No. 22-800

IN THE

Supreme Court of the United States

CHARLES G. MOORE AND KATHLEEN F. MOORE,

PETITIONERS,

V.

UNITED STATES OF AMERICA,

RESPONDENT.

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

AMICI CURIAE BRIEF OF THE LIBERTY JUSTICE CENTER IN SUPPORT OF PETITIONER

Jacob Huebert
Counsel of Record
Reilly Stephens
LIBERTY JUSTICE CENTER
440 N. Wells Street, Suite 200
Chicago, Illinois 60654
(312) 637-2280
jhuebert@ljc.org

September 6, 2023

QUESTION PRESENTED

The Sixteenth Amendment authorizes Congress to lay "taxes on incomes…without apportionment among the several States." Beginning with *Eisner v. Macomber*, 252 U.S. 189 (1920), this Court's decisions have uniformly held "income," for Sixteenth Amendment purposes, to require realization by the taxpayer. In the decision below, however, the Ninth Circuit approved taxation of a married couple on earnings that they undisputedly did not realize but were instead retained and reinvested by a corporation in which they are minority shareholders. It held that "realization of income is not a constitutional requirement" for Congress to lay an "income" tax exempt from apportionment. App.12. In so holding, the Ninth Circuit became "the first court in the country to state that an 'income tax' doesn't require that a 'taxpayer has realized income.'" App.38 (Bumatay, J., dissenting from denial of rehearing en banc).

The question presented is:

Whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Constitutional Provisions

INTEREST OF THE *AMICI CURIAE*[1]

The Liberty Justice Center is a nonprofit, nonpartisan, public-interest litigation center located in Chicago, Illinois that seeks to protect economic liberty, private property rights, free speech, and other fundamental rights. The Liberty Justice Center pursues its goals through strategic, precedent-setting litigation to revitalize constitutional restraints on government power and protections for individual rights. *See, e.g., Janus v. AFSCME,* 138 S. Ct. 2448 (2018).

This case interests *amicus* because the power to tax is also the power to destroy, *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819), and in a free society such power must be strictly constrained to its historical limits under our constitution.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Tax Cuts and Jobs Act ("TCJA"), Pub, L. No. 115097, 131 Stat. 2054, seeks to tax unrealized gains on investments—which is sort of like a bread tax based on the pounds of flour and packets of yeast in the cabinet. Income taxes require that the entity being taxed *derive* the income from somewhere: income must be "received or drawn by the recipient for his separate use, benefit and disposal." *Eisner v. Macomber*, 252 U.S. 189, 207 (1920). Unrealized gains are, by definition, not drawn upon and do not profit the individual being taxed. Rather, they are *hypothetical* gains that

[1] Rule 37 statement: No counsel for any party authored any part of this brief, and no person or entity other than *amicus* funded its preparation or submission.

could disappear tomorrow, or next year—or as investors in Enron[2] and WeWork[3] learned, may never have existed in the first place. The TCJA would tax investors in the foreign equivalent of Theranos[4] on the billions a scam artist made up.

As policy, this is preposterous. But this Court's role is not to pass judgment on the policy—it is to recognize that in addition to being stupid, this is nothing like the original understanding of "income" Congress was empowered to tax by the Sixteenth Amendment. From the earliest income taxes enacted to fund the Union during the civil war, 'income' was always understood as a "derived"—that is, realized—gain. Congress did not, and could not have, taxed citizens on assets they did not possess, and had never possessed. Rather, both the pre- and post- Sixteenth Amendment statutes and case law consistently treat income as something received, realized, or otherwise derived—at no point was income tax assessed on hypothetical gains the taxpayer had never come into possession of in the first place.

ARGUMENT

[2] *See* Bethany McLean, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003).
[3] *See* Eliot Brown, THE CULT OF WE: WEWORK, ADAM NEUMANN, AND THE GREAT STARTUP DELUSION (2021).
[4] *See* John Carreyrou, BAD BLOOD: SECRETS AND LIES IN A SILICON VALLEY STARTUP (2018).

I. This Court held more than a century ago that income must be "derived" before it can be taxed.

From the beginning, federal taxes on income required that the basis of the tax be something that had actually *come in* to the taxpayer—that the person being taxed must have profited in some way. The Revenue Act of 1862 levied tax "upon the annual gains, profits, or income of every person residing in 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." Revenue Act of 1862, ch. 119, 12 Stat. 432 (emphasis added). The act used the terms "gains, profits, or income" together, implying an equivalence between the three terms. And indeed, under the 1862 act the government collected one income tax, rather than three separate taxes. The 1862 Act also specifically taxes income, gains, or profits which are "derived from" a list of various economic activities, establishing that the "derived" element of income from the beginning.

