Rethinking *Eisner v. Macomber*, and the Future of Structural Tax Reform

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Abstract

In June 2023, the Supreme Court granted the petition for a writ of certiorari in Moore v. United States*, ostensibly a challenge to an obscure provision of the 2017 tax legislation.* Moore*'s real target is the constitutionality of federal wealth and accrual taxation, which policymakers have proposed to combat record inequality and raise revenue for social-welfare reform. At the center of the doctrinal dispute in* Moore *is a century-old case,* Eisner v. Macomber*, on which the* Moore *petitioners and other commentators have relied to argue that Congress has no power to tax wealth or unrealized gains—e.g., appreciation in unsold stocks. Most scholars agree that* Macomber *limited Congress's taxing power to realized income, and they argue that subsequent cases have abrogated* Macomber*. However, the Supreme Court has never overruled—in fact, went out of its way not to overrule—*Macomber*, and some contend that it remains good law.*

This Article reconceptualizes Macomber *and analyzes its doctrinal implications for structural tax reform. In contrast to the prevailing scholarly views, it argues that* Macomber *is best read as a case turning on the absence of income rather than realization. Through careful analysis of the majority opinion and its doctrinal background, including constitutional challenges to the Civil War income tax, the Article articulates five interpretive models of* Macomber*. By examining little-read cases on the taxation of lease improvements and corporate reorganizations from the 1920s to the 1940s, the Article shows that* Macomber*'s doctrinal progeny eliminated three of those models, left undisturbed another, and reaffirmed the income-centric model. Under the income-centric model,* Macomber *poses no serious barrier to federal wealth or accretion taxation. In fact, it suggests avenues to designing a constitutional wealth tax that might otherwise fail judicial scrutiny. This firmer ground for a broad conception of the federal taxing power allows Congress to enact structural tax reform to vindicate our democracy's commitment to egalitarianism and distributive justice.*

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Introduction

On June 26, 2023, the Supreme Court granted the petition for a writ of certiorari in *Moore v. United States*.[1] On the surface, *Moore* challenges the Mandatory Repatriation Tax ("MRT")—an obscure provision of the 2017 tax legislation.[2] Before 2017, the United States required domestic shareholders of foreign corporations or subsidiaries to pay taxes on those corporations' offshore business income only when

1 No. 22-800 (U.S. argued Dec. 5, 2023); 143 S. Ct. 2656 (2023) (granting the petition for a writ of certiorari).

2 *See* Petition for a Writ of Certiorari at 9–26, *Moore*, No. 22-800; Brief for the United States in Opposition at 8–25, *Moore*, No. 22-800; Tax Cuts and Jobs Act, Pub. L. No. 115-97, sec. 14103, 131 Stat. 2054, 2195 (2017) (codified at I.R.C. § 965).

such income was repatriated—e.g., through a dividend to the domestic shareholder.[3] In response, U.S. multinational corporations chose not to repatriate overseas income, thus deferring domestic taxation and accumulating more than $2 trillion of earnings in foreign subsidiaries.[4] The 2017 tax legislation provided a general rule exempting U.S. shareholders from domestic taxation when foreign corporations distribute those earnings.[5] But to prevent a windfall to U.S. corporations that retained earnings in foreign subsidiaries, Congress enacted the MRT, under which all foreign earnings accumulated after 1986 are deemed repatriated and subject to preferential rates of taxation.[6] While the MRT primarily affected U.S. corporations that held shares of their foreign subsidiaries, it encompassed individuals with significant holdings in foreign corporations. The individual petitioners in *Moore* held shares of a company that sold farm tools in India, and contended that Congress had no power to tax them for the undistributed gains of their company.[7] Before the grant of certiorari, the district court and the Ninth Circuit—with four conservative judges dissenting from the denial of rehearing en banc—rejected the taxpayers' constitutional challenge of the MRT.[8]

The real target of *Moore* is the constitutionality of federal wealth and accretion taxes.[9] In response to record economic inequality and the rich's skillful evasion of income taxation, progressive lawmakers have proposed to tax the wealth or unrealized appreciation in assets held

3 *See* I.R.C. § 951(a)(1)(A) (requiring U.S. shareholders of controlled foreign corporations to include in gross income their pro rata share of the corporations' "subpart F income"); *id.* § 952(a) (defining "subpart F income" to include interest and investment income but not income from active offshore business); Keith Engel, *Tax Neutrality to the Left, International Competitiveness to the Right, Stuck in the Middle with Subpart F*, 79 Tex. L. Rev. 1525, 1527–28 (2001); Robert E. Holo, Jasmine N. Hay & William J. Smolinski, *Not So Fast: 163(j), 245A, and Leverage in the Post-TCJA World*, 128 Yale L.J.F. 383, 392 n.44 (2018); *Subpart F Overview*, Internal Revenue Serv. (Sept. 3, 2014), https://www.irs.gov/pub/int_practice_units/DPLCUV_2_01.PDF [https://perma.cc/6GWE-JZ9N].

4 *See* Reuven S. Avi-Yonah, Letter to the Editor, *If* Moore *Is Reversed*, 179 Tax Notes Fed. 2215, 2215 (2023); Sean P. McElroy, Bulletin, *The Mandatory Repatriation Tax Is Unconstitutional*, Yale J. on Regul. (2019), https://www.yalejreg.com/bulletin/the-mandatory-repatriation-tax-is-unconstitutional-2 [https://perma.cc/DF76-Q7CR]; Letter from Thomas A. Barthold, Joint Comm. on Tax'n, to Kevin Brady & Richard Neal, H. Comm. on Ways and Means, U.S. Cong. (Aug. 31, 2016).

5 *See* I.R.C. § 245A.

6 *See id.* § 965(a), (c).

7 Petition for a Writ of Certiorari, *supra* note 2, at 3–4, 9–21.

8 *See* Moore v. United States, 36 F.4th 930, 939 (9th Cir. 2022), *aff'g* No. C19-1539, 2020 WL 6799022, at *3 (W.D. Wash. Nov. 19, 2020); Moore v. United States, 53 F.4th 507 (9th Cir. 2022).

9 *See* Daniel J. Hemel, *The Low and High Stakes of* Moore, 180 Tax Notes Fed. 563 (2023) (assessing the stakes of *Moore*); *see also* Steven M. Rosenthal, Moore *Could Invalidate Decades of Tax Rules*, Tax Notes (Oct. 9, 2023), https://www.taxnotes.com/featured-analysis/moore-could-invalidate-decades-tax-rules/2023/10/06/7hdw9 [https://perma.cc/8CDU-CMQ4].

by high-net-worth households.[10] From the very beginning of the *Moore* litigation, a chorus of commentators and think tanks have framed the dispute as one decisive of Congress's power to tax wealth and unrealized gains.[11] When the case was at the district court, lawyers associated with the Cato Institute and the first Bush Administration represented the plaintiffs and later wrote that the case "st[ood] to slam shut the door on a federal wealth tax like the one Sen. Elizabeth Warren wants to enact."[12] At the Ninth Circuit, Judge Bumatay wrote a fiery dissent from the denial of rehearing en banc—in effect a judicial petition for certiorari—and chastised the three-judge panel for "open[ing] the door to new federal taxes on all sorts of wealth and property" outside of the federal taxing authority.[13] At the Supreme Court, a number of amici urged the grant of certiorari, criticizing the Ninth Circuit for paving the path for federal wealth taxation in violation of the Constitution.[14] After the Court granted certiorari, the *Wall Street Journal* asserted that the Justices "will consider the legality of a form of wealth tax that is the

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10 For evidence of economic inequality, see, for example, Ari Glogower, *Taxing Inequality*, 93 N.Y.U. L. Rev. 1421, 1423–24 (2018); Thomas Piketty, Emmanuel Saez & Gabriel Zucman, *Distributional National Accounts: Methods and Estimates for the United States*, 133 Q.J. Econ. 553, 557 (2018); Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data*, 131 Q.J. Econ. 519 (2016). For the wealthy's strategy to evade income taxation, see, for example, Edward J. McCaffery, *Taking Wealth Seriously*, 70 Tax L. Rev. 305, 306 (2017). Senator Elizabeth Warren has proposed a wealth tax of two to six percent based on wealth levels. *Ultra-Millionaire Tax*, Warren for Senate, https://elizabethwarren.com/plans/ultra-millionaire-tax [https://perma.cc/YPS4-S9Y8]; *see also* Ari Glogower, *A Constitutional Wealth Tax*, 118 Mich. L. Rev. 717, 719 n.1 (2020) [hereinafter Glogower, *A Constitutional Wealth Tax*].

11 In general, gains in the value of assets are not taxed until realized, that is, until the underlying assets are sold or disposed of by their owner. *See* I.R.C. § 1001. Unrealized gains—for example, growth in the market value of unsold Apple stocks bought twenty years ago—thus allow elective tax deferral. Skillful taxpayers take advantage of the stepped-up basis rule to achieve complete income-tax forgiveness at death. *See id.* § 1014. President Biden has proposed to tax ultra-wealthy households for unrealized gains in his 2023 budget, but the proposal languished in Congress. *See* Samantha Jacoby, *Biden Proposal Would Eliminate Tax-Free Treatment for Much of Wealthiest Households' Annual Income*, Ctr. on Budget & Pol'y Priorities (May 6, 2022), https://www.cbpp.org/blog/biden-proposal-would-eliminate-tax-free-treatment-for-much-of-wealthiest-households-annual [https://perma.cc/KY53-EH6T]; Brian Schwartz & Christina Wilkie, *Biden's Billionaire Tax Is 'Dead on Arrival' in Congress, Top Wall Street Backers and Democratic Strategists Say*, CNBC (Feb. 9, 2023, 2:14 PM), https://www.cnbc.com/2023/02/09/joe-bidens-billionaire-tax-is-dead-on-arrival.html [https://perma.cc/PS73-QJPS].

12 David B. Rivkin & Andrew M. Grossman, *Can Congress Tax Wealth by 'Deeming' It Income?*, Wall St. J. (Sept. 1, 2021, 6:11 PM), https://www.wsj.com/articles/congress-tax-wealth-courts-constitution-moore-agrawal-kisankraft-elizabeth-warren-11630529642 [https://perma.cc/RAQ4-TDLK]; *Moore*, 2020 WL 6799022.

13 *Moore*, 53 F.4th at 515 (Bumatay, J., dissenting from the denial of rehearing en banc).

14 *See, e.g.*, Brief of Amicus Curiae Landmark Legal Foundation in Support of Petitioners at 13–16, Moore v. United States, No. 22-800 (U.S. argued Dec. 5, 2023); Brief of the Cato Institute as Amicus Curiae in Support of Petitioners at 16–17, *Moore*, No. 22-800.

long-time dream of the political left."[15] At stake in *Moore*, therefore, is not only the MRT but also Congress's authority to enact structural tax reform that substantiates the fiscal system's commitment to distributive justice.[16]

At the center of the doctrinal dispute—whether Congress can tax unrepatriated foreign income, unrealized gains, or wealth—is a century-old case, *Eisner v. Macomber*.[17] In general, the Constitution authorizes Congress to "lay and collect Taxes," but provides that "direct Taxes shall be apportioned among the several States" in accordance with the states' population.[18] Because of regional differences in the distribution of income and wealth, apportioning tax revenue by state population can be challenging as a matter of politics and fairness.[19] And the federal government has not attempted to impose a direct tax, apportioned among the states, since 1861.[20] Until the late nineteenth century, direct taxes were understood to consist in real property and capitation taxes only.[21] In *Pollock v. Farmers' Loan & Trust, Co.*,[22] however, the Supreme Court struck down the income tax of 1894 as an unapportioned direct tax in violation of the Constitution.[23] Shortly thereafter, the states ratified the Sixteenth Amendment, which empowered Congress to "lay and collect taxes on incomes, from whatever source derived, without

15 Editorial, *A Wealth-Tax Watershed for the Supreme Court*, Wall St. J. (June 27, 2023, 7:53 AM), https://www.wsj.com/articles/supreme-court-moore-v-u-s-wealth-tax-patrick-bumatay-ninth-circuit-83610ed [https://perma.cc/KQN8-2YL3].

16 By "structural" tax reform, this Article refers to proposals to change the existing structure or base of federal taxation—e.g., a proposal to introduce a tax on wealth, as opposed to a proposal to increase marginal income tax rates.

17 252 U.S. 189 (1920).

18 U.S. Const. art. I, § 8, cl. 1; *id.* § 2, cl. 3.

19 An apportioned wealth tax, for example, would require Congress to tax wealth in West Virginia at twenty times the tax rate of D.C. Alex Zhang, *The Wealth Tax: Apportionment, Federalism, and Constitutionality*, 23 U. Pa. J.L. & Soc. Change 269, 283–84 (2020). Scholars have recently argued that apportionment is now a *viable* means of taxation because the federal government has the capacity to remedy interstate inequity through transfer payments or fiscal equalization. *See* John R. Brooks & David Gamage, *Taxation and the Constitution, Reconsidered*, 76 Tax L. Rev. 75, 81–82 (2022). This point is well taken. But as scholars also note, the path of apportionment, even though viable, can still be "somewhat more awkward and cumbersome" than taxation at uniform rates. *Id.* at 156.

20 Revenue Act of 1861, ch. 45, § 8, 12 Stat. 292, 294–96 (providing for a $20 million direct tax on land and apportioning revenue among the states). As a practical matter, the direct tax of 1861 never went into effect, and Congress replaced it with an income tax to fund the Civil War. Edwin R.A. Seligman, The Income Tax 435–36 (1911). Scholars have recognized the impracticability and unfairness of direct taxation since the late nineteenth century. *See* Charles F. Dunbar, *The Direct Tax of 1861*, 3 Q.J. Econ. 436, 436 (1889).

21 Springer v. United States, 102 U.S. 586, 602 (1880) ("Our conclusions are, that *direct taxes*, within the meaning of the Constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate.").

22 158 U.S. 601 (1895).

23 *See id.* at 637.

apportionment among the several States."[24] *Eisner v. Macomber* construed the meaning of "income" under the Sixteenth Amendment.[25] At issue was Congress's taxation of a pro rata stock dividend distributed by a company to its shareholders, which did not change the proportional ownership interest that the shareholders had in the company.[26] The Court held that such a stock dividend did not constitute "income" within the Sixteenth Amendment, and was thus beyond Congress's taxing power—at least at uniform rates.[27]

The *Moore* petitioners heavily rely on *Macomber* to argue that the Sixteenth Amendment does not allow Congress to tax unrealized gain—and therefore much of the ultra-rich's wealth[28]—as "income."[29] They focus on the requirement of realization—i.e., the sale or disposal of an asset that triggers taxation—and contend that "an unbroken judicial consensus dating back to *Eisner v. Macomber*" dictates "that the Sixteenth Amendment's exemption from apportionment is limited to taxes on *realized* gains."[30] In particular, *Macomber* noted that despite the stock dividend, the shareholder received no property from the company "for his *separate* use, benefit and disposal."[31] Citing this language, the *Moore* petitioners insist that the MRT—or a wealth tax, for that matter—reaches gains that have not been separated from the initial capital investment.[32] The thrust of their argument, therefore, is that (1) under the Sixteenth Amendment and *Macomber*, Congress can only tax income, that (2) income, by definition, must be realized, and that (3) realization, in turn, requires that the income taxed be separated from the capital—e.g., in the most classic form, the sale of an asset for cash. In response, the government argues that later cases have diminished *Macomber*'s status as a constitutional as opposed to statutory precedent.[33]

Scholars have contested the meaning and implication of *Macomber*. The traditional view is that (1) *Macomber* held that Congress can tax income under the Sixteenth Amendment only if it has been realized, but that (2) *Macomber* has been limited to the stock-dividend context,

24 U.S. CONST. amend. XVI.

25 *See* Eisner v. Macomber, 252 U.S. 189, 206 (1920).

26 *See id.* at 199; *id.* at 229 (Brandeis, J., dissenting).

27 *See id.* at 219. As scholars have argued, *Macomber*'s reasoning is incomplete. *See* Brooks & Gamage, *supra* note 19, at 127–28; *see infra* notes 51–56 and accompanying text.

28 *See* CARL DAVIS, EMMA SIFRE & SPANDAN MARASINI, THE GEOGRAPHIC DISTRIBUTION OF EXTREME WEALTH IN THE U.S. 5 (2022).

29 *See* Petition for Writ of Certiorari, *supra* note 2, at 10–17.

30 *Id.* at 2.

31 *Macomber*, 252 U.S. at 207, 211.

32 Petition for a Writ of Certiorari, *supra* note 2, at 10. Of course, wealth taxes are imposed on the full value of property and analytically distinct from income taxes. *See infra* Section IV.A.

33 Brief for the United States in Opposition, *supra* note 2, at 12–17.

and that (3) the realization requirement is now based on legislative judgment rather than constitutional mandate.[34] In particular, scholars have pointed to subsequent remarks by the Court that realization is "founded on administrative convenience,"[35] and that *Macomber*'s definition of income "was not meant to provide a touchstone to all future [constitutional] gross income questions."[36] Commentators have also referred to extant statutory deviations from the realization rule, some of which lower courts have upheld[37] and dismissed *Macomber* as an archaic relic of the *Lochner*[38] era.[39] However, the Supreme Court has never overruled—in fact, went out of its way not to overrule[40]—*Macomber*

34 *See, e.g.*, Marvin A. Chirelstein & Lawrence Zelenak, Federal Income Taxation: A Law Student's Guide to the Leading Cases and Concepts 80, 89 (14th ed. 2018); Michael J. Graetz, Deborah H. Schenk & Anne L. Alstott, Federal Income Taxation: Principles and Policies 162–63 (8th ed. 2018); Michael J. Graetz, The Decline (and Fall?) of the Income Tax 285 (1997); Stanley S. Surrey, *The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions*, 35 Ill. L. Rev. 779 (1941); Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1, 52 (1999); David J. Shakow, *Taxation Without Realization: A Proposal for Accrual Taxation*, 134 U. Pa. L. Rev. 1111, 1113 n.9 (1986); David M. Schizer, *Realization as Subsidy*, 73 N.Y.U. L. Rev. 1549, 1575–77 (1998); Brooks & Gamage, *supra* note 19, at 84; Deborah H. Schenk, *A Positive Account of the Realization Rule*, 57 Tax L. Rev. 355, 359 n.15 (2004) (collecting scholarly accounts that realization is a constitutional requirement, and dismissing them); Ellen P. Aprill & Richard Schmalbeck, *Post-Disaster Tax Legislation: A Series of Unfortunate Events*, 56 Duke L.J. 51, 79 (2006); Reuven Avi-Yonah, *Should U.S. Tax Law Be Constitutionalized? Centennial Reflections on* Eisner v. Macomber *(1920)*, 16 Duke J. Const. L. & Pub. Pol'y 65 (2021); Dawn Johnsen & Walter Dellinger, *The Constitutionality of a National Wealth Tax*, 93 Ind. L.J. 111, 134 (2018); Marjorie E. Kornhauser, *The Story of* Macomber*: The Continuing Legacy of Realization*, *in* Tax Stories 93 (Paul Caron ed., 2d ed. 2009) [hereinafter Kornhauser, *The Continuing Legacy of Realization*]; Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 Conn. L. Rev. 1, 14 (1992) [hereinafter Kornhauser, *The Constitutional Meaning of Income*]; Jeffrey L. Kwall, *When Should Asset Appreciation Be Taxed? The Case for a Disposition Standard of Realization*, 86 Ind. L.J. 77, 87–89 (2011); Edward A. Zelinsky, *For Realization: Income Taxation, Sectoral Accretionism, and the Virtue of Attainable Virtues*, 19 Cardozo L. Rev. 861, 871 (1997); *see also* Alvin C. Warren Jr., *Financial Contract Innovation and Income Tax Policy*, 107 Harv. L. Rev. 460 462 n.10 (1993).

