax shall be levied as follows: On the excess over the amount legally exempted, one per cent. The above tax shall not be levied upon the income derived from property already taxed, nor upon income less than one thousand dollars. The incomes subject to the above tax are those derived from property not taxed; from salaries,

fees and commissions, public or private; from annuities, from trades or professions, and from any other sources the incomes from which are not specifically exempted from taxation by law.

Section 25. No city, town, township, or county shall levy any inheritance or income tax.

HAWAIIAN INCOME TAX LAW

Session Laws Hawaii, 1901, Act No. 20, pp. 31–35

Section 1. From and after the first day of July, A. D. 1901, there shall be levied, assessed, collected and paid annually upon the gains, profits, and income over and above one thousand dollars, derived by every person residing in the territory of Hawaii from all property owned, and all business, trade, profession, employment or vocation carried on in the territory, and by every person residing without the territory from all property owned, and every business, trade, profession, employment or vocation carried on in the territory, and by every servant or officer of the territory, wherever residing, a tax of two per cent. on the amount so derived during the year preceding.

Section 2. There shall be levied, assessed, collected and paid annually, except as hereinafter provided, a tax of two per cent. on the net profit or income above actual operating and business expenses, from all property owned, and every business, trade, employment or vocation carried on in the territory of Hawaii, of all corporations doing business for profit in the territory, no matter where created and organized: Provided, however, that nothing therein [herein] contained shall apply to corporations, companies or associations conducted solely for charitable, religious, educational or scientific purposes, including fraternal beneficiary

societies, nor to insurance companies taxed on a percentage of the premium under the authority of another act.

Section 3. In estimating the gains, profits, and income of any person or corporation, there shall be included all income derived from interest upon notes, bonds and other securities, except such bonds of the territory of Hawaii, or of municipalities hereafter created by the territory, the principal and interest of which are by the law of their issuance exempt from all taxation; profits realized within the year from sales of real estate, including leaseholds purchased within two years, dividends upon the stock of any corporation; the amount of all premium on bonds, notes or coupons; the amount of sales of all movable property, less the amount expended on the purchase or production of the same, and in the case of a person not including any part thereof consumed directly by him or his family; money and the value of all personal property acquired by gift or inheritance, and all other gains, profits and income derived from any source whatsoever.

Section 4. The net profits or income of all corporations shall include the amounts paid or payable to, or distributed or distributable among shareholders from any fund or account, or carried to the account of any fund or used for construction, enlargements of plant, or any other expenditure or investment paid from the net annual profits made or acquired by said corporation. In computing incomes, the necessary expenses actually incurred in carrying on any business, trade, profession, or occupation, or in managing any property, shall be deducted, and also all interest paid by such person or corporation on existing indebtedness. And all government taxes and license fees paid within the year shall be deducted from the gains, profits or income of the person who, or the corporation which, has actually paid the same, whether such person or corporation be owner, tenant or mortgagor; also all losses actually sustained during the

year incurred in trade or arising from losses by fire not covered by insurance, or losses otherwise actually incurred. Provided, that no deduction shall be made for any amount paid out for new buildings, permanent improvements or betterments made to increase the value of any property or estate. Provided, further, that no deduction shall be made for personal or family expenses, the exemption of one thousand dollars, mentioned in section 1, being in lieu of same. Provided, further, that where allowable herein, only one deduction of one thousand dollars shall be made from the aggregate annual income of all the members of one family composed of one or both parents and one or more minor children, or husband and wife; that guardians shall be allowed to make a deduction in favor of each and every ward, except where two or more wards are comprised in one family, in which case the aggregate deduction in their favor shall not exceed one thousand dollars. Provided, further, that in assessing the income of any person or corporation there shall not be included the amount received from any corporation, as dividends upon the stock of such corporation, if the tax of two per cent. has been assessed upon its net profits by said corporation as required by this act, nor any bequest or inheritance otherwise taxed as such.

Section 5. Every corporation doing business for profit in the Territory shall make and render to the assessor of its tax division, between the first and thirty-first days of July of each year, beginning in the year 1901, a full return verified by oath or affirmation of its duly empowered officer, in such form as the Treasurer of the Territory may prescribe, of all the following matters for the whole twelve months ending June 30th last preceding the date of such return:

First. The gross receipts of such corporation from sales made at home or abroad, and from all kinds of business of any name or nature;

Second. The expenses of such corporation, exclusive of interest, annuities and dividends;

Third. The amount paid on account of interest, annuities and dividends stated separately;

Fourth. The amount expended on permanent improvements;

Fifth. The amount paid in salaries or compensation of more than six hundred dollars to each person employed, and the name and amount paid to each.