And it was not simply the 1862 Act. The Revenue Act of 1864 taxed, *inter alia,* "all income or gains derived from the purchase and sale of stocks or other property," Internal Revenue Act of 1864, 13 Stat. 223, as well as "interest received or accrued upon all notes, bonds, mortgages, or other forms of indebtedness bearing interest, whether paid or not." Internal Revenue Act of 1864, 13 Stat. 223**.** The Revenue Act of 1867 further taxed, "interest received or accrued upon all notes, bonds, mortgages, or other from of indebtedness bearing interest, whether paid or not." Joseph A. Hill, *The Civil War Income Tax*, Vol. 8, *The Quarterly Journal of Economics*, 416, 431 (1894).

When Congress intended to tax income, it referred to "all income or gains *derived* from the *purchase and sale* of stocks." (emphasis added). In contrast, when Congress wanted to tax unrealized interest, it explicitly taxed "interest received or accrued upon . . . forms of indebtedness bearing interest, *whether paid or not*." (emphasis added), explicitly providing for taxation of funds not yet received.

Contemporary case law interpreting the early income taxes demonstrates that the "derived from" element was central to the determination of what was and was not income. When the constitutionality of these income taxes was brought before this Court, the Court found that the income tax was constitutional. *Springer v. United States*, 102 U.S. 586, 599 (1881). However, in that case, the tax was levied against the plaintiff's income from his law practice and the interest accrued from bonds. *Id.* at 590. The Court did not consider whether income taxes included unrealized gains because the case did not involve charges for failure to pay taxes on unrealized gains—perhaps because such a notion would have been entirely alien to the contemporary understanding of "income."

The Court ultimately confirmed this understanding in as "the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale conversion of capital assets." *Eisner v. Macomber*, 252 U.S. 189, 207 (1920) (quoting *Stratton's Independence v. Howbert*, 231 U.S.

399, 415 (1913); *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918)). *Macomber* endorsed two principles relevant here. First, income must actually be "*derived*, that is, received or drawn by the recipient for his separate use, benefit, and disposal." 252 U.S. at 207 (emphasis added). A stock dividend didn't qualify, because the recipient didn't actually derive income from anything, numbers simply moved around on a page. Second, the Court made clear that the word "gain" did not encompass underived income. *Id.* The Court stated that just because there may appear to be a "growth or increment of value in the investment", that incremental value must actually have been drawn on by the recipient for his "separate use, benefit, and disposal." *Id.*

In other words, income taxes have always and only been imposed on those gains that have *come in* to the taxpayers possession. In this case, the Moores derived *nothing* from their investment. They have received no return on their investment—no dividends, no distributions, no proceeds, no interest—no gain at all, except some personal satisfaction in supporting a company that provides affordable equipment to Indian farmers less well off than themselves. There is no money, or anything else, "received or drawn by the [the Moores] for [their] separate use, benefit, [or] disposal." *Macomber*, 252 U.S. at 207. The TCJA is therefore not an *income* tax in any traditional sense know to American law—as a thorough look at the history and tradition of income taxes demonstrates.

II. The history of the federal income tax before and after the Sixteenth Amendment supports *Macomber's* holding that income must be "derived" by definition.

The first federal income tax was introduced in the Revenue Act of 1861, Chap. XLV, 12 Stat. 292. As southern states seceded, President Lincoln sought to raise funds for the impending Civil War. Ellen Terrel, *History of the US Income Tax*, Library of Congress (2012).[5] The act taxed all incomes at or exceeding $800, and charged one principal assessor and one principal collector per state and territory to collect taxes on "the annual income of every person residing in the United States, whether such income is *derived* from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or form any other source whatever." C. F. Dunbar, *The Direct Tax of 1861*, Vol. 3 Quarterly Journal of Economics 436-461 (1889) (emphasis added). This act was never really enforced, however, because Congress hadn't provided a sufficient enforcement mechanism, particularly in the face of war. *Id.*

After the failure of the 1861 Act, Congress passed the Revenue Act of 1862, ch. 119, 12 Stat. 432, which repealed the Revenue Act of 1861, but kept the income tax and restructured the enforcement scheme by creating the Office of the Commissioner of Internal Revenue—renamed the Internal Revenue Service in 1918. Dunbar, *The Direct Tax of 1861* at 436-61. The

---

[5] https://guides.loc.gov/this-month-in-business-history/April/tax-day.