35 Chirelstein & Zelenak, *supra* note 34, at 89 (quoting Cottage Sav. Ass'n v. Comm'r, 499 U.S. 554 (1991)); *accord* Schizer, *supra* note 34, at 1576 (quoting Helvering v. Horst, 311 U.S. 112, 116 (1940)).

36 Avi-Yonah, *supra* note 34, at 67 (quoting Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955)); *see also* Ajay K. Mehrotra, Making the Modern American Fiscal State 370 n.41 (2013).

37 *See, e.g.*, Schenk, *supra* note 34, at 359 n.15 (citing Murphy v. United States, 992 F.2d 929 (9th Cir. 1993) (upholding constitutionality of mark-to-market rules in 26 U.S.C. § 1256); Eder v. Comm'r, 138 F.2d 27, 28–29 (2d Cir. 1943) (upholding taxation of undistributed earnings of foreign personal holding company)).

38 198 U.S. 45 (1905).

39 *See* Kornhauser, *The Constitutional Meaning of Income*, *supra* note 34, at 24–25; John R. Brooks & David Gamage, The Indirect Tax Canon, Apportionment, and Drafting a Constitutional Wealth Tax 24 (Aug. 27, 2021) (unpublished manuscript) (on file with author).

40 Helvering v. Griffiths, 318 U.S. 371, 394, 404 (1943) (declining to overrule *Macomber* despite the government's request, on the ground that Congress did not intend to tax the stock dividends at issue); *see also* Nicholas R. Parrillo, *Leviathan and Interpretive Revolution: The*

and has favorably cited it for doctrinal tax propositions in *National Federation of Independent Business v. Sebelius*.[41] Some scholars therefore argue that *Macomber* remains good law, and poses substantial if not insurmountable hurdles to federal taxation of wealth and unrealized gains.[42]

This Article reconceptualizes *Macomber* and analyzes its implications for structural tax reform today. Combining close analysis of little read cases with careful attention to the doctrinal background, this Article argues that *Macomber*, as refined by its progeny in the lease-improvement and corporate-reorganization cases from the 1920s to the 1940s, is best read as a case turning on the absence of economic income. That is, under *Macomber*, Congress can tax—and can only tax—an object or transaction that is constitutive of an actual accretion to wealth.[43] This Article thus challenges the traditional view: *Macomber* is not about realization at all but instead about income.[44] Further, contrary to the *Moore* petitioners, this Article contends that *Macomber* poses no barrier to most forms of accretion and wealth taxation, but without relying on dicta from subsequent cases that the Court may easily dismiss. In fact, *Macomber* provides tax policymakers with insights into how to implement wealth taxation that both effectively reaches the net worth of the ultra-rich and would survive constitutional scrutiny.[45]

Two caveats are necessary at the outset. First, the nature of this project is doctrinal. Scholars have articulated distinct modalities of constitutional interpretation.[46] This Article focuses on the principles

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Administrative State, the Judiciary, and the Rise of Legislative History, 1890–1950, 123 Yale L.J. 266, 377 (2013); Charles L.B. Lowndes, *The Taxation of Stock Dividends and Stock Rights*, 96 U. Pa. L. Rev. 147, 149 (1947).

41 567 U.S. 519, 571 (2012) (citing *Eisner v. Macomber*, 252 U.S. 189, 218–19 (1920), for the proposition that taxes on personal property are direct taxes).

42 *See* Erik M. Jensen, *Did the Sixteenth Amendment Ever Matter? Does It Matter Today?*, 108 Nw. U. L. Rev. 799, 818 (2014) [hereinafter Jensen, *Sixteenth Amendment*]; Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 Colum. L. Rev. 2334, 2408 n.393 (1997) [hereinafter Jensen, *Apportionment*]; Henry Ordower, *Revisiting Realization: Accretion Taxation, the Constitution,* Macomber*, and Mark to Market*, 13 Va. Tax Rev. 1, 99 (1993); Edward T. Roehner & Sheila M. Roehner, *Realization: Administrative Convenience or Constitutional Requirement?*, 8 Tax L. Rev. at 173, 175 (1953); Brooks & Gamage, *supra* note 19, at 130–34; *see also* Philip Balzafiore, Mike Gaffney & Dylan Lionberger, *The Constitutional Uncertainty of a Broad Mark-to-Market Rule for Derivatives*, 172 Tax Notes Fed. 2101, 2116–17 (2021).

43 A more remote surviving doctrinal possibility concerns liquidity: that is, Congress can only tax unrealized gains as income where no liquidity problem exists —i.e., the taxpayer can easily sell the underlying asset on an open market and use the proceeds to pay the tax. *See infra* Section I.B.3, Part II.

44 Or, if one adopts the liquidity model, *Macomber* is concerned solely with an aspect of realization—i.e., liquidity—that applies today not to stocks but to illiquid assets like art and certain real estate.

45 *See infra* Part IV.

46 *See, e.g.*, Philip Bobbitt, Constitutional Interpretation 11–22 (1991) (distinguishing among historical, textual, structural, doctrinal, ethical, and prudential modes of constitutional

generated by and the internal logic underlying existing precedents. In Dworkinian terms, it is about "fit" rather than "justification."[47] As a corollary, this Article is not about whether *Macomber* was correctly decided or should be overruled.[48] Instead, it assumes *Macomber*'s continuing precedential status, reconstructs its meaning in light of subsequent doctrinal development, and articulates the limits, if any, that *Macomber* places on Congress's taxing power. In any event, the Court might not overrule *Macomber* in *Moore*. In 1943, even as New Deal liberals who hated *Macomber* filled the Supreme Court, a majority of the Justices voted not to overrule *Macomber* despite the government's insistence.[49] Due to its doctrinal scope and focus, this Article points out, but does not fully develop, limitations that the Sixteenth Amendment may place on Congress's income-tax powers that caselaw has not developed. For example, while the *Macomber* framework allows Congress wide latitude as to valuation in taxing economic income, the language of the Sixteenth Amendment itself may limit that latitude to require some form of recovery for unrealized losses.[50]

Second, this Article only concerns the Sixteenth Amendment and *Macomber*'s construal of it. As Jake Brooks and David Gamage have argued, holding that stock dividends are not "income" is not dispositive of Congress's power to tax them.[51] Before *Macomber*, the Supreme Court had developed a broad understanding of "excises" under the Constitution to include the use and privilege of property ownership.[52]

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argument). For a defense of Congress's power to tax unrealized gains that speaks to textual and historical modalities, see John R. Brooks & David Gamage, Moore v. United States *and the Original Meaning of Income* (Fordham L. Legal Stud. Rsch. Paper No. 4491855, 2023), https://papers.ssrn.com/abstract_id=4491855 [https://perma.cc/5RVD-CWM4].

47 *See* Ronald Dworkin, Taking Rights Seriously 81–130 (1977). There are reasons to think that this Article's doctrinal analysis coheres with broader normative values and other modes of constitutional argument. The legislative impulse behind income taxation in its infancy was equitable. It aimed to make the wealthy bear a fair share of federal tax burdens. *See* Erik M. Jensen, *The Taxing Power, the Sixteenth Amendment, and the Meaning of "Incomes"*, 33 Ariz. St. L.J. 1057, 1095 (2001) The Sixteenth Amendment therefore authorized income taxation as a means to achieve broader redistributive goals, and the doctrinal implication of *Macomber* proposed by this Article is consistent with this understanding. *See also infra* Part III. But a more detailed discussion is beyond the scope of this project.

48 Scholars have disputed whether *Macomber* was correctly decided, and the majority view is that the Court got it wrong. *Compare* Avi-Yonah, *supra* note 34, at 67 ("*Macomber* . . . was widely regarded as wrongly decided."), Brooks & Gamage, *supra* note 46, at 6 ("We believe *Macomber* was wrongly decided . . . ."), *and* John R. Brooks, *The Definitions of Income*, 71 Tax L. Rev. 253, 269 (2018), *with* Jensen, *Sixteenth Amendment*, *supra* note 42. *But see* Charles E. Clark, Eisner v. Macomber *and Some Income Tax Problems*, 29 Yale L.J. 735, 737 (1920).

49 Helvering v. Griffiths, 318 U.S. 371, 404 (1943); Parrillo, *supra* note 40, at 377; Charles L.B. Lowndes, *Current Conceptions of Taxable Income*, 25 Ohio St. L.J. 151 (1964).

50 *See infra* Section III.D.

51 *See* Brooks & Gamage, *supra* note 19, at 127.

52 *See id.* at 111.

Under this "Excise Tax Canon," the Court would refrain from subjecting to the apportionment requirement a tax that directly burdened property when the tax could be characterized—and especially where Congress did characterize the tax—as an excise.[53] In *Macomber*, the Court provided an extensive analysis as to why stock dividends were not "income."[54] This should not have ended the inquiry; even if stock dividends were not income taxable under the Sixteenth Amendment, they still could have been taxable under Congress's power to tax excises at uniform rates.[55] But *Macomber* treated the nontaxability of stock dividends *under the Sixteenth Amendment* as sufficient for their nontaxability *simpliciter*, and thus ignored the rationale of the Excise Tax Canon.[56] This Article does not purport to evaluate *Macomber*'s relationship with the Excise Tax Canon, or the broader question of whether wealth or accrual taxes are within Congress's excise tax power. The Article is only about Congress's power under the Sixteenth Amendment as construed by *Macomber* and its doctrinal progeny.

The remainder of this Article proceeds as follows. Part I of the Article introduces *Macomber*, its doctrinal and statutory background, as well as its reception. In particular, it shows that *Macomber* could stand for at least five different propositions: that under the Sixteenth Amendment, Congress can tax as income (1) only where the object or transaction taxed is constitutive of an accretion to wealth—the *income* reading of *Macomber*, (2) only where the taxpayer receives an asset separate from the initial capital that she invested—the *formal severability* reading, (3) only where the taxpayer receives liquid gains—the *functional severability* reading, (4) only where the taxpayer disposes of the initial capital that she invested—the *disposition* reading, and (5) only where the taxpayer gains full control of a new asset—the *control* reading. Part II of the Article explores *Macomber*'s doctrinal progeny. It argues that only the *income* and the *functional severability* readings of *Macomber* survive after the Supreme Court's doctrinal refinement in the 1920s to the 1940s. In particular, the lease-improvement cases made clear that neither formal separation nor disposition was required for Congress to tax a gain in value as income. The corporate reorganization cases eliminated control as the touchstone of constitutional "income." In addition, Part II discusses doctrinal outliers like *Helvering v. Horst*,[57] *Helvering v. Griffiths*,[58] and *Commissioner v. Glenshaw Glass*,[59] on which some have

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53 *Id.* at 82–83.

54 *See* Eisner v. Macomber, 252 U.S. 189 *passim* (1920).

55 *See* Brooks & Gamage, *supra* note 19, at 127.

56 *See id.*

57 311 U.S. 112 (1940).

58 318 U.S. 371 (1943).

59 348 U.S. 426 (1955).

relied to dismiss *Macomber* as a precedent. Part III addresses objections to this Article, including those based on cash dividends, *Macomber*'s realization language, the business transactions reading of *Helvering v. Bruun*,[60] and Congress's discretion over valuation. Finally, Part IV analyzes *Macomber*'s implications for federal wealth and accretion taxes. It contends that the income reading leaves Congress with wide latitude in determining the federal tax base under the Sixteenth Amendment.

This Article therefore makes a twofold contribution to the scholarly discourse. First, it uncovers five distinct doctrinal interpretations of *Macomber*—in contrast to today's consensus that reads *Macomber* as grounded in formal severability. In fact, while commentators see *Macomber* as a case about realization, the most natural doctrinal proposition for which it stands—the income reading—does not concern realization at all. Second, this Article shows that *Macomber* poses little hurdle to many proposals of accretion and wealth taxation. But this is not because, as most commentators explain, the Court has in effect abrogated *Macomber*; instead, the surviving doctrinal strands of *Macomber* coincide with the administrative and functional considerations in designing income taxes.[61]

I. *Eisner v. Macomber*: Income, Realization, Severability, and Exchange

This Part of the Article introduces *Macomber* and the protean range of its doctrinal meanings. First, it discusses the statutory and doctrinal background leading up to the Court's much-anticipated decision. Second, it examines the decision itself and articulates five different readings of the opinion. Third, it provides an overview of the reception of *Macomber* by scholars and lower courts.

A. *The Doctrinal Background:* Hubbard*,* Springer*,* Pollock*, and* Towne

Macomber arose from Congress's taxation of stock dividends under the Revenue Act of 1916,[62] but Congress had taxed income before during the 1860s to fund the Civil War.[63] In 1870, a question regarding Congress's authority to tax shareholders for unrealized gains arose

60 309 U.S. 461 (1940).

61 *See* Brooks, *supra* note 48, at 266 ("[D]efinitional arguments about income are frequently arguments about something else, such as practical feasibility, fairness, distribution, or economic efficiency, and . . . the definitions themselves generally follow from policy or political goals rather than being prior to them.").

62 *See* Revenue Act of 1916, ch. 463, § 2(a), 39 Stat. 756, 757; Eisner v. Macomber, 252 U.S. 189, 199–200 (1920).

63 *See* Revenue Act of 1862, ch. 119 § 90, 12 Stat. 432, 473; Seligman, *supra* note 20, at 435–40.

before the Supreme Court. Under the Revenue Act of 1864, Congress taxed as income an individual owner's share of a company's profits, "whether divided or otherwise."[64] In *Collector v. Hubbard*,[65] the taxpayer owned shares in two manufacturing companies that had used accumulated profits to invest in business properties rather than distributing them to the shareholders.[66] Importantly, the "excess [profit] was not divided, nor had it been in any way set apart from the general assets of the respective corporations, or appropriated for the use of the stockholders."[67] Hubbard failed to report as income his share of the undistributed earnings of the manufacturing companies and paid taxes on them under protest in 1865.[68] At that time, Hubbard had the right—but was not required—to appeal from the judgment of the tax assessor to the Commissioner of Internal Revenue, so he filed suit in a federal circuit court.[69] In 1866, however, Congress stripped courts of jurisdiction over tax suits where the taxpayer failed to exhaust administrative remedies.[70] After the circuit court dismissed Hubbard's case, he sued the government in Connecticut state court, which ruled in his favor.[71] The Supreme Court reversed, and sustained the government's assessment of tax liability.[72]

Hubbard was therefore primarily a case about jurisdiction and administrative exhaustion. But the Supreme Court also addressed the merits. The question presented was strictly speaking one of statutory construction: "[W]ere the undivided profits [of the manufacturing companies in which Hubbard held ownership interests] . . . 'income' within the meaning of the [Revenue A]ct of 1864?"[73] The Court first held that

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64 Revenue Act of 1864, ch. 173, § 117, 13 Stat. 223, 282. The Revenue Act of 1864 also taxed another form of unrealized gains that was not litigated before the Court: section 117 included as the taxpayer's income "the increased value of live stock, *whether sold or on hand*." *Id.* (emphasis added).

65 79 U.S. (12 Wall.) 1 (1870).

66 *See id.* at 2.

67 *Id.*

68 *Id.* at 2–3.

69 *Id.* at 3; Revenue Act of 1864 §§ 44, 118, 13 Stat. at 239, 283.

70 Revenue Act of 1866, ch. 184, § 19, 14 Stat. 98, 152. Notably, until the creation of the Court of Claims in 1855, taxpayers could not sue the United States in any forum to recover overpayments and appealed to Congress to reassess their liabilities. William T. Plumb Jr., *Tax Refund Suits Against Collectors of Internal Revenue*, 60 Harv. L. Rev. 685, 687 (1947); Steve R. Johnson, *Reforming Federal Tax Litigation: An Agenda*, 41 Fla. St. U. L. Rev. 205, 213 (2013). In 1836, the Supreme Court held tax collectors personally liable for common law assumpsit actions if taxpayers paid their liabilities under protest and with notice of litigation. Elliott v. Swartwout, 35 U.S. (10 Pet.) 137, 150–51, 156 (1836); *see also* City of Philadelphia v. Collector, 72 U.S. (5 Wall.) 720 (1866). Hubbard thus would have had to invoke *diversity* jurisdiction in order to sue the collector in the federal circuit court. *See Hubbard*, 79 U.S. (12 Wall.) at 8.

71 *See Hubbard*, 79 U.S. (12 Wall.) at 3; Hubbard v. Brainard, 35 Conn. 563 (1869).

72 *See Hubbard*, 79 U.S. (12 Wall.) at 18.

73 *Id.* at 4.

based on statutory language and structure, Congress intended to tax all undistributed corporate profits and "properly included" manufacturing companies in its taxation of unrealized gains.[74] Second, Hubbard had contended that under state law, stockholders were not entitled to corporate profits before the declaration of a dividend, and those undistributed corporate profits were nontaxable as "mere increment and augmentation of the stock."[75] The Court squarely rejected this argument. As a matter of form, the Court reasoned that individuals held corporate stock "with all its incidents," and those incidents included a proportional share of all undistributed profits.[76] Functionally, the Court recognized that corporate profits, whether distributed or not, "serve[d] to increase the market value of the shares," that is, constituted economic income or an accretion to wealth.[77] Third, while the question on the merits was statutory, the Court concluded that Congress *both* had the constitutional authority to tax undistributed corporate profits to the shareholder *and* intended to tax them. With unmistakable clarity, the Court held: "[T]he decisive answer . . . is that Congress possesses the power to lay and collect taxes, duties, imposts, and excises, and it is as competent for Congress to tax annual gains and profits before they are divided among the holders of the stock as afterwards . . . ."[78]

Hubbard thus confirmed Congress's power to tax unrealized gains. In 1880, a broader attack on income taxation arose. In *Springer v. United States*,[79] the federal government levied and acquired the land of a delinquent taxpayer in satisfaction of a tax debt.[80] When the government brought an ejectment action against Springer, he argued that income taxes were "direct" taxes and must be apportioned in accordance with each state's census population; because Congress failed to apportion income taxes in the Revenue Act of 1864, they were void under the Constitution.[81] In a lengthy discussion, Justice Noah Swayne—Abraham Lincoln's first appointee to the Court—concluded that "direct" taxes

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74 *Id.* at 17.

75 *Id.* at 5–6 (quoting Phelps v. Farmers & Mechs. Bank, 26 Conn. 268, 272 (1857)); *accord* Minot v. Paine, 99 Mass. 101, 106 (1868) ("The net earnings of a railroad corporation remain the property of the company as fully as its other property till the directors declare a dividend. A shareholder *has no title to them* prior to the dividend being declared." (emphasis added)); Goodwin v. Hardy, 57 Me. 143, 145 (1869).

76 *Hubbard*, 79 U.S. (12 Wall.) at 18.

77 *Id.*

78 *Id.*

79 102 U.S. 586 (1880).

80 *See id.* at 587.