Section 6. It shall be the duty of all persons of lawful age having an income of six hundred dollars or more for the preceding year, from all sources, and of all corporations made liable to income tax, to make and render a list or return, between the first and thirty-first days of July of each year, in such form as the Treasurer of the Territory may direct, to the assessor of the division in which such persons or corporations reside, locate or do business, of the amount of their or its income, gains and profits as aforesaid; and all guardians, trustees, executors, administrators, agents, receivers, and all corporations or persons acting in a fiduciary capacity, shall make or render a list or return, as aforesaid, to the assessor of the division in which such person or corporation, acting in a fiduciary capacity, resides or does business, of the amount of income, gains, and profits of any minor or person for whom they act; and the assessor shall require every list or return to be verified by the oath or affirmation of the person or authorized officer of the corporation making the same. If any person or corporation refuse or neglect to render such return within the time required as aforesaid, or renders a return which in the opinion of the assessor is false and fraudulent, or contains any understatement, it shall be lawful for the assessor to summon such person, or any of the officers of such corporation, or any person having possession, custody or care of books

of account containing entries relating to the business of such person, or corporation, or any other person he may deem proper, wherever residing or found, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogations under oath, respecting any income liable to tax or the returns thereof. False, willful testimony, given before such assessor shall be deemed perjury and punished as such.

Section 7. It shall be the duty of every person or corporation doing business for profit to keep full, regular and accurate books of accounts upon which all its transactions shall be entered from day to day in regular order, which books shall be open to the inspection of the assessor of the division or any person authorized by him to inspect the same, during business hours.

Section 8. When any person or corporation having a taxable income refuses or neglects to render any return or list required by law, or declines to take oath or affirmation thereto, the assessor may make such assessments as he may consider just, and the same shall be binding and conclusive upon all parties and shall not be subject to appeal. In case of any false or fraudulent return or valuation by any taxpayer, the assessor shall add 200 per cent. to the just valuation of the income of such taxpayer and the amount of the tax assessed on such increase shall become part of the tax on the said income.

Section 9. Any person or corporation who or which has made a legal return as aforesaid may appeal from the amount assessed to the Tax Appeal Court constituted under Act 51 of the Session Laws of 1896, in like manner as allowed in case of property tax appeals, and the said court is hereby authorized to hear and determine such appeals subject to the revision of the Supreme Court as provided in the case of property taxes. Where the words "valuation of

property" or similar words occur in said act concerning such appeals the words "amount of taxable income" shall be understood in all proceedings in regard to appeals from assessments or judgments in income tax matters. Any person or corporation appealing from the assessment of the assessor shall lodge with the assessor on or before the first day of October of each year a notice in writing of his intention to appeal and the grounds of such appeal, and deposit with him the costs of appeal as prescribed in case of property taxes, which costs shall be subject to the regulations prescribed in said act. The said Tax Appeal Court shall sit for hearing of tax appeals under the authority of this act between the fifth and twenty-fifth days of October of each year.

Section 10. The taxes on income imposed shall be due and payable on or before the fifteenth day of November of each year; and any sum or sums annually due and unpaid after the said fifteenth day of November shall have added thereto ten per cent. on the amount which shall be and become a part of such tax. Interest at the rate of nine per cent. per annum shall be added to the amount of such tax and penalty from the time same shall become due.

INCOME TAX PROVISIONS IN STATUTES OF OTHER STATES

Massachusetts

"Personal estate, for the purpose of taxation, shall include * * * the income from an annuity, or from ships and vessels engaged in the foreign carrying trade within the meaning of section seven, and the excess above two thousand dollars of the income from a profession, trade or employment accruing to the person to be taxed during the year ending on the first day of May of the year in which the tax is assessed. Incomes derived from property subject to taxation shall not be taxed." Rev. Laws Mass. 1902, p. 206 (Gen. Stat. Mass. c. 11, § 4.)

Tennessee

"The amount of income derived from United States bonds, and all other stocks and bonds not taxed ad valorem, shall be taxable" at the rate of five per cent. Code Tenn. §§ 690, 710.

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