1862 Act declared that "there shall be levied, collected, and paid annually, upon the annual gains, profits, or income of every person residing in 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." Revenue Act of 1862, ch. 119, 12 Stat. 432. Two points stand out in this definition. First, the concepts of "income," "gains," and, "profits" were sufficiently similar so that Congress treated them interchangeably by stating that the taxes will be levied, "upon the annual gains, profits *or* income." Revenue Act of 1862, ch. 119, 12 Stat. 432. Indeed, the interrelatedness of these terms goes back to the founding era—Samuel Johnson defined "Income" as "Revenue; produce of any thing"; Gain as "Profit; advantage"; and "Profit" as "Gain; pecuniary advantage." Samuel Johnson, A Dictionary of the English Language (1755).[6] Needless to say, the Moores have brought in no revenue, and have experienced no pecuniary advantage.

Second, as in 1861 the 1862 Act uses the term "derived," such that income must come in from some prior action or event. Revenue Act of 1862, ch. 119, 12 Stat. 432. Income must have a source—typically labor or capital, or in the terms specified in the 1862 Act either "property, rents, interest, dividends, salaries" or "any profession, trade, employment or vocation carried on in the United States or elsewhere," and also "from any other source whatever." Note that even under the

[6] Available online at https://johnsonsdictionaryonline.com/views/search.php?term=income.

catchall at the end the income must be *derived* from a *source*—the source of what? The source of the *gain*, *profit¸* or *income*. The Moores' investment is not a source of anything for them (except personal satisfaction at chipping in for a good cause).

The Revenue Act again received significant updates in 1864 and 1867. These later revisions clarified that income from securities was only considered income when the securities were actually sold. Internal Revenue Act of 1864, 13 Stat. 223. The Revenue Act of 1864 taxed "all income or gains derived from the purchase and sale of stocks or other property, real or personal." Internal Revenue Act of 1864, 13 Stat. 223. In contrast, the Revenue Act of 1867 retained the provision on stocks and added "interest received or accrued upon all notes, bonds, mortgages, or other forms of indebtedness bearing interest, whether paid or not." Joseph A. Hill, *The Civil War Income Tax*, Vol. 8, *The Quarterly Journal of Economics*, 416, 431 (1894).

The Civil War income tax was repealed in 1873, and the underlying question of the tax's constitutionality did not reach this Court until 1881 in *Springer*. William Springer challenged the income tax imposed by the 1864 Revenue Act on the grounds that it was a direct tax in violation of Article I of the Constitution. *Springer,* 102 U.S. at 595. Article I requires that "direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers . . . [and] No Capitation, or other direct tax, shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. Const. art. I, §§ 2, 9.

In *Springer*, the Court held that the 1864 income tax did not qualify as a direct tax, pointing out that "whenever the government has imposed a tax which it recognized as a direct tax, it has never been applied to any objects but real estate and slaves." *Springer v. United States*, 103 U.S. 586, 599 (1881). By contrast, Springer's two sources of income were his law practice and the interest accrued from U.S. Bonds. *See Pollock v. Farmers; Loan & Trust Co.*, 157 U.S. 429, 579 (1895) ("The original record discloses that the income [in *Springer*] was not derived in any degree from real estate but was in part professional as attorney-at-law and the rest interest on United States bonds."). In other words, the taxes *Springer* approved were not taxes on the underlying value of property such as the common stock owned by the Moores, but on revenue he'd received.

This Court changed course in 1895, ruling against a new income tax imposed by the 1894 Wilson-Gorman Tariff Act in *Pollock*. The Court overruled the decision in *Springer,* finding that taxation of income *was* a direct tax without apportionment. *Pollock,* 157 U.S. at 581. Going further, the Court found that the income tax violated the doctrine of intergovernmental tax immunity, since "the United States [has] no power under the Constitution to tax either the instrumentalities or the property of the state." The Wilson-Gorman tariff applied the income tax to "income derived from state, county, and municipal securities." The Court found that the income tax on such securities was a tax, "on the power of the States and their instrumentalities to borrow money" and was therefore, "repugnant to the Constitution." *Pollock*,157 U.S. at 607.

But even when overturning *Springer* and finding a direct tax, the court still referred to income as something that must be *derived* from preexisting labor or capital. When the Court discusses the historical usage of the income tax in *Pollock*, "income" is used in reference to interest from bonds, rents of real estate, or otherwise "derived from property or profession, trade or vocation." *See Pollock*, 157 U.S. at 573. When discussing whether state income from securities can be taxed, the Court describes it as "derived from state, county, and municipal securities." *Id.* at 5585. From the first federal income tax in 1861 through the 1895 decision in *Pollock*, this Court consistently held that income must be derived from some preexisting source, and that stocks were only treated as income *when sold*.