81 *See id.* at 588–89. Springer found no doctrinal support—there was none—for the proposition that income taxes were "direct," and relied on philosophical and social-scientific literature like Adam Smith's *The Wealth of Nations* and John Stuart Mill's *Principles of Political Economy*. *See id.* at 590.

included only real-estate and capitation taxes.[82] The Court found three sets of evidence persuasive, in ascending order of importance: (1) founding-era evidence that, if helpful at all, spoke of taxes on land and people *only* as direct taxes;[83] (2) consistent legislation by Congress that apportioned as direct taxes only those on land and slaves from 1798 to 1861;[84] and (3) cases that consistently declined to require apportionment of federal taxes, as well as the underlying doctrinal logic that only land and poll taxes required apportionment and taxes whose apportionment would lead to inequitable results—e.g., taxes on luxury goods and income—were not "direct" taxes.[85] In the end, the Court's rejection of Springer's constitutional arguments was clear as day: "Our conclusions are, that *direct taxes*, within the meaning of the Constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate, and that the tax of which [Springer] complains is within the category of an [indirect] excise or duty."[86]

Given *Springer*'s sanction of an unapportioned income tax and *Hubbard*'s specific blessing, one might expect Congress's authority to tax unrealized corporate profits a settled question. But in 1895 came *Pollock v. Farmers' Loan & Trust* ("*Pollock II*").[87] The few decades between *Hubbard* and *Pollock* saw dramatic transformations in American society and the perceived ends of federal taxation. Equity and

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82 *Id.* at 602.

83 *See id.* at 596–97 (quoting The Federalist No. 21 (Alexander Hamilton); Letter from James Madison to Thomas Jefferson (May 11, 1794), *in* 2 Letters and Other Writings of James Madison 14, 14 (1865); Letter from James Madison to Edmund Pendleton (Feb. 7, 1796), *in* 2 Letters and Other Writings of James Madison, *supra*, at 77; Brief for the United States, Hylton v. United States, 3 U.S. (3 Dall.) 171 (1796)). *Compare* Ackerman, *supra* note 34, at 28 (citing *Springer* as an example of judicial restraint), *with* Robert G. Natelson, *What the Constitution Means by "Duties, Imposts, and Excises"—and "Taxes" (Direct or Otherwise)*, 66 Case W. Rsrv. L. Rev. 297, 348 (2015) (criticizing *Springer* for "the erroneous belief that the ratification debates did not address the subject" of direct taxes), *and* Erik M. Jensen, Murphy v. Internal Revenue Service*, The Meaning of "Income," and Sky-Is-Falling Tax Commentary*, 60 Case W. Rsrv. L. Rev. 751, 768–69 (2010) (faulting *Springer* for blindly following the dicta in *Hylton*).

84 *See Springer*, 102 U.S. at 598–99; *see also, e.g.*, Revenue Act of 1798, ch. 75, 1 Stat. 597 (apportioned tax on real estate and slaves); Revenue Act of 1813, ch. 37, 3 Stat. 53 (same); Revenue Act of 1815, ch. 21, 3 Stat. 164 (same); Revenue Act of 1861, ch. 45, 12 Stat. 292 (apportioned tax on real estate).

85 *See Springer*, 102 U.S. at 599–603; *see also Hylton*, 3 U.S. (3 Dall.) at 171–72, 184 (opinion of Chase, J.) (upholding an unapportioned tax on carriages); Pac. Ins. Co. v. Soule, 74 U.S. (7 Wall.) 433 (1868) (upholding an unapportioned tax on insurance premiums); Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533 (1869) (upholding an unapportioned tax on state bank notes paid out by other banks); Scholey v. Rew, 90 U.S. (23 Wall.) 331 (1874) (upholding an unapportioned succession tax); *see also* Calvin H. Johnson, *Fixing the Constitutional Absurdity of the Apportionment of Direct Tax*, 21 Const. Comment. 295, 336 (2004); Sheldon D. Pollack, *The First National Income Tax, 1861–1872*, 67 Tax Law. 311, 318 (2014).

86 *Springer*, 102 U.S. at 602.

87 158 U.S. 601 (1895).

social justice, as opposed to government structure and its revenue needs, started shaping the design of tax policy, and economic unrest led to class warfare about the proper scope of redistribution.[88] *Laissez-faire* jurists on the Supreme Court saw the mildly progressive individual income tax of 1894—the first since the Civil War—not as a small step to address growing inequality but a gasping gateway to an "assault upon capital" and socialism.[89] In this polarizing milieu, five justices voted to strike down the income tax of 1894 as an unapportioned direct tax. Over four vigorous dissents, they read the apportionment requirement as a federalism provision designed to preserve the taxing capacity of states, and adopted a simple logic of decision: a tax on the income from real or personal property was a tax on the property itself, and must be apportioned under the Constitution.[90] To the consternation of the dissenters, the *Pollock* majority did not find *Springer* decisive, which had upheld an unapportioned income tax a mere fifteen years earlier.[91] The Court noted two facts: (1) The taxpayer in *Springer* had income from professional services and interest on government bonds, not from real estate, and (2) *Springer* did not specifically say that a tax on income from real or personal property was not equivalent to a tax on real or personal property itself.[92] That is, the *Pollock* majority distinguished *Springer* on the ground that the Civil War income tax, or at least Springer's income tax, fell primarily on earned or labor income, whereas the outcome in *Pollock* turned on income generated by real and personal property.[93] The *Pollock* Court thus suggested that an income tax on earned income could survive constitutional scrutiny.[94] This explanation, however, is not

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88 *See* Ajay K. Mehrotra, *Envisioning the Modern American Fiscal State: Progressive-Era Economists and the Intellectual Foundations of the U.S. Income Tax*, 52 UCLA L. Rev. 1793, 1797–98 (2005); Ackerman, *supra* note 34, at 28–29.

89 Pollock v. Farmers' Loan & Tr. Co. (*Pollock I*), 157 U.S. 429, 607 (1895) (Field, J., concurring); *Pollock II*, 158 U.S. at 674 (Harlan, J., dissenting) ("It was said in argument that the passage of the statute imposing this income tax was an assault by the poor upon the rich, and by much eloquent speech this court has been urged to stand in the breach for the protection of the just rights of property against the advancing hosts of socialism."); *see also* Jensen, *supra* note 47, at 1093–95; Brooks & Gamage, *supra* note 46, at 24.

90 *See Pollock II*, 158 U.S. at 620–21, 637.

91 *See id.* at 656–58 (Harlan, J., dissenting) (discussing *Springer*, 102 U.S. 586; *id.* at 689 (Brown, J., dissenting) ("[A] general income tax was broadly upheld in *Springer* . . . ."); *id.* at 709 (White, J., dissenting) ("[W]e are told that all the decisions of this court from the *Hylton case* down to the *Springer case* in regard to direct taxation are wrong if they limit the word 'direct' to land and capitation, and must, therefore, be disregarded, because 'a century of error' does not suffice to determine a question.").

92 *See Pollock I*, 157 U.S. at 578–79.

93 *See* Jensen, *Apportionment*, *supra* note 42, at 2342–43, 2364; *see also Pollock I*, 157 U.S. at 578–79 ("The original record [in *Springer*] discloses that the income 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.").

94 *See Pollock II*, 158 U.S. at 637.

fully satisfying: *Springer*, after all, upheld the Civil War income tax against a broad constitutional attack, and the Civil War Congress taxed income from property.[95]

Pollock was controversial at the time, and most scholars today think that the Court decided it incorrectly.[96] In any event, the Sixteenth Amendment soon abrogated the outcome in *Pollock*. Ratified in 1913, it empowered Congress "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census of enumeration."[97] Pursuant to the Sixteenth Amendment, Congress soon enacted the Revenue Act of 1913, and proceeded to tax "the entire net income arising or accruing from all sources."[98] In particular, the Act defined "net income" to include all "gains, profits, and income derived from . . . interest, rent, *dividends*, securities, or the transaction of any lawful business carried on for gain or profit."[99] The statute did not say whether *stock* dividends, that is, dividends issued by a company to shareholders in the form of additional stocks in the company, were taxable as true "dividends."[100] But the Treasury Department interpreted the statutory definition of "net income" to include stock dividends. The Commissioner of Internal Revenue provided in an administrative ruling: "Stock dividends paid from the net earnings or the established surplus or undivided profits of corporations . . . are held to be the equivalent of cash and to constitute taxable income under the same conditions as cash dividends."[101]

The issue of Congress's taxation of stock dividends first arose before the Supreme Court in 1918. In *Towne v. Eisner*,[102] a manufacturing company issued stock dividends to its shareholders in 1914.[103] The stock dividends were pro rata: that is, they were proportional to the number of existing stocks held by the shareholders, and their issuance did not change the shareholders' proportional ownership interests in the

95 *Springer*, 102 U.S. at 602; Revenue Act of 1864, ch. 173, § 116, 13 Stat. 223, 281.

96 *See, e.g.*, Edward S. Corwin, Court over Constitution 209 (1938); Francis R. Jones, Pollock v. Farmers' Loan and Trust Company, 9 Harv. L. Rev. 198 (1895); Jos. R. Long, *Tinkering with the Constitution*, 24 Yale L.J. 573, 576 (1915) ("No decision since the *Legal Tender Cases* has attracted such general attention, and probably none since the *Dred Scott Case* has been so widely condemned."); Ackerman, *supra* note 34, at 4–6 (comparing *Pollock* with *Plessy v. Ferguson*, 163 U.S. 537 (1896)); Kornhauser, *The Constitutional Meaning of Income*, *supra* note 34, at 22–23; Johnson, *supra* note 85, 298. *But see* Jensen, *Apportionment*, *supra* note 42, at 2372–74; Owen M. Fiss, Troubled Beginnings of the Modern State, 1888–1910, at 88–91 (Stanley N. Katz ed., 1993).

97 U.S. Const. amend. XVI.

98 Revenue Act of 1913, ch. 16, § 2(a), 38 Stat. 114, 166.

99 *Id.* § 2(b), 38 Stat. at 167 (emphasis added).

100 *Id.*

101 T.D. 2274, 17 Treas. Dec. Int. Rev. 279, 279 (1915).

102 245 U.S. 418 (1918).

103 *See* Towne v. Eisner, 242 F. 702, 703–04 (S.D.N.Y. 1917), *rev'd*, 245 U.S. 418 (1918).

company.[104] Suppose, for example, that a company has two shareholders, each of whom owns 50 of the company's 100 common stocks. A pro rata stock dividend of 1 additional common stock per existing common stock would result in each shareholder owning 100 of the company's 200 common stocks. Their ownership interests in the company remain the same before and after the transaction.[105] The taxpayer in *Towne* paid income taxes on the pro rata stock dividends under protest and brought suit to recover them in the Southern District of New York.[106] Judge Augustus Noble Hand—cousin to and later colleague with Judge Learned Hand on the Second Circuit—sustained the government's demurrer to the taxpayer's complaint, and dismissed the suit.[107]

Importantly, the district court rejected the taxpayer's argument that the stock dividend was not taxable as income because it did not increase the taxpayer's wealth. Judge Hand acknowledged the "impressive" objection that the stock dividend "did not affect the market value of the [taxpayer's] aggregate holdings," and "that the transaction in no wise affected what the stockholder already had, except to give him additional pieces of paper evidencing his ownership."[108] However, Judge Hand held that the stock dividend converted the taxpayer's "mere chance" to receive the company's profits into "a permanent interest in the capitalized surplus."[109] According to the district court, the fact that the taxpayer was rendered no richer—economically—by the stock dividend presented no bar to taxability.[110]

The Supreme Court reversed. In a pithy opinion, Justice Oliver Wendell Holmes adopted the taxpayer's reasoning that the district court rejected. The Court held under the Revenue Act of 1913 that stock dividends were not taxable income, on the ground that they resulted in no accretion to the taxpayer's wealth.[111] In no uncertain language, Justice Holmes wrote:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. . . . The proportional interests of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original

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104 *See id.* at 704, 706.

105 *See* Brooks, *supra* note 48, at 267 n.68.

106 *See Towne*, 242 F. at 703–04.

107 *Id.* at 709; *see also Learned Hand*, BRITANNICA (Aug. 14, 2023), https://www.britannica.com/biography/Learned-Hand [https://perma.cc/G2UU-7KSC].

108 *Towne*, 242 F. at 706.

109 *Id.*

110 *Id.*

111 Towne v. Eisner, 245 U.S. 418, 426–27 (1918).

> shares together representing the same proportional interest that the original shares represented before the issue of new ones." In short, the corporation is no poorer and the stockholder is no richer than they were before.[112]

That is, the taxpayer received no economic income because (1) the company was worth exactly the same before and after the declaration of the stock dividend[113] and (2) pro rata stock dividends did not change the taxpayer's proportional ownership interest in the company. To be sure, the company's value could have increased during the years preceding the declaration of the stock dividend, because the company ran a profitable business. But the object of taxation itself—the company's declaration and the taxpayer-shareholder's receipt of the stock dividends—did not ground or coincide with an accretion to wealth. In other words, the substance—i.e., economic income—must match the form—i.e., the object of taxation under the statutory language.

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Hubbard, *Springer*, *Pollock*, and *Towne* thus formed the foundation of the doctrine by the time of *Macomber*. Two aspects of this Section's analysis are especially relevant to understanding *Macomber*: First, there is a strong argument that Congress had the *authority* to tax unrealized corporate gains to the shareholder under *Hubbard*.[114] Although *Pollock* held that an income tax must be apportioned among the states, the Sixteenth Amendment righted the Court's wrong or granted Congress an additional power.[115] Under either interpretation of the Sixteenth Amendment's relationship with *Pollock*, Congress can tax income. And

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112 *Id.* at 426 (omission in original) (citation omitted) (quoting Gibbons v. Mahon, 136 U.S. 549, 559, 560 (1890)).

113 Where a company's stock price is extremely high, a sufficiently large stock dividend might increase the market value of the company by making its stocks more affordable to lower-income investors. For example, one Class A stock in Warren Buffett's Berkshire Hathaway costs over $500,000, a price out of reach for most investors. *Berkshire Hathaway Inc. Cl A*, Wall St. J., https://www.wsj.com/market-data/quotes/BRK.A [https://perma.cc/VG74-4GWK]. If Berkshire Hathaway declares a pro rata stock dividend of 1000 per 1 common stock, its price per share would decrease dramatically, thus making the company a more affordable investment option and potentially increasing its overall market value. *See, e.g.*, Gow-Cheng Huang, Kartono Liano & Ming-Shiun Pan, *The Effects of Stock Splits on Stock Liquidity*, 39 J. Econ. & Fin. 119, 132 (2015). However, such a maneuver increases a company's market value by increasing its shares' liquidity, not because the company is intrinsically worth more. *See id.* In addition, those considerations were certainly not before the Court as it considered *Towne*.

114 Collector v. Hubbard, 79 U.S. (12 Wall.) 1 (1870).

115 In *Brushaber v. Union Pac. R.R. Co.*, 240 U.S. 1 (1916), the Supreme Court read the Sixteenth Amendment to have overruled *Pollock*'s holding that a tax on income from property was a direct tax on property. *See id.* at 18–19. But the Court went as far as noting that the Sixteenth Amendment *affirmed Pollock*'s holding that direct taxes included taxes on personal property in addition to land. *See id.* at 19; *see also* Ackerman, *supra* note 34, at 40; sources cited *supra* note 96.

Congress's—new or restored—power to tax income was consistent with and left undisturbed *Hubbard*'s subsidiary doctrinal refinement that Congress can tax undistributed corporate profits as income to the shareholder. Second, at least as a statutory matter, the controlling law before *Macomber* was that stock dividends were not taxable *because they did not constitute economic income to the shareholder*.[116] That is, the absence of income justified the nontaxability of stock dividends. With respect to this income-centric test, substance-form mismatch can be fatal: previous accretions to wealth cannot save the taxation of an object or transaction that by itself generated no income.

B. Eisner v. Macomber

This Section examines *Eisner v. Macomber*. It argues that *Macomber* can be read in at least five different ways, as turning on (1) the absence of income, (2) the receipt of separate assets, (3) the receipt of liquid assets, (4) the disposition of the initial investment, and (5) the gain of control over a new asset. As this Section and Part II show, the two most plausible readings of *Macomber* that survived doctrinal refinement in the 1920s to the 1940s—the income reading and the liquidity reading—have been overlooked in scholarship.

Towne was a statutory decision.[117] The Court held that the absence of economic income to the taxpayer meant that stock dividends were not taxable under the Revenue Act of 1913.[118] Congress was therefore free to modify the decision by amendment, and it did precisely that. Under the Revenue Act of 1916, "stock dividend shall be considered income, to the amount of its cash value."[119]

This congressional override of *Towne*'s statutory ruling paved the path for *Eisner v. Macomber*. In 1916, the Standard Oil Company of California declared a half stock dividend for each existing stock.[120] The taxpayer—Mrs. Myrtle H. Macomber—was the daughter of Lamon V. Harkness, an early associate of John D. Rockefeller and a significant stockholder in Standard Oil, who died intestate.[121] As relevant here, Macomber owned 2,200 shares of the existing Standard Oil stock, received certificates for 1,100 additional stocks as dividends, and paid income taxes under protest on those 1,100 dividend stocks.[122] As in

116 *See Towne*, 245 U.S. at 426–27.

117 *See* Clark, *supra* note 48, at 735–36.

118 *Towne*, 245 U.S. at 426–27.

119 Revenue Act of 1916, ch. 463, § 2(a), 39 Stat. 756, 757.

120 *See* Eisner v. Macomber, 252 U.S. 189, 200 (1920).

121 *See In re* Harkness' Est., 169 P. 78, 78 (Cal. 1917); *L.V. Harkness Dies: Racing Man Was Early Associate of John D. Rockefeller*, N.Y. Times, Jan. 18, 1915, at 9; *About L.V. Harkness*, L.V. Harkness, https://www.lvharkness.com/about/company [https://perma.cc/YA7P-8CXQ].

122 *Macomber*, 252 U.S. at 200–01.

Towne, the stock dividends were pro rata and did not change any shareholder's proportional ownership of the company.[123] Writing for a five-four majority, Justice Pitney held that Congress has no constitutional power to tax stock dividends as income to the shareholder.[124] The *Macomber* Court rested its holding on at least five different rationales, which this Section lays out.

1. *The Absence of Income or Accretion to Wealth*

First, the Court expressly grounded Congress's inability to tax stock dividends in the fact that pro rata stock dividends generated no economic income for the taxpayer.[125] After a recitation of facts, the majority opinion bifurcates its doctrinal analysis, and asserted that (1) *Towne v. Eisner* controlled as precedent and (2) a reexamination of the question confirmed that *Towne*'s decision and reasoning were sound.[126]

Macomber's self-conscious framing of its own relationship with *Towne* is odd. As discussed in the previous Section, *Towne* was a statutory, not constitutional, case, and Justice Holmes read the Revenue Act of 1913, *not* the Sixteenth Amendment, to exclude stock dividends from net income.[127] In fact, *Towne* expressly noted that the statutory term of "income" could have a meaning distinct from the constitutional term of "income."[128] For the Court to say that it was "constrained"[129] to place a constitutional limit on Congress's taxing power on the basis of its previous construction of Congress's own words is a non sequitur.[130] The missing piece of the puzzle is the *Macomber* majority's insistence that *Towne* "treated the construction of the [Revenue Act of 1913] as inseparable from the interpretation of the Sixteenth Amendment."[131]

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123 *Id.*; Kornhauser, *The Continuing Legacy of Realization*, *supra* note 34, at 98.

124 *See Macomber*, 252 U.S. at 219.

125 *See id.* at 204–05.

126 *Id.* at 201.

127 *See supra* notes 103–13 and accompanying text.

128 *See* Towne v. Eisner, 245 U.S. 418, 425 (1918) (citing Lamar v. United States, 240 U. S. 60, 65 (1916)) ("But it is not necessarily true that income means the same thing in the Constitution and the act. A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.").

129 *Macomber*, 252 U.S. at 201.

130 Justice Holmes, who wrote *Towne*, dissented in *Macomber*, on the precise ground that *Towne* construed a statute. *See id.* at 219 (Holmes, J., dissenting). According to Holmes, the Sixteenth Amendment was designed to eliminate "nice questions" about direct taxes, and the constitutional meaning of "income" included stock dividends. *Id.* at 219–20; *see also* Gregory L. Germain, *Taxing Emotional Injury Recoveries: A Critical Analysis of* Murphy v. Internal Revenue Service, 60 ARK. L. REV. 185, 265 (2007); Richard B. Stone, *Back to Fundamentals: Another Version of the Stock Dividend Saga*, 79 COLUM. L. REV. 898, 902 (1979); Jensen, *supra* note 47, at 1134–35 (2001).

131 *Macomber*, 252 U.S. at 202 (characterizing the district court opinion in *Towne*); *accord id.* at 203 (characterizing the Supreme Court's opinion in *Towne*).

That is, for the *Macomber* majority, the constitutional and the statutory meanings of "income" were coextensive. Because "Congress intended in [the] act to exert its power to the extent permitted by the Amendment," judicial interpretation of "net income" taxed by the Revenue Act of 1913 was dispositive of any question regarding "income" that *could* be taxed by Congress under the Sixteenth Amendment.[132] Armed with this—somewhat spurious—statute-Constitution equivalence, Justice Pitney quoted at length the opinion in *Towne*; in particular, he relied on *Towne*'s reasoning that the "proportional interest of each shareholder remains the same," and that "the stockholder is no richer than they were before."[133] *Towne*'s analysis of "the essential nature of a stock dividend" thus disqualified any pro rata stock dividend from "being regarded as income in any true sense," including under the Constitution.[134]

Macomber thus constitutionalized the statutory holding of *Towne*: Congress's inability to tax stock dividends could rest on the absence of economic income generated by those dividends. It is worth noting that this income-centric reading of *Macomber* departs from the traditional scholarly understanding: commentators have generally characterized *Macomber* as holding that Congress could tax income only if *realized*, but under the income-centric reading, *Macomber* has nothing to do with realization and instead turns on the absence of accretion to the taxpayer's wealth.[135]

Substantively, pro rata stock dividends do not generate economic income because they do not change the shareholders' proportionate ownership of the company. The Court clearly recognized this, and reasoned that Standard Oil's declaration of stock dividends "[did] not alter the preëxisting [sic] proportionate interest of any stockholder *or increase the intrinsic value of his holding* or of the aggregate holdings of the other stockholders as they stood before."[136] The absence of economic income manifested in—even if it did not depend doctrinally on—a lack of substantial change in the market value of the company before and after the issuance of the stock dividends.[137] To be sure, the taxpayer in *Macomber* could have experienced a significant accretion to her wealth by virtue of the growth in the value of the Standard Oil Company during the years preceding the issuance of the stock dividend. Standard Oil ran a profitable business and held $45 million of undivided surplus earnings in 1916.[138] But *Macomber* made explicitly constitutional the statutory

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132 *Id.* at 203.

133 *Id.* (quoting *Towne*, 245 U.S. at 426).

134 *Id.* at 205.

135 *See supra* note 34 and accompanying text; *infra* Section I.C.

136 *Macomber*, 252 U.S. at 211 (emphasis added).

137 *See id.* at 215.

138 *Id.* at 200.

rationale of *Towne*: "[T]he antecedent accumulation of profits . . . while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction" taxed by Congress.[139] Again, the mismatch between substance—the generation of economic income—and form—what the statute purports to tax—is fatal.

2. *Receipt of Separate Assets*

The second reading of *Macomber* focuses on the Court's language about formal severability, that is, whether the taxpayer has received a separate asset from the taxed transaction. In a passage often quoted by commentators, the majority opinion attempted to disentangle "the term 'income,' as used in common speech, in order to determine its meaning in the [Sixteenth] Amendment."[140] After examining dictionary definitions, the Court adopted a definition of income from its previous cases that construed the corporate income tax of 1909: "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets . . . ."[141] Justice Pitney wrote:

> Here we have the essential matter: *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 from* the capital however invested or employed, and *coming in*, being "'*derived,*" that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description.[142]

That is, taxpayers must have received an asset separate from their initial capital investment before Congress had the power to tax it. The *Macomber* majority repeatedly emphasized that stock dividends fell outside of this definition: stock dividends were "in essence not a dividend . . . [as] no part of the assets of the company [was] separated from the common fund, [and] nothing [was] distributed."[143] "[T]he stockholder has received nothing out of the company's assets for his separate use and benefit."[144] In short, "segregation of profits" was required

139 *Id.* at 212.

140 *Id.* at 206–07.

141 *Id.* (quoting Stratton's Indep., Ltd. v. Howbert, 231 U.S. 399, 415 (1913); Doyle v. Mitchell Bros. Co., 247 U.S. 179, 185 (1918)); *see also* Revenue Act of 1909, Pub. L. No. 61-5, § 38, 36 Stat. 11, 112.

142 *Macomber*, 252 U.S. at 207.

143 *Id.* at 210.

144 *Id.* at 211.

before Congress could tax something as income under the Sixteenth Amendment.[145] The Court's strong language about severability—in fact, taxpayer's formal receipt of something *separate* from her initial capital investment—has driven many commentators to see—and criticize—it as the central thrust of *Macomber*.[146]

3. *The Problem of Liquidity*

But *Macomber*'s focus on formal severability is problematic. At the most basic level, stock dividends *are* formally separate from the shareholders' existing stocks in the company. By definition, stock dividends are *additional* shares that shareholders receive on the basis of their existing stocks, and therefore distinct legal entitlements.[147] Macomber did receive a formally separate asset: 1,100 additional shares of Standard Oil that were separate from her initial holding of 2,200 shares.[148] To say that the taxpayer in *Macomber* received nothing separate is therefore a fiction.

The Court's response to this problem is twofold: first, Justice Pitney made clear that mere receipt of a separate asset in the form of additional stock certificates, which, in combination with existing stock certificates, evidenced the same ownership interest in the company, did not suffice.[149] This substance-over-form argument relates back to the absence of economic income: pro rata stock dividends change neither the shareholders' proportionate ownership nor the company's intrinsic value, and generates no accretion to wealth for the taxpayer.[150] Second, the *Macomber* majority emphasized the need for the shareholder to receive something out of the company's assets for her separate benefit.[151] That is, taxability required the receipt of not simply *any* separate asset, but a *particular kind* of asset from the company: cash or other property whose value did not derive from the taxpayer's existing ownership interest in the company. But this explanation begs the question why the taxpayer must receive one kind of severable asset over another in the first place.

We see here the Court's concern with the functional values underlying severability: the problem of liquidity. In general, policy proposals

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145 *Id.* at 213.

146 *See supra* note 34 and accompanying text; *infra* notes 197–99 and accompanying text.

147 *E.g.*, Brooks, *supra* note 48, at 267 n.68; James Chen, *Stock Dividend: What It Is and How It Works, With Example*, INVESTOPEDIA (June 30, 2023), https://www.investopedia.com/terms/s/stock-dividend.asp [https://perma.cc/VZA8-H7MA].

148 *Macomber*, 252 U.S. at 200–01; Transcript of Record at 4, *Macomber*, 252 U.S. 189 (No. 914).

149 *Macomber*, 252 U.S. at 203–05 (quoting Towne v. Eisner, 245 U.S. 418, 426 (1918)).

150 *See supra* Section I.B.1.

151 *See Macomber*, 252 U.S. at 207.

to tax unrealized gains often face the constraints of liquidity: that is, the fear that to pay the tax assessment, taxpayers must sell prematurely an indivisible asset or a larger-than-desired share of an asset.[152] If an accretion to wealth is not accompanied by the receipt of a marketable good, taxpayers would have no cash to pay the government. *Macomber* recognized this concern: "[W]ithout selling [the stock dividends], the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock."[153] But this liquidity problem appears artificial and self-imposed. After all, the taxpayer could have sold the stock dividends themselves to pay for the income taxes assessed on their receipt. To this objection, the Court responded that if the taxpayer sold the additional stock dividends to raise the cash for the tax payment, she would no longer own the same portion of the company and would no longer be "entitle[d] . . . to the same proportion of future dividends."[154] The need for a "conversion" of the shareholder's initial capital investment meant that the government was taxing a previous capital increase rather than income.[155] This argument again sounds in *Macomber*'s income-centric rationale: if stock dividends had any value beyond the stockholders' existing ownership interest in the company, their sale should result in at least some cash without disturbing the stockholders' proportionate ownership.

The Court's focus on functional severability also reflects a deeper concern. It is not only that sale of the additional stock dividends would diminish the taxpayer's ownership of the company. The taxpayer may also have trouble finding buyers for her stocks.[156] This retort will strike modern readers as odd, bordering on frivolous, and likely explains why most contemporary commentators do not see a legitimate concern with liquidity in *Macomber*: after all, Standard Oil, whose dividend shares were contested in *Macomber*, would appear to have the most liquid stocks readily tradable on the stock market. But the reality of stock trading was different in the 1910s, when Standard Oil declared the stock dividends at issue. Recent scholarship has shown that the United States

152 *See, e.g.*, Alan J. Auerbach, *Retrospective Capital Gains Taxation*, 81 Am. Econ. Rev. 167, 168 (1991); Jane G. Gravelle, *Sharing the Wealth: How to Tax the Rich*, 73 Nat'l Tax J. 951, 960 (2020); David Elkins, *The Myth of Realization: Mark-to-Market Taxation of Publicly-Traded Securities*, 10 Fla. Tax Rev. 375, 379 (2010); Mark L. Louie, Note, *Realizing Appreciation Without Sale: Accrual Taxation of Capital Gains on Marketable Securities*, 34 Stan. L. Rev. 857, 865 (1982); Lily Batchelder & David Kamin, *Policy Options for Taxing the Rich*, *in* Maintaining the Strength of American Capitalism 200, 211–14 (2019).

153 *Macomber*, 252 U.S. at 213.

154 *Id.* at 212.

155 *Id.* at 213.

156 *Id.* at 212 ("It is said that a stockholder may sell the new shares acquired in the stock dividend; and so he may, *if he can find a buyer*." (emphasis added)).

lacked a broad-based stock market in the 1910s.[157] Early stock markets in the United States were dominated by select industries and suffered from structural fragmentation. Railroad companies constituted almost a majority, or a supermajority, of all companies traded on the New York Stock Exchange until at least 1910, and it was only World War I and the enthusiasm for stock trading in the 1920s that resulted in the diversification—by industrial sector—of domestic markets' offerings.[158] Many companies' stocks were only traded on the Curb Market, an informal stock exchange that operated on the street outside of the main New York Stock Exchange.[159] In general, those stocks were considered too speculative for the main exchange, and included stocks of Standard Oil, which were at issue in *Macomber*.[160] Many stocks were therefore illiquid and only "thinly traded" until the late 1920s.[161] Further, stock liquidity not only was low but also volatile. A stock easily sold on the Curb one year could have no buyer the next if there was any market turmoil.[162] Both stock liquidity and volatility improved significantly as U.S. stock markets matured in the twentieth century, but not until long after the Court's decision in *Macomber*.[163] The problem of liquidity—the functional value underlying *Macomber*'s language about severability—is therefore a more legitimate doctrinal concern than most realize. A separate asset whose value did not rest on the shareholder's existing ownership interest—e.g., cash or business property—might be more easily disposable on an open market, and the taxpayer might be better able to pay the assessed tax.

4. *Disposition of the Initial Capital Investment*

Macomber might also be read to turn on the taxpayer's disposition of the initial capital investment. This would be a conditional

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157 *See, e.g.*, Mary O'Sullivan, *The Expansion of the U.S. Stock Market, 1885–1930: Historical Facts and Theoretical Fashions*, 8 Enter. & Soc'y 489 *passim* (2007); Raghuram G. Rajan & Luigi Zingales, Saving Capitalism from the Capitalists 194 (2003); *see also* Lance Davis, *The Capital Markets and Industrial Concentration: The U.S. and U.K., a Comparative Study*, 19 Econ. Hist. Rev. 255 (1966); Ranald C. Michie, *The London and New York Stock Exchanges, 1850–1914*, 46 J. Econ. Hist. 171 (1986). *But see* Richard Sylla, *Schumpeter Redux: A Review of Raghuram G. Rajan and Luigi Zingales's* Saving Capitalism from the Capitalists, 44 J. Econ. Literature 391, 401 (2006) (book review).

158 *See* O'Sullivan, *supra* note 157, at 492, 499 tbl.2 (showing that 44% to 81% of all companies traded on the New York Stock Exchange were railroads from 1885–1910); *see also* Thomas R. Navin & Marian V. Sears, *The Rise of a Market for Industrial Securities, 1887–1902*, 29 Bus. Hist. Rev. 105 (1955); Ralph L. Nelson, Merger Movements in American History, 1895–1956, at 89–91 (1959).

159 *See* O'Sullivan, *supra* note 157, at 497.

160 *See id.* at 497, 509.

161 *See id.* at 497, 518, 521.

162 *See* Charles M. Jones, A Century of Stock Market Liquidity and Trading Costs 5–6, 28 (May 22, 2002) (unpublished manuscript).

163 *See id.* at 10.

requirement: that is, where the taxpayer has not received property—e.g., cash dividend or some other asset[164]—*separate* from the underlying property holding—e.g., her ownership interest in a publicly traded company—Congress may tax the growth in value of the *underlying* property holding *only if* the taxpayer disposes of it.[165] Disposition of the underlying property holding takes various forms—sale of the property for cash, exchange of the property for other assets, or gift of the property to another[166]—but generally means that the taxpayer no longer holds any legal entitlement to her underlying property holding after the disposition. Under the disposition reading, Congress had no power to tax Macomber either for (1) her receipt of separate property from Standard Oil's corporate holdings—she had received none whose value did not derive from her ownership in Standard Oil or (2) Standard Oil's earnings accumulated before the declaration of the stock dividends and the growth in the value of Standard Oil as a company—because she had not sold her initial capital investment.

The disposition reading is doctrinally grounded in *Macomber*'s self-fashioning of its relationship with *Hubbard*. As discussed in the previous Section, the *Hubbard* Court had held in 1870 that Congress could tax a corporation's undistributed profits to a shareholder.[167] In *Macomber*, the government in effect conceded that stock dividends by themselves generated no accretion to wealth and, in the Court's words, "recogniz[ed] the force of the decision in *Towne v. Eisner*."[168] In order to rely to the fullest extent possible on *Hubbard* as a precedent, the government in *Macomber* argued in the alternative that the Revenue Act of 1916 only taxed stock dividends in disguise, and was in fact designed to tax the shareholders' entitlement to the undistributed profits of the corporation.[169] *This*, the government rightly argued, was upheld in *Hubbard*.[170] The *Macomber* majority therefore asked: "If so construed, would the [Revenue Act of 1916] be constitutional?"[171] The Court

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164 If the taxpayer received a cash dividend or an asset from corporate holdings, the law by 1919 was established that Congress could—and did—tax the value of the receipt. *See* Kornhauser, *The Continuing Legacy of Realization*, *supra* note 34, at 99.

165 *See* Eisner v. Macomber, 252 U.S. 189, 209 (1920) ("The dividend normally is payable in money, under exceptional circumstances in some other divisible property; and when so paid, then only (excluding, of course, a possible advantageous sale of his stock or winding-up of the company) does the stockholder realize a profit or gain which becomes his separate property, and thus derive income from the capital that he or his predecessor has invested."); *id.* at 212 ("It is . . . true that if he does sell, and in doing so realizes a profit, such profit, like any other, is income, and so far as it may have arisen since the Sixteenth Amendment is taxable by Congress without apportionment.").

166 *See* Helvering v. Horst, 311 U.S. 112 (1940).

167 *See supra* notes 64–72 and accompanying text.

168 *Macomber*, 252 U.S. at 217.

169 *See id.*

170 *See* Collector v. Hubbard, 79 U.S. (12 Wall.) 1, 18 (1870).

171 *Macomber*, 252 U.S. at 217.

proceeded to answer this hypothetical question in the negative, and concluded without much reasoning that *Pollock* must have overruled *Hubbard*, to the extent that *Hubbard* "uph[e]ld the right of Congress to tax without apportionment a stockholder's interest in accumulated earnings prior to dividend declared."[172]

Macomber's thin analysis regarding *Hubbard* is both frustrating and doctrinally suspect. First, Congress's power to tax a company's undistributed profits to the shareholders was not a question presented in *Macomber*.[173] Despite the government's efforts to frame the 1916 tax on *stock dividends* as one in fact imposed on *undistributed profits*, Congress simply did not attempt to tax the latter.[174] The statute taxed income and included stock dividends as a form of income to override the Court's statutory decision in *Towne*.[175] The Court's answer to the hypothetical question of whether Congress could tax Macomber for the undistributed profits of Standard Oil was therefore an advisory opinion.[176]

Second, *Macomber* failed to justify why *Hubbard* had been overruled. To be sure, *Pollock* had announced that an unapportioned income tax was unconstitutional.[177] But *Pollock* did not expressly overrule *Hubbard*. In any event, the Sixteenth Amendment abrogated *Pollock*: even if *Pollock*'s holding on unapportioned federal income taxation conflicted with *Hubbard*, that part of *Pollock* itself had no force after 1913. The *Macomber* Court never explained how an abrogated judicial decision could vitiate a precedent that (1) had not been expressly overruled and (2) was consistent with the constitutional amendment that settled the federal government's power to tax income.[178]

Third, the internal logic of *Macomber* provided a strong reason to differentiate between Congress's power to tax stock dividends and its

172 *Id.* at 218; *see* Alvin Warren, *The Relation and Integration of Individual and Corporate Income Taxes*, 94 Harv. L. Rev. 717, 740 n.64 (1981).

173 *See Macomber*, 252 U.S. at 199.

174 *See id.* at 199–200.

175 Revenue Act of 1916, ch. 463, § 2(a), 39 Stat. 756, 757.

176 *See* Carney v. Adams, 141 S. Ct. 493, 498 (2020) ("The Constitution grants Article III courts the power to decide 'Cases' or 'Controversies.' We have long understood that constitutional phrase to require that a case embody a genuine, live dispute between adverse parties, thereby preventing the federal courts from issuing advisory opinions. ('[I]t was not for courts to pass upon . . . abstract, intellectual problems but only if a concrete, living contest between adversaries called for the arbitrament of law.')" (alteration in original) (citations omitted) (quoting Coleman v. Miller, 307 U.S. 433, 460 (1939) (opinion of Frankfurter, J.))).

177 *See* Pollock v. Farmers' Loan & Tr. Co. (*Pollock II*), 158 U.S. 601, 637 (1895).

178 The government made similar arguments in its *Macomber* briefing in favor of the continued precedential vitality of *Hubbard*, which the Court did not convincingly address. *See* Brief for the United States, *Macomber*, 252 U.S. 189 (No. 318), *in* 20 Landmark Briefs and Arguments of the Supreme Court of the United States: Constitutional Law 3, 14–17 (Philip B. Kurland & Gerhard Casper eds., 1975).

power to tax shareholders for undistributed corporate profits. Recall that, under the income-centric reading, *Macomber* constitutionalized *Towne*, and required Congress to tax only objects or transactions that coincide with an accretion to the taxpayer's wealth.[179] As both *Towne* held as a matter of statutory interpretation and *Macomber* as a matter of constitutional power, stock dividends generate no economic income. By contrast, *Hubbard* expressly concluded that accumulated corporate profits, whether distributed or not, add to shareholders' wealth, even if only on paper.[180] Under an income-centric reading of *Macomber*, Congress should therefore have the power to tax corporate profits to the shareholders but not stock dividends to the recipients. This third point accentuates the advisory-opinion nature of *Macomber*'s conclusion on the nontaxability of undistributed corporate profits: not only was that question not presented, the Court did not need to answer it to reach its holding on stock dividends. It also highlights the price that the *Macomber* majority had to pay in relying on *Towne*: *Macomber*'s own logic dictates that corporate dividends are wholly different from undistributed corporate profits, at least with respect to Congress's taxing power.