The unconstitutionality of the income tax was overcome in 1913 with the passage of the Sixteenth Amendment, which states 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." U.S. Const., amend. XVI. Although the Court upheld the Amendment in *Brushaber v. Union P.R. Co.,* 240 U.S. 1 (1916), there remained the sticky problem that Sixteenth Amendment lacked a definition of, well, "income."

This Court's first attempt came in *Towne v. Eisner*, 245 U.S. 418 (1918). There, the Court ruled that a stock dividend was not the equivalent of "income" under the Revenue Act of 1913 because "the corporation is no poorer and the stockholder is no richer than they were before." *Towne v. Eisner*, 245 U.S. 418, 426 (1918). This turned out to be not quite clear enough, and it fell to *Eisner v. Macomber*, 252 U.S. 189 (1920), to address the bigger constitutional question of whether a stock dividend could be construed as income within the meaning of the Sixteenth Amendment.

In *Macomber,* the taxpayer received a stock dividend from the Standard Oil company, which was taxed as income under the Revenue Act of 1916 as a "gain derived from capital." *Id.* at 201. The Government argued that the word "gain" implied that income included the "growth or increment of value in the investment." *Id.* at 207. The Court rejected this conception, limiting income to "the gain derived from capital, from labor, or from both combined provided it be understood to include profit gained through a sale conversion of capital assets." *Id*. Income was "not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed form the capital however invested or employed, and coming in, being derived, that is, received or drawn by the recipient for his separate use, benefit and disposal." *Id.* Under *Macomber*, therefore, in order for something to be income, it must be derived from a source of revenue. And in order for something to be derived, it must be, "received or drawn by the recipient for his separate use, benefit and disposal." *Macomber*, 252 U.S. at 207. The Moores have received nothing, drawn nothing, and have had no ability to use, benefit from, or dispose of the retained earnings of this company they happen to own 11% of.

A year later, this Court returned to the question of income realization in *Merchants' Loan & Tr. Co. v. Smietanka*, 255 U.S. 509 (1921), which addressed the taxation of *realized* capital gains. The Court rejected "the refinements of lexicographers or economists" in defining "income," instead attempting to ascertain the "commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment." *Id.* at 519. The Court found that

> since the fund here taxed was the amount realized from the sale of the stock . . . [it was] palpable that it was a "gain or profit" "produced by" or "derived from" that investment, and that it "proceeded," and was "severed" or rendered severable, from it, by the sale for cash, and thereby became that "realized gain" which has been repeatedly declared to be taxable income within the meaning of the constitutional amendment and the acts of Congress.

Id. at 519-20 (quoting *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918)). The Court cited its earlier decision in *Hays v. Gauley Mountain Coal Co.*, 247 U.S. 189 (1918), which had interpreted earlier income tax regimes as "measur[ing] the tax by the income *received* within the year for which the assessment was levied, whether it accrued within that year or in some preceding year while the act was in effect." (emphasis added). That is: the Court understood both the revenue act of 1867 and the 1909 Corporate Excise tax at issue in *Hays* to impose a tax on money only once it was actually in hand: until the taxpayer had received the funds, there was nothing to trigger the obligation to pass on a percentage to Uncle Sam.

One final early case drives home the distinction. In *Cullinan v. Walker*, 262 U.S. 134 (1923) this Court found that, distinct from *Macomber*, stock shares issued in the event of reorganization *were* taxable as income, despite not being a cash payment. Cullinan had purchased shares for $26,640 in a company that was liquidated, with the assets transferred to two successor corporations, whose shares were then issued to Cullinan—and worth more than a million dollars. The Court found that the reorganization amounted to a realization event, equivalent to if the shares had been sold and the cash proceeds distributed to Cullinan. Unlike *Macomber*, where the stock dividend had not *created* any value—the extra shares represented essentially the same ownership interest in—here the new shares Cullinan had received were a realization of the value in the prior company, even if that realization had been a receipt of new property rather than of cash—a difference now appreciated by game show contestants who get stuck with a tax bill for the new car they won on TV.

CONCLUSION

For the foregoing reasons, and those stated by Petitioner, the decision below should be reversed.

Respectfully submitted,

Jacob Huebert
Counsel of Record
Reilly Stephens
LIBERTY JUSTICE CENTER
440 N. Wells Street,
Suite 200
Chicago, Illinois 60654
(312) 637-2280
jhuebert@ljc.org

September 6, 2023