5. *The Problem of Control*

The fifth reading of *Macomber* centers on the problem of control. That is, Congress's power to tax, as income, the growth in the value of an asset turns on whether the taxpayer exercises control over the distribution of the economic gains. The *Macomber* majority reasoned that absent liquidation or declaration of a cash dividend, stockholders "ha[d] no right to withdraw any part of either capital or profits from the common enterprise."[181] In particular, stockholders like Macomber had no ownership interest in the company's assets themselves, as "the corporation has full title, legal and equitable, to the whole."[182] In short, undistributed profits do not "give[] to the stockholders as a body, much less to any one of them, either a claim against the going concern for any particular sum of money, or a right to any particular portion of the assets or any share in them."[183] That is, "unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for the purpose."[184] Of course, if the taxpayer *does* have control over the decision whether to declare a cash dividend—e.g., by holding a majority or a substantial share of the

179 *See supra* notes 127–35 and accompanying text.

180 *See* Collector v. Hubbard, 79 U.S. (12 Wall.) 1, 18 (1870).

181 *Macomber*, 252 U.S. at 208.

182 *Id.*

183 *Id.* at 209.

184 *Id.*

company's stocks—her access to the undistributed corporate profits would no longer be hypothetical.

C. *Scholarly Receptions of* Macomber

This Section provides a brief overview of the scholarly reception of *Macomber*. Legal-academic commentary has proceeded in three stages: (1) mixed contemporary evaluation as to the merits of the majority opinion, (2) fierce challenge of *Macomber* as a constitutional precedent, in particular by Stanley Surrey based on a *formal severability* reading of the opinion, and (3) general agreement today with Surrey's position that *Macomber* concerned severability and has little doctrinal thrust, albeit with notable dissenting voices.

In its immediate aftermath, *Macomber* generated mixed evaluations.[185] Two influential articles are representative of the spectrum of the early views.[186] Charles E. Clarke, a tax expert who later became the Dean of Yale Law School and a principal drafter of the *Federal Rules of Civil Procedure*, thought that the *Macomber* majority got the doctrine right.[187] Clark noted the Court's focus on the fact that the declaration of stock dividends did not change the shareholders' proportionate ownership interests in the company.[188] He also acknowledged the problem of liquidity, and thought it "[e]specially telling . . . that by such declaration [of dividends] the taxpayer receives no income from which to pay an income tax and, if without other assets, must sell some of his shares to make payment."[189] For Clark, the Court's "reiterat[ion of] the previous view" articulated in *Towne v. Eisner* meant that the *Macomber* decision "was scarcely unexpected."[190] In short, "the decision in *Eisner v. Macomber* seems quite simply correct," but Clark recognized that

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185 *See* C.E.C., *Further Limitations upon Federal Income Taxation*, 30 Yale L.J. 75, 75 (1920) ("Since [the] announcement [of *Eisner v. Macomber*,] it has been the subject of extensive comment, both favorable and adverse."). Newspapers at first misreported the Supreme Court's decision in *Macomber*, because the Court, at that time, reported its decisions orally. This led to speculative trading of stocks and substantial business losses. *See Constitutional Unlimitations*, 29 Yale L.J. 677, 678–79 (1920). The misreporting in *Macomber* and a later case resulted in the Supreme Court's decision to make written opinions available at the time of oral announcement. *See* Kornhauser, *The Continuing Legacy of Realization*, *supra* note 34, at 109.

186 For other scholarly reactions, see, e.g., T.W.S., *Profit on Investments as Taxable Income*, 30 Yale L.J. 396 (1921); *Is Appreciation in Value of Property Income?*, 34 Harv. L. Rev. 536 (1921); Thomas Reed Powell, *Income from Corporate Dividends*, 35 Harv. L. Rev. 363 (1922); Roswell Magill, *The Taxation of Unrealized Income*, 39 Harv. L. Rev. 82 (1925).

187 *See* Clark, *supra* note 48, at 737, 744; *see* Michael E. Smith, *Judge Charles E. Clark and The Federal Rules of Civil Procedure*, 85 Yale L.J. 914, 915 (1976).

188 *See* Clark, *supra* note 48, at 735–36.

189 *Id.* at 736.

190 *Id.* at 735–36.

the majority opinion should not be pressed to the extreme and "unduly hamper[] Congress" in designing the minutiae of tax policy.[191]

By contrast, Edward H. Warren, the Story Professor at Harvard, heavily criticized the *Macomber* majority.[192] Warren focused on an income-centric reading of *Macomber* and argued that stock dividends *were* accretions to a taxpayer's wealth. Warren theorized that stock dividends drove up at least in the short term the price of the company's stocks on the market—e.g., due to investors' perception of the company's financial strength in declaring a dividend.[193] But he knew that the Revenue Act of 1916 did not tax stock dividend on that basis; instead, Warren posited that stock dividends were constitutive of the taxpayer's unrealized gains in her ownership interest in the company—i.e., appreciation in the stock price.[194] Where the value of a company—and the stockholder's shares—had increased before the dividend declaration, "a stock dividend is income, although the taxpayer's wealth is not increased *at the moment of its receipt*."[195] For Warren, the *Macomber* majority failed to see that Congress could tax accrued gains and stock dividends "capitalize[d]" those gains.[196]

Early commentary therefore recognized, even if it did not develop extensively, the manifold doctrinal possibilities of *Macomber*, including the income-centric and the liquidity readings. By the time of the New Deal, however, the scholarly view took a distinctive turn. Perhaps the most prominent tax scholar of his generation, Stanley Surrey wrote an influential article that read *Macomber* as resting on the linchpin of formal severability. Surrey noted that the *Macomber* Court laid a "cornerstone" for future doctrinal evolution in requiring realization and receipt of separate assets.[197] But Surrey contended that subsequent cases never built on *Macomber*'s foundation; instead, the Court completely rejected *Macomber* in *Helvering v. Bruun*, and departed from a physical conception of income in *Helvering v. Horst*.[198] For Surrey,

191 *Id.* at 737.

192 *See generally* Edward H. Warren, *Taxability of Stock Dividends as Income*, 33 Harv. L. Rev. 885 (1920).

193 *See id.* at 886–87.

194 *See id.* at 887–88, 897–99.

195 *Id.* at 888 (emphasis added).

196 *Id.* at 895.

197 Surrey, *supra* note 34, at 782; *see also* Roswell Magill, Taxable Income 52–68 (1936); Ordower, *supra* note 42, at 8 n.25 (surveying scholarly treatment of this topic contemporaneous with Surrey).

198 *See* Surrey, *supra* note 34, at 783, 785–86; *see* Helvering v. Bruun, 309 U.S. 461 (1940); Helvering v. Horst, 311 U.S. 112 (1940). Scholars have argued that Surrey overstated the importance of *Bruun* as sounding the death knell of *Macomber*. *See, e.g.*, Ordower, *supra* note 42, at 40. As Section II.B shows, Surrey was right insofar as *Bruun* eliminated the formal-severability model of *Macomber*, but erred insofar as he suggested that *Bruun* abrogated *Macomber* in its entirety. *See infra* Section II.B.

those decisions "mark[ed] the end of one era in our tax history," made "the Sixteenth Amendment . . . an [sic] historical relic," and meant that "*Eisner v. Macomber* was both the first and the last decision declaring an application of the income tax unconstitutional under the Sixteenth Amendment."[199] Surrey thus concluded that Congress could design the tax structure without fear of opposition from the courts.[200]

Surrey's commentary on *Macomber* reigns as the consensus today.[201] As already discussed in the Introduction to this Article, modern scholars generally adopt the following set of views: (1) *Macomber* held that Congress could only tax realized income, and realization under *Macomber* requires the receipt of an asset separate from the initial capital; (2) although *Macomber* has not been overruled, it has been limited to the stock-dividend context; and (3) the Court has downgraded realization from a constitutional mandate to a matter of administrative convenience within legislative discretion.[202] By contrast, this Article argues that the two surviving doctrinal strands of *Macomber* do not concern formal severability. In fact, the income-centric reading of *Macomber* has nothing to do with realization at all. This nuanced analysis demonstrates that while part of *Macomber* survives, those surviving doctrinal strands do not, as a practical matter, constrain congressional discretion in designing tax policy today.[203] This Article thus puts Congress's power to redistribute through taxation on a firmer footing.

II. *Macomber*'s Doctrinal Progeny

This Part of the Article investigates subsequent caselaw in light of the doctrinal possibilities of *Macomber* presented in Part I. First, it examines the lease-improvement cases from the 1910s to the 1940s.[204]

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199 Surrey, *supra* note 34, at 783, 792–93.

200 *See id.* at 793.

201 A leading treatise summarizes the scholarly view:

> It is important to remind oneself . . . that realization is strictly an administrative rule and not a constitutional . . . requirement of "income." Early cases, like *Macomber*, do give support to the idea that the Constitution limits "income" to realized gains, but at present most tax commentators would be likely to feel that the Congressional taxing power is not seriously restricted by such an implied requirement.

Chirelstein & Zelenak, *supra* note 34, at 80; *see also* Ordower, *supra* note 42, at 3, 7 (1993) (noting that "Professor Surrey persuaded us that the Supreme Court abandoned the constitutional realization requirement it enunciated in the case of *Eisner v. Macomber*," and describing "general acceptance of Surrey's conclusion that administrative convenience replaced the constitutional realization requirement").

202 *See supra* notes 34–39 and accompanying text (discussing the scholarly consensus). *But see supra* note 42 and accompanying text (describing the few voices dissenting from the general consensus).

203 *See infra* Part III.

204 *See infra* Section II.A.

There, the Court found that Congress could tax accrued gains in the underlying property to the property owner. Those cases required neither separation nor disposition, but were consistent with an income-centric reading of *Macomber*. Second, this Part of the Article examines the corporate-reorganization cases.[205] Those cases initially appeared to put forth a disposition-centric model of taxability, but the Court eventually moved toward a doctrinal outcome more consistent with the income model. Third, this Part briefly assesses other caselaw which critics of *Macomber* see as repudiating its logic.

A. *The Lease-Improvement Cases*

The lease-improvement cases provide a crucial gloss on the meaning of *Macomber* as a precedent on Congress's taxing power. Dating from 1919 with a Ninth Circuit decision, these disputes arose from a lessee's demolition of an old building and erection of a new one on leased land. The leases usually provided that title in the new building vested immediately in the lessor. As a result, the lessor experienced an accretion to wealth in the form of the new building—or more precisely, in the value differential between the erected new building and the demolished old building, after taking into account any diminution in value due to the lessee's continued occupation of the premises. The lease-improvement cases raised a number of tax questions ranging from taxability—i.e., could Congress tax under *Macomber* the value of the new building which was not severable from the land?—to timing—i.e., if Congress could tax it, did tax liability arise in the year of the new building's construction or at a subsequent time? As this Section shows, the Court eventually repudiated the formal severability and disposition requirements. But the lease-improvement cases are equally important for what they did *not* say: the income-centric, functional-severability—liquidity—and control-centric readings survive as doctrinal models of *Macomber*.

The lease-improvement saga started with *Miller v. Gearin*,[206] a Ninth Circuit case from 1919.[207] The taxpayer, Matilda Gearin, wife to John Gearin who had served as Senator from Oregon,[208] owned land in Portland that had been leased in 1907 to a local corporation for

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205 *See infra* Section II.B.

206 258 F. 225 (9th Cir. 1919), *cert. denied*, 250 U.S. 667 (1919).

207 For accounts of *Gearin* and the subsequent evolution of lower court adjudications and administrative rulings in the taxation of lease improvements, see, e.g., Louis Eisenstein, *Some Iconoclastic Reflections on Tax Administration*, 58 HARV. L. REV. 477, 484–85 (1945); *Constitutional Limitations on the Power to Tax*, 47 HARV. L. REV. 1209, 1268–70 (1934); *Income Taxes—What Is Income—Improvements by Lessee Held Income to The Lessor*, 53 HARV. L. REV. 1206, 1207 (1940).

208 *See* HISTORY OF THE BENCH AND BAR OF OREGON 138 (1910).

twenty-three years.[209] Pursuant to the lease contract, the lessee demolished the wood-framed building on Gearin's land, and erected a seven-story brick building at a cost of $140,000, before defaulting on rent payments in 1916.[210] After Gearin repossessed the premises, the government assessed income taxes to Gearin, as lessor and owner of the land, on the value of the new building at the time of repossession.[211] The government relied on the Revenue Act of 1916, which taxed gains derived from dealings in real property, as well as a Department of Treasury ruling in 1917, which held that any permanent improvements made by lessees under the lease were taxable income to the lessor in the year of the lease's termination.[212] The Ninth Circuit held for the taxpayer: the court reasoned that repossession of the improved premises did not result in income to the lessor.[213] Instead, any income was "'derived' . . . when the completed building was added to the real estate and enhanced its value," the court found.[214] That value, according to the court, was a lump-sum prepayment of rent for the twenty-three-year lease.[215]

Gearin is consistent with an income-centric model of reading *Macomber*. The court struck down the 1917 Treasury ruling on the ground that any accretion to the taxpayer's wealth took place when the lessee erected the new building, not when the lessor reacquired the leased premises.[216] In other words, the doctrinal crux in determining the timing of taxation is when the object of taxation—e.g., the newly erected building—*generated economic income*. It is *not*, for example, when the object of taxation was severed from the initial capital or when the taxpayer gained control over the object of taxation. *Gearin* therefore anticipated the income-centric model of taxability, though it predated the decision of *Macomber*.

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209 *See Gearin*, 258 F. at 225.

210 *See id.*

211 *See id.*

212 Revenue Act of 1916, ch. 463, § 2, 39 Stat. 756, 757; T.D. 2442, 19 Treas. Dec. Int. Rev. 25 (1917); Eisenstein, *supra* note 207, at 484–85.

213 *Gearin*, 258 F. at 226.

214 *Id.*

215 *Id.*

216 Assuming that the newly erected building has a useful life longer than the twenty-three-year term of the lease, the taxpayer-lessor would be able to sell the premises for a higher price on the market and therefore received a substantial economic income in the year of construction. On the other hand, repossession of the premises likely also resulted in some accretion to wealth: assuming similar market conditions, the lessor could now enter into a new lease with a different lessee and charge a higher rent, given the better, new building. But perhaps the *Gearin* court made a fine distinction: any income received by the lessor during the year of the lease termination resulted not from the improvement made by the lessee but from the lessor's reacquisition of the premises. This distinction reflects a control-centric model of taxability.

Following *Gearin*, the Treasury Department made two principal amendments to its regulations. First, Treasury allowed lessors to report as income the fair market values of lessee-made improvements—subject to the lease—in the year of the completion of the improvement.[217] This provision followed from the substantive holding of the Ninth Circuit—that the taxpayer "derived" income when the replacement building "was added to the real estate and enhanced its value."[218] Second, Treasury devised an alternative allocation method and allowed the taxpayer to spread the depreciated value of the improvement over the term of the lease.[219] This provision mirrored *Gearin*'s conception of the lessee's improvement as the functional equivalent of a prepayment of rent.[220] However, the Treasury's careful compliance with the Ninth Circuit's holding did not settle the matter. In 1935, the Treasury's revised regulations came before the Second Circuit. In *Hewitt Realty v. Commissioner*,[221] the taxpayer owned a property located on Lexington Avenue in New York City, and leased it in 1929 for an original term of 21 years.[222] Under the lease agreement, if the lessee erected a new building on the site, the lessee would have the option to renew the lease for three successive twenty-one year terms, with the rent adjusted only on the basis of the value of the land.[223] That is, the contract was designed to enable the lessee to use a new, replacement building while paying a lower-than-market rent.[224] In turn, the lessor would receive additional income in the form of a building whose title vested immediately.[225] In 1931, the lessee exercised its option to erect a new building, with a fair market value of just under $600,000.[226] The Commissioner of Internal Revenue assessed income to the lessor under the allocation method—i.e., allocating a fraction of the market value of the improvement to the taxpayer's income in 1931—and the taxpayer challenged the regulations.[227]

A splintered panel of the Second Circuit ruled against the government. Judge Chase would have sustained the Treasury regulations but remanded for a new valuation by the agency; the regulations rightly provided that the value of the new building subject to the lease was income to the lessor, but the Commissioner's calculation in this case

217 *See* T.D. 4282, 31 Treas. Dec. Int. Rev. 43, 44 (1929).
218 *Gearin*, 258 F. at 226.
219 T.D. 4282, 31 Treas. Dec. Int. Rev. at 44.
220 *See Gearin*, 258 F. at 226.
221 76 F.2d 880 (2d Cir. 1935).
222 *See id.* at 880 (Chase, J., dissenting).
223 *See id.*
224 *See id.*
225 *Id.*
226 *Id.*
227 *See id.*

failed to account for the lessee's option to renew the lease.[228] This makes sense. The possibility that the lessor may not be able to lease the premises at market rent necessarily diminished the accretion to the lessor's wealth that resulted from the addition of the new building. Judge Learned Hand, however, penned a short opinion for the majority. Hewing to the formal severability reading of *Eisner v. Macomber*, Judge Learned Hand asked: "The question . . . is whether the value received is embodied in something *separately disposable*, or whether it is so merged in the land as to become financially a part of it, something which, though it increases its value, has no value of its own when torn away."[229] Because the new building obviously could not be taken off the land and sold "as separate chattels," the lessor realized no taxable income in 1931.[230] Instead, the improvement made by the lessee was like unrealized gains in a shareholder's stocks.[231] Importantly, Judge Learned Hand emphasized the constitutional nature of the inquiry. The fact that Congress reenacted the income-tax statute with knowledge of the Treasury regulations might be evidence of congressional intent but was not persuasive as to the meaning of the Sixteenth Amendment.[232]

The panel's decisions in *Hewitt Realty* again reflect distinct conceptions of *Macomber*. Like the Ninth Circuit in *Gearin*, Judge Chase adopted the income-centric model: if the object of taxation—i.e., the improvement made by the lessee—generated economic income, Congress could tax it.[233] The only question was precisely how much income or accretion to wealth the taxpayer received, as it was limited by the lessee's option to renew the lease at a lower-than-market rent. Judge Learned Hand's opinion for the Second Circuit, however, adopted the formal severability and disposition models of *Macomber*: income taxation required realization, and realization came in the form of the disposition of the original capital and the receipt of an asset segregated from the original capital.[234]

With the circuit split, the Supreme Court spoke, first in *M.E. Blatt Co. v. United States*[235] and then decisively in *Helvering v. Bruun*.[236] In *M.E. Blatt*, the Court held for the taxpayer but equivocated as to the grounds of its decision. That case involved the lease of a movie theater,

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228 *See id.* at 883–84.

229 *Id.* at 884 (majority opinion) (emphasis added).

230 *Id.*

231 *See id.*

232 *See id.* ("However that may be, this is not merely a question of the meaning of a statute, but of what can normally be taxed under the Sixteenth Amendment, and the re-enactment of the income tax law has little or no effect upon that.").

233 *See id.* at 882–83 (Chase, J., dissenting).

234 *See id.* at 884 (majority opinion).

235 305 U.S. 267 (1938).

236 309 U.S. 461 (1940).

where the lessee was required to install theater seats and a film apparatus that became property of the lessor at termination of the lease.[237] The Court rejected the Ninth Circuit's view that improvements made by the lessee, at least in the context of the movie theater, were imputed rent.[238] Instead, the costs of installing furniture and film apparatus were like operating costs.[239] But the Court did not revive the Second Circuit's view of formal severability as the *exclusive* test of what Congress could tax as income. To be sure, the Court asserted that receipt of separate assets with exchangeable value was a component of constitutional income,[240] but it was unclear whether the Court cared about formal segregation or the functional concern of liquidity. At the same time, the Court also endorsed an income-centric model, and thought it "conjectural" the "assumption that the [costs of installation] represent enhancement of value of the leased premises by reason of the improvements."[241] This echoed Judge Chase's position in *Hewitt Realty*: Congress's income-tax power extended only to instances of *real* accretion to wealth resulting from the object taxed.

Justice Harlan Fiske Stone concurred in the majority opinion in *M.E. Blatt*: he saw the Court's commentary on realization and severability as an unnecessary advisory opinion.[242] The crux of *M.E. Blatt*, Justice Stone argued, was not whether the taxpayer *realized* any income, but whether the taxpayer received *any income at all*.[243] Because the facts failed to show that the lessee-made improvements generated economic income to the lessor, realization, even if it were a requirement to taxability, had no place in the Court's reasoning.[244]

Justice Stone's concurrence thus reflected an income-centric reading of *Macomber*. It anticipated the Court's decision in *Helvering v. Bruun* in 1940, when New Deal appointees started filling the Court. In *Bruun*, the taxpayer leased real property for 99 years to the lessee, who demolished the old building and erected a new one before defaulting on rent payments in 1933.[245] The Commissioner assessed income taxes on the fair market value of the new building to the lessor in 1933 upon repossession of the leased premises, and the taxpayer obtained relief

237 *See M.E. Blatt Co.*, 305 U.S. at 274–75.

238 *See id.* at 277.

239 *See id.*

240 *See id.* at 279 ("Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor." (citing inter alia Hewitt Realty Co. v. Comm'r, 76 F.2d 880, 884 (2d Cir. 1935); Eisner v. Macomber, 252 U.S. 189, 207 (1920))).

241 *Id.* at 278.

242 *Id.* at 280 (Stone, J., concurring).

243 *See id.*

244 *See id.*

245 *See* Helvering v. Bruun, 309 U.S. 461, 464 (1940). Chief Justice Hughes concurred in the result of *Bruun*, and Justice McReynolds did not take any part in the decision. *Id.* at 469.

against the government at the Board of Tax Appeals and the Eighth Circuit.[246]

This time, the Supreme Court spoke decisively, and held without dissent that the federal government's power to tax income did not depend on formal severability or disposition.[247] The taxpayer expressly relied on the severability model of *Macomber* and argued that "the economic gain consequent upon the enhanced value of the [leased real estate] is not gain derived from capital or realized within the meaning of the Sixteenth Amendment and may not, therefore, be taxed without apportionment."[248] The Court squarely rejected this contention: as long as the lessee's improvement increased the value of the lessor's real estate, the lessor realized income to the amount of that added value in the year of repossession due to default.[249] Importantly, the Court dismissed *Macomber*'s language about the need to receive separate assets from the corporation. That comment, *Bruun* explained, was "meant to show that in the case of a stock dividend, the stockholder's interest in the corporate assets after receipt of the dividend was the same as and inseverable from that which he owned before the dividend was declared."[250] In other words, *Bruun* theorized formal severability, or rather the lack thereof, as a *proxy* for the absence of economic income: formal severability only indicated that the stockholders had the same proportionate ownership interests in the company before and after the declaration of a stock dividend. The same proportionate ownership, in turn, meant that the taxpayer owned the same percentage of a company with the same valuation—that is, the taxpayer experienced no accretion to his wealth.[251] In this way, *Bruun* concluded that "recognition of taxable gain" does not require that the taxpayer "be able to sever the improvement begetting the gain from his original capital."[252]

Two additional notes on *Bruun*: first, in connection with its conclusion that realization need not be in cash, the Court remarked that "economic gain is not always taxable as income."[253] This comment appears to cut against the income-centric model. However, it is unclear whether this comment referred to taxability under the Sixteenth Amendment or under the income tax statute then in force. The Court had referred to the statute earlier in its opinion and thought it an easy question that section 22 of the Revenue Act of 1932—the statutory definition of gross income—encompassed the economic gain of the *Bruun*

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246 *See id.* at 465.
247 *See id.* at 469.
248 *Id.* at 467–68.
249 *See id.* at 468.
250 *Id.* at 468–69.
251 *See supra* Section I.B.1.
252 *Bruun*, 309 U.S. at 469.
253 *Id.*

taxpayer.[254] That same section excluded from gross income various forms of accretion to wealth—e.g., certain interest payments and compensation for personal injuries.[255] The Court's comment could therefore be grounded in statutory not constitutional interpretation.[256]

Second, the Court initially suggested that under the stipulated facts, "[i]t does not appear what kind of a building was erected by the tenant or whether the building was readily removable from the land."[257] The suggestion that a building could be "readily removable from the land" stretches the imagination.[258] But the factual stipulations filed with the Board of Tax Appeals in 1938, and included in the Supreme Court's transcript of record, indeed said nothing about the building's severability from land.[259] But the Court did not rest its holding on this initial suggestion. It first stated: "We *might* rest our decision upon the narrow issue presented by the terms of the stipulation."[260] It then addressed the taxpayer's argument that the stipulated facts only "assert[ed] that the sum of $51,434.25 was the measure of the resulting enhancement in value of the real estate at the date of the cancellation of the lease."[261] Importantly, the government acquiesced in the taxpayer's reading of the stipulated facts.[262] The Court concluded that "[e]ven upon this assumption"—that is, the sole assumption that the taxpayer received economic income—Congress had the power to tax as income the extent to which the taxpayer became richer by termination of the lease by default.[263] In other words, the Court's holding did not require

254 *See id.* at 468; Revenue Act of 1932, ch. 209, § 22, 47 Stat. 169, 178 (providing the then-operative definition of gross income that is currently defined at I.R.C. § 61).

255 Revenue Act of 1932 § 22(b), 47 Stat. at 178.

256 The Court also relied on the taxpayer's receipt of economic income through a "business transaction." *Bruun*, 309 U.S. at 469. This phrasing might suggest that a change in the taxpayer's relationship with the object of taxation is necessary to trigger Congress's power to tax income. Indeed, today's income tax is primarily a tax on transactions due precisely to the statutory—and perhaps shadow-constitutional—requirement of realization. *See* Kornhauser, *The Continuing Legacy of Realization*, *supra* note 34 *passim*. But the nature of the "business transaction" in *Bruun* is curious; the lessee defaulted, the taxpayer held the same asset before and after the transaction, and the taxpayer had no active role in initiating the transaction. *See Brunn*, 309 U.S. at 464, 469. The main difference in the taxpayer's relationship with the property after the lessee's default is that he regained full control of the leased premises. *See id.* at 464, 467. The issue of control is addressed in Section II.B, *infra*.

257 *Bruun*, 309 U.S. at 467–68.

258 *Id.*

259 Transcript of Record at 14, *Bruun*, 309 U.S. 461 (No. 479) (stating only that "prior to December 31, 1929, the lessee constructed a new building upon said premises, which had a useful life of not more than fifty years").

260 *Bruun*, 309 U.S. at 467 (emphasis added).

261 *Id.* at 468.

262 *Id.*

263 *See id.*

the building's severability from land. The taxpayer's concession of economic income was enough.

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The lease-improvement saga from 1917 to 1940 constitutes a crucial refinement of *Macomber*'s constitutional holding. Litigants ventilated, and jurists endorsed, a number of views of *Macomber*'s doctrinal reach. This Section's analysis yields four main insights. First, *Bruun* eliminated the formal severability reading of *Macomber*. The Court said in no uncertain terms that receipt of separate assets was not required for Congress's taxation of income under the Sixteenth Amendment. The taxpayer's concession of an "enhancement in value" upon the lessee's default was enough for the Court to find constitutional income.[264] The formal severability rationale of *Macomber* was dubious from the beginning, and *Bruun* put a decisive end to it. Second, *Bruun* eliminated the disposition reading of *Macomber*. In the lease-improvement cases, the lessor-taxpayer never *sold* or disposed of its initial capital. Instead, the taxpayer either held title to the real property throughout the duration of the dispute, or regained full control of the property due to termination of the lease.

Third, *Bruun* affirmed the income-centric model. The lessor's concession that the new building erected by the lessee enhanced the value of the leased property (and increased the lessor's wealth) was fatal to the lessor-taxpayer, and decisive of the government's victory. The Court subsumed formal severability—what most commentators, following Stanley Surrey, see as the main thrust of *Macomber*—under the income-centric model. As a constitutional mandate, the realization requirement is in name only, and in fact concerns the antecedent question of whether there has been an accretion to wealth. Fourth, *Bruun* left undisturbed the functional severability and the control models of *Macomber*. The facts of *Bruun* itself might lend support to the control reading: in 1933, the year of taxation, the *Bruun* taxpayer repossessed and thereby regained full control and use of the leased property.[265] But as the next Section shows, the corporate-reorganization cases would eliminate the control reading of *Macomber*.

B. The Corporate-Reorganization Cases

This Section examines the corporate-reorganization cases and their impact on *Macomber*'s constitutional holding. Starting with *United States v. Phellis*[266] in 1921, the reorganization cases generally

264 *Id.* at 468.
265 *See id.* at 464.
266 257 U.S. 156 (1921).

arose when a corporation either reincorporated or split its operations into two companies—the existing company and a new corporation.[267] The corporation's business model, and often its name, did not change, and the intrinsic value of the entire business remained the same before and after the reorganization.[268] In this process, the stockholders of the existing company would receive stock dividends and ownership interests in the new company.[269] Often, but not always, the stockholders' proportionate interests in the existing and new corporations combined would remain the same.[270] The question presented in the reorganization cases was whether the federal government could constitutionally tax the stockholders' receipt of stock dividends under the Sixteenth Amendment.

As this Section will show, the Supreme Court immediately walked back from the constitutional strictures it erected in *Macomber*. But the Court followed a circuitous path. At first, the Court held that Congress could tax stock dividends received in connection with corporate reorganizations where the stockholder held a materially different property interest.[271] There, the Court rejected the income-centric model and appeared to endorse a disposition model of *Macomber*. But the Court also suggested, in intervening caselaw, that Congress's power to tax stock dividends rested on a change in the stockholders' proportionate ownership interest in the company. *This*, as already discussed, was the basis of an income-centric reading of *Macomber*. Confusion reigned in the lower courts, before the Court clarified in 1943 that the proportionate-interest test—*not* the materially-different-interest test—governed, thus returning to an income-centric model. Throughout the development of the corporate-reorganization caselaw, the problem of control never arose as a serious doctrinal concern.

The saga started with *United States v. Phellis* and its companion case, *Rockefeller v. United States*,[272] both decided by the Supreme Court in 1921. In *Phellis*, the E.I. DuPont de Nemours Powder Company, a New Jersey chemical manufacturer, formed a new corporation under the laws of Delaware and transferred all its assets to the Delaware company.[273] In turn, each common stockholder of the New Jersey

267 For example, in *Rockefeller v. United States*, 257 U.S. 176 (1921), two companies that produced and transported oil each split their transportation and pipeline arm into a different company. *See id.* at 180–81. By contrast, in *Weiss v. Stearn*, 265 U.S. 242 (1924), a manufacturing company—the National Acme Manufacturing Company—reincorporated as the National Acme Company. *See id.* at 251.

268 *See, e.g.*, *Rockefeller*, 257 U.S. 176; *Phellis*, 257 U.S. 156.

269 *See, e.g.*, *Phellis*, 257 U.S. 156.

270 *See, e.g.*, *id.*

271 *See infra* notes 281–84, 291–92 and accompanying text.

272 257 U.S. 176 (1921).

273 *See Phellis*, 257 U.S. at 165–66.

company received two dividend common stocks in the Delaware company.[274] As relevant here, the market value of the New Jersey company pre-reorganization was the same as the combined market value of the New Jersey and Delaware companies post-reorganization.[275] The taxpayer-stockholder had the same proportionate ownership interest in the business enterprise and therefore received no economic income through the reorganization.[276] On precisely this basis, the Court of Claims ruled for the taxpayer after he paid income taxes on the Delaware company's stocks.[277] In particular, the Court of Claims found that the taxpayer-stockholder was "in exactly the same situation as to the value of his holdings in both corporations that he was prior to the reorganization," and that "by the transaction the [taxpayer] did not gain or lose a penny."[278] Relying on *Eisner v. Macomber*, the Court of Claims held the stock dividends nontaxable, but the court made clear that "[i]f any income had accrued to the plaintiff by reason of the sale and exchange made[,] it would doubtless be taxable."[279]

The Court of Claims thus adopted an income-centric model in *Phellis*. The Supreme Court reversed. The *Phellis* majority at the Supreme Court noted that only "income derived *in the way of* dividends shall be taxed," and gestured toward a requirement of substance-form match that grew from the income-centric model of taxability.[280] But the majority rejected the reasoning of the Court of Claims, observing that the lack of "increase in aggregate wealth through the mere effect of the reorganization and consequent dividend" did not control.[281] Instead, the dispositive question was whether "stockholders . . . [had] property rights and interests materially different from those incident to ownership of stock in the old company."[282] In *Phellis*, the majority concluded that the taxpayer did receive materially different property interests after the reorganization: the New Jersey company formed a *new* corporation, organized "under the laws of a *different State*," and subject

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274 *Id.* at 167.

275 Before the reorganization, one common stock of the New Jersey company had a fair market value of $795. *See id.* at 167–68. After the reorganization, one common stock of the New Jersey company had a fair market value of $100, and one common stock of the Delaware company had a fair market value of $347.50. *See id.* Each common stockholder of the New Jersey company received two common stocks in the Delaware company for each existing common stock of the New Jersey company and retained her existing stock in the New Jersey company. *See id.* at 167–68. The stockholder's ownership interest in the two companies combined therefore had a fair market value of $795, same as before reorganization. *See id.* at 167–68.

276 *See id.* at 167.

277 *See* Phellis v. United States, 56 Ct. Cl. 157, 173–74, 176 (1921).

278 *Id.* at 175.

279 *Id.* at 176.

280 *Phellis*, 257 U.S. at 169 (emphasis in original); *see supra* note 139 and accompanying text.

281 *Phellis*, 257 U.S. at 170.

282 *Id.* at 173.

to "presumably different rights between stockholders and [the] company and between stockholders *inter sese*."[283] Under this logic, the Court disposed of *Rockefeller*, which involved two oil producers' decisions to split their pipeline businesses into newly formed corporations and provide stock dividends in the new corporations to existing shareholders.[284]

The doctrinal battle between the proportionate-interest test and the materially-different-interest test reflects an underlying conceptual debate, the contest among the distinct possibilities of *Macomber* articulated in Part I of this Article. As the Court of Claims reasoned in *Phellis*, the proportionate-interest test is grounded in the income-centric model of *Macomber*: if the shareholders have the same ownership interests in the business venture, they have experienced no accretion to wealth, and Congress's income-tax power under the Sixteenth Amendment is not triggered, based on the simple reason that there is no economic income to tax.[285] By contrast, the materially-different-interest test is more consistent with the disposition and formal severability models of *Macomber*. As the *Phellis* and *Rockefeller* majority explained, if the shareholders have received materially different property interests in the form of the stock dividends, they have received "separate property" and "actual exchangeable assets" that satisfied the constitutional requirement of *Macomber*.[286] The receipt of materially different interests also signals the disposition of the initial capital, or at least the absence of the same capital that the taxpayer possessed before the reorganization.[287] Under either model, the failure to "produce any increase of wealth to the stockholders" is not fatal to Congress's taxing power.[288]

The Court's rejection of the income model in *Phellis* therefore was a functional retreat from the thrust of *Macomber*, and allowed Congress to tax as income the stock dividends that generated no economic income in corporate reorganizations. In today's fiscal reality, that retreat had a doctrinal price, and would have in fact limited congressional latitude in enacting structural tax reform.[289]

But the Court did not persist in its rejection of the income-centric model, and gradually moved away from the materially-different-interest test. In the 1920s, a series of three intervening cases muddled the

283 *Id.* (emphasis in original).

284 Rockefeller v. United States, 257 U.S. 176, 181–84 (1921).

285 *See Phellis*, 257 U.S. at 176 (McReynolds, J., dissenting) ("It seems incredible that Congress intended to tax as income a business transaction which admittedly produced no gain, no profit, and hence no income." (quoting Phellis v. United States, 56 Ct. Cl. 157, 176 (1921))); S.M.G., *Are Dividends in the Stock of Reorganized Corporations Income?*, 8 Va. L. Rev. 445, 448, 450 (1922).

286 *Phellis*, 257 U.S. at 175; *Rockefeller*, 257 U.S. at 183.

287 *Phellis*, 257 U.S. at 174.

288 *Rockefeller*, 257 U.S. at 183.

289 *See infra* Part III.

doctrine. First, in *Cullinan v. Walker*,[290] the Court appeared to stick to the materially-different-interest standard: a Texas oil company split its producing and pipeline operations into two new companies, and the taxpayer-stockholder received pro rata stocks in a new Delaware holding company that owned the two new companies.[291] The Court held the stocks taxable, on the ground that shares in a Delaware holding company were property interests materially different from shares in a Texas oil company.[292] But in 1924, one year later, came *Weiss v. Stearn*.[293] The stockholders in *Stearn* had full ownership of the old company before the reorganization, and received half of the stocks in the new company, incorporated in the same state, as well as cash for the other half of their share in the business.[294] The government argued that the stockholders should be taxed on their receipt of—half of the stocks in the new company in addition to the cash.[295] The Supreme Court disagreed. Writing for the majority, Justice McReynolds wrote that the reorganization was "a transfer of the old assets and business, *without increase or diminution* or material change of general purpose, to the new corporation . . . and an exchange of the remain[ing half of the stocks] for new stock representing the *same proportionate interest* in the enterprise."[296] As the "value of the [taxpayer's] holdings" remained the same, he did not receive any taxable, separate income under *Macomber*.[297] Finally, in *Marr v. United States*,[298] the Court appeared to endorse a standard that incorporated both the materially-different-interest test and the proportionate-ownership test: Congress could tax a stockholder's receipt of corporate shares as long as the stockholders did not "have the same proportional interest of the same kind in essentially the same corporation" after the reorganization.[299]

By this point in 1925, it was unclear precisely how the corporate-reorganization cases affected *Macomber* as a constitutional precedent. The Court began by expressly rejecting the income-centric model and hewing to the disposition and formal severability models in *Phellis* and *Cullinan*. But the Court moved closer to an income-centric model in

290 262 U.S. 134 (1923).

291 *See id.* at 136–37.

292 *See id.* at 137–38 ("The corporation, whose stock the trustees distributed, was a holding company. In this respect, it differed from Farmers Petroleum Company, which was a producing and pipe line company. It differed from the latter, also, because it was organized under the laws of another State.").

293 265 U.S. 242 (1924).

294 *See id.* at 251–52.

295 *See id.* at 252.

296 *Id.* (emphasis added).

297 *Id.* at 253 (citing *Eisner v. Macomber*, 252 U.S. 189 (1920)).

298 268 U.S. 536 (1925).

299 *Id.* at 541–42.

Stearn, and *Marr* gave credence to all three models without guidance on which controlled.

The next phase of doctrinal evolution reached a more decisive conclusion, but not at first. In 1936, *Koshland v. Helvering*[300] came before the Court. This was not a corporate-reorganization case, but presented the question whether Congress could tax a stockholder for the receipt of *common voting* stock dividends on the basis of his existing *preferred nonvoting* stocks.[301] Recall that *Macomber* held, at a minimum, that taxing the receipt of *common* stock dividends on the basis of existing *common* stocks, without changing the shareholders' proportionate ownership interests, was beyond Congress's powers under the Sixteenth Amendment.[302] *Koshland* was therefore a more direct challenge to *Macomber*'s doctrinal reach.[303] Relying on the logic of the corporate-reorganization cases, the Court held that the receipt of common voting stocks on the basis of nonvoting preferred stocks was *income*, and was *not* accrual to capital under *Macomber*.[304] The precise ground of the Court's decision, however, is hard to decipher. The *Koshland* majority characterized the corporate-reorganization cases as making a "distinction between" (1) "a stock dividend which worked no change in the corporate entity, *the same interest in the same corporation* being represented after the distribution by more shares of precisely the same character" and (2) "such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the *proportional interest of the stockholder*

300 298 U.S. 441 (1936).

301 *Id.* The precise dispute in *Koshland* involved basis allocation. In 1924 and 1926, the taxpayer bought *preferred* stocks of Columbia Steel Corporation. *Id.* at 442. Between 1925 and 1928, Columbia Steel chose to pay dividends on existing preferred stocks in *common stock*. *Id.* The taxpayer therefore received common stocks as dividends. *Id.* In 1930, Columbia Steel redeemed the preferred stocks from the taxpayer. *Id.* at 442–43. Gain from sale of stocks is in general calculated by subtracting the cost basis—what the taxpayer paid for the asset—from the amount realized—what the taxpayer received in consideration upon disposition of the asset. *See* I.R.C. § 1001; Revenue Act of 1928, Pub. L. No. 70-562, §§ 111(a), 113, 45 Stat. 791, 815, 818 (providing the operative definitions for "gain from the sale or other disposition of property" and the "basis for determining the gain or loss from sale or other disposition of property" for *Koshland* in 1936). Instead of subtracting from the amount realized what the *Koshland* taxpayer paid to buy the preferred stocks, the Commissioner allocated part of that cost basis to the taxpayer's common stock dividends. *Koshland*, 298 U.S. at 443. This allocation resulted in an increase in the taxpayer's liability. *Id.* Here comes the doctrinal question: if the common stock dividends were *returns to capital*, and *not* income, the Commissioner was right to decrease the taxpayer's cost basis. But if the common stock dividends were *income*, and *not* returns to capital, the Commissioner had no power to reduce the taxpayer's cost basis. *See id.* at 443–47.

302 *See* Eisner v. Macomber, 252 U.S. 189 (1920); *see supra* Section I.B.

303 The Court clearly saw the corporate-reorganization cases and *Koshland* itself as the doctrinal progeny of *Macomber*. *See Koshland*, 298 U.S. at 443–45 (analyzing *Towne v. Eisner*, *Macomber*, and the corporate-reorganization cases).

304 *See id.* at 445, 447.

after the distribution was *essentially different* from his former interest."[305] *Koshland* then concluded that the taxpayer received income "where a stock dividend gives the stockholder an interest *different* from that which his former stock holdings represented."[306] This "difference," of course, can take the form of qualitative difference—i.e., gesturing toward the materially-different-interest standard, as well as the underlying interpretive models of formal severability and disposition—or quantitative difference—i.e., gesturing toward the proportionate-interest standard, as well as the underlying interpretive model of economic income. Like in *Marr*, the Court did not say which controlled.[307]

Confusion ensued in the lower courts,[308] and the Supreme Court resolved the lower court split in 1943. In *Helvering v. Sprouse*,[309] the Court decisively concluded that the proportionate-interest test controlled.[310] The Court framed its holding as a refinement of *Koshland* and wrote:

> [*Koshland*] was a case where there were both preferred and common stockholders, and where a dividend in common was paid on the preferred. We held, in the circumstances there disclosed, that the dividend was income, but we did not hold that any change whatsoever in the character of the shares issued as dividends resulted in the receipt of income. On the contrary, the decision was that, to render the dividend taxable as income, there must be a change brought about by the issue of shares as a dividend whereby the proportional interest of

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305 *Id.* at 445 (emphasis added) (citing United States v. Phellis, 257 U.S. 156 (1921); then Rockefeller v. United States, 257 U.S. 176 (1921); Cullinan v. Walker, 262 U.S. 134 (1923); Marr v. United States, 268 U.S. 536 (1925)).

306 *Id.* at 446 (emphasis added); *see also* Comm'r v. Koshland, 81 F.2d 641, 646 (9th Cir. 1936) (Denman, J., dissenting) ("We thus see that in no sense could either Mrs. Koshland's voting power or interest in corporate capital be deemed the same after a common stock dividend was issued to her as it was before. The effect of the common dividend was to increase both her interest or expectancy in the company's capital and to change her voting power in its management."), *rev'd*, 298 U.S. 441 (1936).

307 Treasury rulings on the taxation of stock dividends tracked this understanding. *See* T.D. 4674, 15-2 CB. 53, 71 (1936).

308 *Compare, e.g.*, Sprouse v. Comm'r, 122 F.2d 973, 977 (9th Cir. 1941) ("Therefore, we believe the real test to be used in determining whether the stockholder who receives a dividend of stock in the same corporation has received income, is whether the distribution effects a change in the proportionate interests of the stockholders."), *aff'd*, 318 U.S. 604 (1943), *and* Dreyfuss v. Manning, 44 F. Supp. 383, 385 (D.N.J. 1942) (applying the proportionate-interest test), *with* Strassburger v. Comm'r, 124 F.2d 315, 317 (2d Cir. 1941) (applying the materially-different-interest test of *Koshland*), *rev'd*, 318 U.S. 604 (1943). *See also* John Andrew Pickens, Note, *The Taxation of Stock Dividends and the Tax Reform Act of 1969—Foreboding Implications and Constitutional Uncertainties*, 24 VAND. L. REV. 545, 550 nn.30–31 (1971).

309 318 U.S. 604 (1943).

310 *See id.* at 608.

the stockholder after the distribution was essentially different from his former interest.[311]

* * *

The corporate-reorganization cases, as well as *Koshland* and *Sprouse* which relied on them, provided crucial doctrinal refinement of *Macomber*.[312] This Section's analysis provides four main insights. First, the Court quickly walked away from its initial endorsement in *Phellis* of the formal severability and disposition models. *Phellis* articulated the materially-different-interest test of Congress's taxing power over stock dividends, but *Stearn* and *Marr* soon muddled the doctrine, and reintroduced the proportionate-interest test. Second, while the Court initially rejected the income-centric model, it eventually adopted the proportionate-interest test that was the doctrinal instantiation of the income-centric model.[313] The materially-different-interest test is qualitative, and inquires into the differing *natures* of the taxpayers' property holdings before and after a reorganization or receipt of stock dividends. The proportionate-interest test is quantitative, and inquires into any potential change in the taxpayer's proportionate ownership interest in the same business enterprise. As discussed, a change in a stockholder's proportionate ownership of a company could generate economic income or loss.[314] Third, the problem of control never arose as a serious

311 *Id.* at 607–08; *see also* James Wm. Moore & Robert Stephen Oglebay, *The Supreme Court, Stare Decisis and Law of the Case*, 21 Tex. L. Rev. 514, 514 (1943) ("*Eisner v. Macomber* still lives. Recently the Court left intact, at least momentarily, its doctrine that Congress lacks power under the Sixteenth Amendment to levy an income tax upon a stock dividend which does not change the proportionate interests of the shareholder.").

312 All recognized that the question presented was constitutional and went to the heart of Congress's taxing power under the Sixteenth Amendment. In part due to the litigants' reliance, and in part due to the Court's self-awareness of its doctrinal departure, the reorganization and stock-dividend cases saw themselves as *Macomber*'s progeny. *See, e.g.*, *Sprouse*, 318 U.S. at 606–07 (affirming a lower court's conclusion that the stock dividend "was not constitutionally the subject of income tax if it was distributed . . . in proportion to their respective holdings"); Weiss v. Stearn, 265 U.S. 242, 253–54(1924) (reasoning through *Eisner v. Macomber* and *Towne v. Eisner*); Marr v. United States, 268 U.S. 536, 539 (1925) ("It is clear . . . that Congress intended to tax as income of stockholders such gains when so distributed. The serious question for decision is whether *it had power* to do so." (emphasis added)); Rockefeller v. United States, 257 U.S. 176, 182 (1921) ("[T]he facts were specially pleaded so as to present the question whether the distribution of the stocks of the pipe line companies among the stockholders of the oil companies constituted . . . income within the meaning of the Sixteenth Amendment."); Henry Rottschaefer, *Present Taxable Status of Stock Dividends in Federal Tax Law*, 28 Minn. L. Rev. 163, 171 (1944) ("But each of [the reorganization and stock-dividend cases] professed to be developing the implications of *Eisner v. Macomber*, and may, therefore, be treated as defining the tests for determining when a distribution of a stock dividend involves the realization of income by its recipient.").

313 *See* Henry Rottschaefer, *Present Taxable Status of Stock Dividends in Federal Tax Law*, 22 N.C. L. Rev. 1, 12–14 (1943).

314 *See supra* Section I.B.1.

doctrinal concern. Recall that in *Macomber*, one strand of the Court's reasoning rested on an individual stockholder's inability to withdraw cash or other assets from the corporation.[315] In *Helvering v. Bruun*, the lease-improvement case, the Court held that Congress could tax the improvement on the lease when the lessor repossessed the premises, thus accentuating control as a doctrinal concern.[316] In at least some of the corporate reorganization cases, the stockholders similarly lacked the ability to withdraw separate assets from the corporation in which they held ownership interests.[317] And the lack of control was not dispositive of the federal government's power to tax those interests.

Finally, the reorganization caselaw refined the substance-form mismatch that first arose from *Macomber*'s doctrinal interaction with *Hubbard* and *Towne*.[318] This strand of doctrinal reasoning is a component of the income-centric model of *Macomber*, and requires that the object of congressional taxation—i.e., the form—coincide or generate economic income or accretion to wealth—i.e., the substance. In the reorganization caselaw, the proportionate-interest test corresponded with the income-centric model. But the Court *only* required that the object of taxation—i.e., the additional stocks—generate some economic income. That is, the Court *did not* require that the *precise amount taxed* correspond to the *precise amount generated by* the object of taxation, the additional stocks. The point was merely that the possibility of an accretion to wealth *opened up* the avenue to congressional income taxation. The issue of valuation was left to legislative discretion and not a matter of constitutional mandate.

C. Helvering v. Horst, Helvering v. Griffith*, and* Glenshaw Glass

This Section briefly examines three cases on which modern commentators have relied to argue that *Macomber* has been abrogated. However, none of these cases undermined the core logic of *Macomber*, and the Supreme Court could easily dismiss as dicta the assertions which modern commentators cite. The framework articulated and developed in Parts I and II of this Article, therefore, provides a firmer footing for Congress's power to enact structural tax reform today.

First is *Helvering v. Horst*. There, a father detached interest coupons from his negotiable bonds and gave those interest coupons to his son as a gift.[319] The son, in turn, collected the interest at maturity.[320]

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315 *See supra* Section I.B.5.

316 *See supra* Section II.A.

317 For example, the taxpayer in *United States v. Phellis* owned only 250 shares of the E.I. duPont de Nemours Powder Company. *See* United States v. Phellis, 257 U.S. 156, 165, 169 (1921).

318 *See supra* notes 116, 139 and accompanying text.

319 *See* Helvering v. Horst, 311 U.S. 112, 114 (1940).

320 *See id.*

The question arose whether the *father* should be taxed for the interest payments that his son received through the father's gift.[321] *Horst* was therefore about the assignment of income, that is, *who* should be taxed for the accretion to wealth that indisputably (1) took place, and (2) was realized.[322] *Horst* was *not* about *whether* there was income or realization in the first place—the object of inquiry in *Macomber* and its progeny. The Court held that the father should be taxed for the interest collected by the son, on the ground that the father "has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure those satisfactions, or whether he disposes of his right to collect it as the means of procuring them."[323] To be sure, *Horst* stated, as dicta, that the realization rule was "founded on administrative convenience."[324] *Horst* also phrased its assignment-of-income holding in the realization language, and noted that the father "realized" the "enjoyment of the economic benefit accruing to him."[325] But the mere fact that a rule was "founded on administrative convenience"[326] does not necessarily mean that it had no constitutional status. And *pace* Surrey,[327] framing the father's tax liability in the language of realization does not mean that *Horst*'s assignment-of-income holding transformed or overruled the substantive income-realization doctrine of *Macomber* and its progeny.

Commentators have also relied on *Helvering v. Griffiths*, which arose in 1943.[328] *Griffiths* presented substantially similar facts as *Eisner v. Macomber*, and exactly the same question whether Congress could tax the receipt of common stock dividends on the basis of existing common stocks.[329] The decision before the Court was thus whether to overrule *Macomber*, and the government specifically asked the Court to do so.[330] The Court went out of its way to dodge the question, and decided, as a matter of statutory construction, that Congress never intended to tax the

321 *See id.*

322 *See* Ordower, *supra* note 42, at 49–50.

323 *Horst*, 311 U.S. at 117.

324 *Id.* at 116.

325 *Id.* at 117.

326 *Id.* at 116.

327 See Surrey, *supra* note 34, for a discussion of the realization language of *Horst*. Perhaps Surrey foresaw a logical outgrowth, which did not materialize, from the *Horst* case that would rely on the assignment-of-income doctrine to expand Congress's taxing power under the Sixteenth Amendment.

328 *See, e.g.*, Lowndes, *supra* note 40, at 149 ("Although a majority of the [*Griffiths*] Court held that a common stock dividend declared upon common stock is not taxable as income, the opinion leaves small room for doubt that the entire Court agreed that *Eisner v. Macomber* is wrong and that there is no constitutional prohibition against taxing *any* stock dividend as income." (emphasis in original)); Johnsen & Dellinger, *supra* note 34, at 135.

329 *See* Helvering v. Griffiths, 318 U.S. 371, 372 (1943).

330 *See id.* at 394.

stock dividends in question. The statute had provided for the taxation of stock dividends "to the extent that it [constituted] income to the shareholder within the meaning of the Sixteenth Amendment."[331] Relying on an exhaustive overview of legislative history, including statements by Congressman—later Chief Justice—Vinson and Senator—later Justice—Black, the *Griffiths* majority concluded that key legislators thought that Congress had no power to tax stock dividends unless they changed the proportionate ownership interests of the stockholders.[332] This treatment prompted a dramatic statement in the dissent: "*Eisner v. Macomber* dies a slow death. It now has a new reprieve . . . ."[333] To be sure, the entire *Griffiths* Court had sympathy for the government, and even the majority opinion had an air that did not inspire confidence in the continued vitality of *Macomber* as a precedent.[334] But *Griffiths* did not—in fact, emphatically declined to—undermine the existing doctrinal framework.

Finally, in *Commissioner v. Glenshaw Glass*, the Court confronted the question whether punitive damages were taxable under § 22 of the Internal Revenue Code of 1939.[335] Importantly, *Glenshaw Glass* was a case of "*statutory* construction" and did not bear on *Macomber*'s constitutional holding.[336] In fact, the taxpayer conceded that "there is no constitutional barrier to the imposition of a tax on punitive damages" and the Court held that Congress intended to tax such damages.[337] Like *Griffiths* and *Horst*, *Glenshaw Glass* did not undermine the doctrine of *Macomber* and its progeny.[338] Tellingly, the *Moore* petitioners and the *Wall Street Journal* both rely on *Glenshaw Glass* as evidence of the Court's continued endorsement of *Macomber*.[339]

D. Synthesis

This Part of the Article has analyzed the doctrinal progeny of *Macomber* under the theoretical framework articulated in Part I.

331 I.R.C. § 115(f) (1939) (distributions by corporations are now governed by I.R.C. §§ 301–318).

332 *See Griffiths*, 318 U.S. at 380–86, 389 (quoting 80 CONG. REC. 6214–15 (1936)). Justice Jackson, who wrote the majority opinion in *Griffiths*, was himself involved in the legislative process as Chief Counsel of the Internal Revenue Bureau in 1936. Parrillo, *supra* note 40, at 376–78.

333 *Griffiths*, 318 U.S. at 404 (Douglas, J., dissenting).

334 *See* Kornhauser, *The Continuing Legacy of Realization*, *supra* note 34, at 128–29.

335 I.R.C. § 22 (1939).

336 Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 429 (1955) (emphasis added).

337 *Id.*

338 *See* Henry Ordower, *Abandoning Realization and the Transition Tax: Toward a Comprehensive Tax Base*, 67 BUFF. L. REV. 1371, 1387 (2019); Leon Gabinet & Ronald J. Coffey, *The Implications of the Economic Concept of Income for Corporation-Shareholder Income Tax Systems*, 27 CASE W. RSRV. L. REV. 895, 925 (1977).

339 *See* Petition for a Writ of Certiorari, *supra* note 2, at 13 (quoting *Glenshaw Glass*, 348 U.S. at 431); Rivkin & Grossman, *supra* note 12.

As discussed in Part I, there are at least five interpretive models of *Macomber*'s limit on Congress's income tax power under the Sixteenth Amendment: (1) *Income*: the object of taxation must be constitutive of an accretion to wealth, (2) *Formal Severability*: the taxpayer must receive an asset separate from the initial capital, (3) *Functional Severability*: the taxpayer must receive liquid gains, (4) *Disposition*: the taxpayer must dispose of the initial capital, and (5) *Control*: the taxpayer must gain full control of a new asset. The income model is quantitative, looking to the economic gain, or lack thereof, that the taxpayer has received through a transaction. The last four models are qualitative, looking to the nature of the taxpayer's receipt. As Section II.A has shown, the lease-improvement cases have eliminated the formal severability and the disposition models. By upholding congressional taxation of improvements to the lessor upon repossession, those cases endorsed the income model and gestured toward the control model. As Section II.B has shown, the corporate-reorganization cases, in addition to the stock-dividend cases in the 1930s and 1940s which relied on them, have eliminated the control model. By upholding congressional taxation of stock dividends that effected a change in the stockholder's proportionate ownership in the company, those cases endorsed again the income model. These cases left undisturbed the functional severability-liquidity model, but did not reaffirm the model as the touchstone of constitutional income. As the dust settled after *Bruun* and *Sprouse*, *Macomber* is now best read as a case about economic income: Congress could tax under the Sixteenth Amendment any object or transaction that was constitutive or generative of an accretion to wealth. Valuation is left to legislative discretion: Economic income opens the door to constitutional income taxation, but the amount taxed need not correspond to precisely the amount of accretion to wealth generated by the object of taxation.

III. Objections and Clarifications

This Part addresses main objections to the arguments made in Parts I and II regarding the income-centric view of *Macomber*. It first addresses Congress's authority to tax cash dividends, and then examines *Macomber*'s language of realization.

A. *The Treatment of Cash Dividends*

The doctrinal fact that Congress can constitutionally tax cash dividends appears to create a difficulty for the income-centric reading. One might argue that like stock dividends, cash dividends produce no economic income to the stockholder-taxpayer. In perfect market conditions without taxes or transaction costs, the share price of a company that has declared a cash dividend should fall by precisely the same amount as the value of the dividend paid on each share.[340] The company has transferred economic value to the shareholders, in the process reducing its own value as a company.

That is, upon receipt of a cash dividend, a stockholder-taxpayer experiences a concomitant reduction in the value of her stock holdings to the same amount as the value of her cash receipt—i.e., in perfect market conditions with no taxes or transaction costs. Because the economic income in the form of the dividend cash is offset by the corresponding loss in value of the stocks, the stockholder-taxpayer experiences no accretion to wealth. The majority in *Macomber* saw no constitutional obstacle to federal taxation of cash dividends.[341] But under the income-centric model, Congress could only tax an object or a transaction generative of economic income. For the income-centric model to hold, therefore, one might argue that cash dividends would also need to be nontaxable under the Sixteenth Amendment.

Two responses are due here. First, Congress's power to tax cash dividends had already been settled by *Macomber*. In *Lynch v. Hornby*,[342] decided two years before *Macomber*, a company declared an extraordinary cash dividend from its earnings accumulated before the ratification of the Sixteenth Amendment and the reinstitution of income taxation in 1913.[343] The Revenue Act of 1913 provided a deduction for the receipt of cash dividends from the basic individual income tax of 1%, to avoid "double" taxation at both the corporate and the individual level.[344] Congress, however, assessed a surtax on individuals' net income above $20,000, and did not provide a deduction for cash dividends against surtax liability.[345] The taxpayer in *Hornby* received a cash dividend from a lumber company in which he held ownership interest.[346] The Commissioner imposed additional tax liability on the *Hornby* taxpayer's receipt of cash dividends from the lumber company, and the taxpayer obtained

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340 *See* Murray Frank & Ravi Jagannathan, *Why Do Stock Prices Drop by Less Than the Value of the Dividend? Evidence from a Country Without Taxes*, 47 J. Fin. Econ. 161 (1998). In practice, the share price of a company declines by slightly less than the value of the cash dividend paid on each share. *See id.* Finance scholars have explained this phenomenon with reference to the presence of taxes and the behavior of investors. *Id.*

341 *See* Eisner v. Macomber, 252 U.S. 189, 204, 215 (1920).

342 247 U.S. 339 (1918).

343 *See id.* at 340–41.

344 *See* Revenue Act of 1913, ch. 16, § 2(b), 38 Stat. 114, 167 ("[I]n computing net income for the purpose of the normal tax there shall be allowed as deductions . . . 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."); Staff of Joint Comm. on Internal Revenue Tax'n, History of Exemption of Dividend Income Under the Individual Income Tax, 1913–1961, at 1 (1961).

345 *See* Revenue Act of 1913, § 2(a)–(b), 38 Stat. at 166–67.

346 *See Hornby*, 247 U.S. at 341.

relief in both the district and the circuit courts.[347] The Supreme Court unanimously reversed. Justice Pitney, who later authored the majority opinion in *Macomber*, saw "no constitutional obstacle" to federal taxation of cash dividends, including those declared based on earnings that accrued before the Revenue Act of 1913.[348] Congress's power to tax cash dividends therefore predated *Macomber*, and was arguably a preexisting carve-out from the models of taxability that *Macomber* articulated.

Second, the nature and constitutional taxability of cash dividends could in fact provide additional support for the income-centric model. There is strong evidence that both according to the *Hornby* Court and in reality, cash dividends do generate—even in small amounts—economic income. In *Hornby*, the Court noted: "We do not overlook the fact that every dividend distribution diminishes by just so much the assets of the corporation, and in a theoretical sense reduces the intrinsic value of the stock."[349] That is, Justice Pitney recognized that the taxpayer appeared to have experienced no accretion to wealth upon receipt of a cash dividend, and saw this as a potential problem with *Hornby*'s holding. He explained: "But, at the same time, [the declaration of cash dividends] demonstrates the capacity of the corporation to pay dividends, holds out a promise of further dividends in the future, and quite probably increases the market value of the shares."[350] In other words, cash dividends could result in a smaller-than-expected drop in the share price, because the company's decision to declare such dividends signals its financial health and strengthens investor confidence in the company's future performance. More recent data appear to bear out Justice Pitney's observation in *Hornby*: as already noted, the share price of a company in general declines by slightly less than the value of the cash dividend paid on each share.[351] Importantly, *Hornby*'s rationale applies to *cash* dividends only and not to *stock* dividends. Cash dividends signal the company's financial health because of the company's ability to distribute cash to the shareholders. The same is not true of stock dividends.

Further, cash dividends generate economic income to shareholders because of the value of liquidity. That is, assume that the share price of a company drops by the same amount as the value of the cash dividend paid on each stock. In this scenario, the stockholder receives a cash dividend but experiences a concomitant reduction in her stock holdings that completely offsets the book value of the cash dividend. Even here,

347 *See id.* at 340–41.

348 *Id.* at 343.

349 *Id.* at 346.

350 *Id.*

351 *See supra* note 340 and accompanying text. To be sure, contemporary finance scholars have provided explanations for this phenomenon different from Justice Pitney's rationale in *Hornby*. *See, e.g.*, Frank & Jagannathan, *supra* note 340. But *Hornby* did not incorrectly rely on the fundamental fact that cash dividends result in a slightly smaller drop in share price than expected.

the stockholder-taxpayer has received *economic* income: the increased liquidity of her investment portfolio, which now has more cash and less stock, is worth something. The empirical literature has shown that although cash does not generate income in the ordinary sense, it does generate "transaction services income," that is, the economic benefit that liquid assets confer on their owners by making purchases cheaper and easier.[352] The value of liquidity, for example, accounts for the fact that restricted stocks tend to yield substantially higher returns than publicly traded stocks in the same company with the same legal rights.[353] Part of the value of publicly traded stocks consists in the absence of any restriction on their trade. This value of increased liquidity compared to restricted stocks accounts for the lower yield of publicly traded stocks. Unlike cash dividends, stock dividends do not generate any value in the form of increased liquidity. Upon receipt of a stock dividend, the liquidity of a shareholder's investment portfolio remains unchanged.[354]

B. Macomber*'s Language of Realization*

As discussed, *Macomber* contains passages about separation which commentators have often quoted to argue in favor of the formal-severability model.[355] Stanley Surrey read this discussion as laying the foundation of a constitutional realization requirement, which he argued that subsequent cases overruled.[356] And today the *Moore* petitioners heavily rely on these passages to contend that Congress has no power to tax unrealized gains.[357] One might argue that *Macomber*'s language of realization poses a difficulty for the income-centric model. After all, if "enrichment through increase in value of capital investment is not income in any proper meaning of the term," then formal severability,

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352 Yair Listokin, *Taxation and Liquidity*, 120 Yale L.J. 1682, 1682, 1685 (2011).

353 *See id.* at 1699.

354 The value of liquidity generated by cash dividends may have been much more significant at the time of *Macomber*, given the absence of mature stock markets. *See supra* notes 157–61 and accompanying text.

355 *See supra* note 142 and accompanying text. For the reader's convenience, an often-quoted passage reads:

> Here we have the essential matter: *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 from* the capital, however invested or employed, and *coming in*, being "*derived*," that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description.

Eisner v. Macomber, 252 U.S. 189, 207 (1920) (emphasis in original); *see also id.* at 214–15 ("[E]nrichment through increase in value of capital investment is not income in any proper meaning of the term.").

356 *See supra* notes 197–99 and accompanying text.

357 *See supra* notes 29–32 and accompanying text.

not the presence of economic income, would seem to be the controlling constitutional test.[358]

Two responses are due here. First, as the taxonomy of Section I.B shows, the majority opinion in *Macomber* is not a monolith but admits of at least five different interpretive models. Each interpretive model is independently sufficient to support the holding. That is, pro rata stock dividends are not taxable under the Sixteenth Amendment because (1) they do not generate economic income, *or* (2) they are not segregated from the initial capital investment, *or* (3) they are—or at least were—somewhat illiquid, *or* (4) the taxpayer has not disposed of the initial capital investment, *or* (5) the taxpayer does not have full control over the asset. To decide on the best reading of *Macomber* today, we look to both the opinion itself and subsequent doctrinal development. The point of Part II is to argue that only the income-centric and liquidity models are viable interpretations of *Macomber* after the lease-improvement and corporate-reorganization cases from the 1920s to the 1940s. The presence of realization language in *Macomber* is therefore not fatal to the income-centric model. Just as, for example, *Macomber*'s language about control would not have been fatal to the formal-severability model, if later cases, to use Surrey's words, had built on the doctrinal foundation of constitutional realization.

Second, even if we look at *Macomber* alone without regard to subsequent doctrinal development, there is strong evidence that the income model is more vital to the case than the realization model. As discussed, the majority opinion in *Macomber* has a bipartite structure: the first part holds that *Towne* controls the question presented, and the second part is a "reëxamination [sic]" confirming that *Towne* was rightly decided.[359] Recall that *Towne* held as a statutory matter that stock dividends were not taxable because they generated no economic income, and that *Macomber* constitutionalized this statutory holding of *Towne*.[360] The entire first part of the opinion, therefore, is an exposition of the income-centric model that fully decides the controversy in *Macomber*.

Because the income-centric model fully disposes of the case, the second part of *Macomber* is unnecessary. The majority, however, addressed the taxability of stock dividends from the perspectives of other interpretive models due to "the additional light thrown upon it

358 *Macomber*, 252 U.S. at 207, 214–15.

359 *Id.* at 201 ("We are constrained to hold that the judgment of the District Court must be affirmed: First, because the question at issue is controlled by *Towne v. Eisner*, *supra*; secondly, because a reëxamination [sic] of the question, with the additional light thrown upon it by elaborate arguments, has confirmed the view that the underlying ground of that decision is sound, that it disposes of the question here presented, and that other fundamental considerations lead to the same result.").

360 *See supra* Sections I.A–B.1.

by elaborate arguments."[361] This Article has argued that parts of the majority's discussion here are, strictly speaking, an advisory opinion.[362] That is, the *Macomber* majority indeed stated that accrued gains were not income, and that income should be severed from capital. But the majority made these two claims in response to the question of whether Congress had the power to tax a stockholder's share of corporate earnings. *That* question was hypothetical and not properly before the Court. The question properly before the Court in *Macomber* was whether *stock dividends*, not whether the stockholder's share of corporate earnings, were taxable under the Sixteenth Amendment. The majority's discussion of a hypothetical question which was not properly presented, when its adoption of the income model in the first part of the opinion fully disposes of the controversy at hand, was at best dicta.

To see why the *Macomber* majority discussed realization—i.e., severability—and accrual gains at all, we need to look to the briefing before the Court. The first round of briefing barely discussed separation. The taxpayer's primary argument was that the stock dividends generated no economic income.[363] In his brief, Charles E. Hughes, who had served as Associate Justice on the Supreme Court until 1916, and would later become Chief Justice in 1930, wrote:

> The fundamental fact is that there was *no gain or income* to the defendant-in-error [i.e., the taxpayer] by virtue of the receipt of the additional shares constituting the 'stock dividend'. The value of the shares held by the defendant-in-error was not increased by the increase in the number of shares. The shareholder was *no richer than before*.[364]

That is, the conceptual basis for the nontaxability of stock dividends lies in the income model—whether the taxpayer has experienced an accretion to wealth by the object of taxation. The government echoed this view. In its supplemental brief, the government contended, "The fundamental and *controlling* fact is that defendant in error *is richer than she was* on March 1, 1913, to the extent of 198 shares of Standard Oil stock which actually and in truth constitute a gain which she has derived from capital."[365]

361 *Macomber*, 252 U.S. at 201.

362 *See supra* notes 169–76 and accompanying text.

363 *See* Brief and Argument for Defendant-in-Error, *Macomber*, 252 U.S. 189 (No. 318), *in* Landmark Briefs and Arguments of the Supreme Court of the United States, *supra* note 178, at 47, 57, 62–68.

364 *Id.* at 62 (emphasis added).

365 Supplemental Brief for the United States, *Macomber*, 252 U.S. 189 (No. 318), *in* Landmark Briefs and Arguments of the Supreme Court of the United States, *supra* note 178, at 117, 129 (emphasis added).

The government and the taxpayer therefore agreed that the fundamental and dispositive question is whether the shareholder received any economic income—the thrust of the income-centric model. What they disagreed on is the timing and the actual object of taxation. That is, they disagreed on *what* Congress intended to tax—stock dividends versus the stockholder's share of the company's profits—and on *what time window* to use to measure whether the taxpayer experienced an accretion to wealth—before and after the receipt of stock dividends in 1916 versus from the beginning of the company's profit generation in 1913 and the receipt of the cash dividend in 1916. The taxpayer argued that the tax on stock dividends imposed by the Revenue Act of 1916 was a tax on, well, stock dividends. The time period for the constitutional taxability analysis was before and after the receipt of the stock dividends. Pro rata stock dividends left the taxpayer "with precisely the same ownership and actual interest" and "no richer because they were received."[366] With no accretion to wealth, there was no income to be taxed.[367] The future Chief Justice put it bluntly: "[I]f [stock dividends] are not income in the sense that they make the shareholder richer than he was before, it can hardly be contended that they should be regarded as income within the meaning of the constitutional provision."[368]

By contrast, the government argued that the tax on stock dividends imposed by the Revenue Act of 1916 was *not* a tax on stock dividends but a tax on the stockholder's share of the profits of the company.[369] The government conceded that stock dividends by themselves generated no economic income.[370] But the profitability of the company from 1913 onward made the taxpayer richer. Because the company ran a profitable business, its intrinsic worth increased, and the stockholder's same proportionate share of a larger pie was worth more. If Congress had intended to tax the stockholders for their pro rata shares of the company's profits, the fact that the stock dividends themselves generated no economic income would have been no object.[371] The controlling time period for the constitutional taxability analysis was whether the stockholder became richer between 1913 and 1916.[372] And the *Macomber*

366 Brief and Argument for Defendant-in-Error, *supra* note 363, at 64, 68.

367 *Id.* at 68.

368 *Id.* at 91.

369 *See* Brief for the United States, *supra* note 178, at 20–33.

370 Supplemental Brief for the United States, *supra* note 365, at 157 ("Counsel for defendant in error assert that the fundamental fact is that a stockholder is no richer after than before a dividend. The fact is admitted but its importance is denied.").

371 *See id.* ("The fact that a stockholder is no richer immediately after than immediately before a stock dividend is wholly unimportant.").

372 *See id.* at 145 ("The result is that, instead of an *annual tax on accruing profits*, we have a *single tax on accumulated profits* levied when they are distributed [e.g., in the form of stock dividends backed up by the company's profits]. . . . Congress . . . limited the tax to dividends declared

taxpayer no doubt did. With an—here substantial—accretion to wealth, Congress could tax it as income.

Both parties therefore saw the presence or absence of economic income as the touchstone of constitutionality. That is, the income-centric model without dispute governed. But they disagreed over the application of the income-centric model to the tax on stock dividends. The government contended that in imposing a tax on stock dividends, Congress in fact intended to tax the stockholder's share of the company's profits, against which the stock dividends were declared.[373] As a matter of statutory construction, this argument is specious. The Revenue Act of 1916 provided that "stock dividend shall be considered income, to the amount of its cash value."[374] That is, the statute taxed stock dividends, and said nothing about the stockholder's share of the company's profits. Congress knew exactly how to tax the stockholder's share of the company's profits when it wanted to. As discussed in the context of *Collector v. Hubbard*, the Revenue Act of 1864 provided that the "gains and profits of all companies, whether incorporates or partnership, . . . shall be included in estimating the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise."[375] To be sure, the government made a calculated, strategic choice. Assuming, as both parties did, that the income-centric model governed, the government must argue for the presence of economic income, and the stockholder's share in the company's accumulated profits was as good a bet as any. And the government could then rely on *Hubbard* as a precedent.[376] But the foundation of the government's argument was weak: there was little evidence that Congress intended to tax anything but the stock dividends themselves. This fact did not escape the notice of the taxpayer's counsel.[377] Indeed, the future Chief Justice started the supplemental brief with a clear rebuttal of the government's position: "The tax in question is not laid with respect to the taxpayer's interest in undivided corporate profits as constituting income to the taxpayer, or upon the 'stock dividend' as the form or dress in which a previous gain

out of earnings accruing subsequent to [March 1, 1913]. The result is that the taxable period for such gains as are received in the form of dividends begins with March 1, 1913, and ends with the receipt by the stockholder of the dividend.").

373 *Id.* at 140–44.

374 Revenue Act of 1916, ch. 463, § 2(a), 39 Stat. 756, 757.

375 Revenue Act of 1864, ch. 173, § 117, 13 Stat. 223, 281; *see supra* note 64 and accompanying text.

376 Collector v. Hubbard, 79 U.S. (12 Wall.) 1, 2 (1870); *see* Brief for the United States, *supra* note 178, at 5 (citing *Hubbard* five times); Supplemental Brief for the United States, *supra* note 365, at 119 (citing *Hubbard* three times).

377 *See* Brief and Argument for Defendant-in-Error, *supra* note 363, at 79 ("There is in the present case, however, no attempt to tax an interest in undivided profits . . . .").

or income to the taxpayer appears."[378] Instead, "[t]he tax is laid upon the 'stock dividend' as constituting income in itself."[379]

The government therefore argued—unconvincingly—that Congress intended to tax interests in corporate profits. It was in response to this argument that the taxpayer advanced the idea that realization and severability were requirements of constitutional income. That is, like any good lawyer, Hughes covered his bases: he argued, first, that stock dividends generated no economic income and were not taxable; second, that Congress never attempted to tax interests in corporate profits, so the time period for measuring any accretion to wealth did not stretch to 1913; and finally, that even if Congress had taxed interests in corporate profits, they would not have been taxable income because the taxpayer did not receive any segregated asset from the company. For example, Hughes contended that "the unseparated and unrealized increment of capital cannot be treated as income" in order to establish that "undivided corporate profits are not income to the stockholder."[380] The majority's opinion reflects Hughes's strategy: the Court stated that "enrichment through increase in value of capital investment is not income" to counter the government's suggestion that "gains accumulated by the corporation have made [the taxpayer] . . . richer."[381]

This genesis of *Macomber*'s realization language provides two insights. First, it confirms what the majority opinion itself implies: the formal-severability model arose from the majority's response to a hypothetical question not properly before the Court. The question presented and the holding of *Macomber* concerned the constitutional taxability of stock dividends. The Court had no occasion to address Congress's power to tax interests in corporate profits or unrealized gains in general. In this regard, *Macomber* was just like *Helvering v. Griffiths*.[382] If anything, there is a stronger argument that the *Macomber* Congress did not tax interests in corporate profits than that the *Griffiths* Congress did not tax stock dividends. Recall that in *Griffiths*, the Court declined to overrule *Macomber* because the statute excluded a stock dividend from income "to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment."[383] The Court took an additional inferential step with the premise that stock dividends indeed were not constitutionally taxable. In *Macomber*, no

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378 Supplemental Brief for Defendant-in-Error, Eisner v. Macomber, 252 U.S. 189 (1920) (No. 318), *in* Landmark Briefs and Arguments of the Supreme Court of the United States, *supra* note 178, at 165, 177.

379 *Id.*

380 *Id.* at 185, 188–89.

381 *Macomber*, 252 U.S. at 214–215.

382 *See* Helvering v. Griffiths, 318 U.S. 371 (1943).

383 Revenue Act of 1936, ch. 690, § 115(f), 49 Stat. 1648, 1688.

such step was necessary: the statute said nothing about the stockholder's interests in corporate profits.

Second, this genesis shows that the formal-severability model is subordinate to the income-centric model. The former arose only as a response to the parties' disagreement over how the latter should apply to stock dividends. As both parties' briefing made clear, the "fundamental" question is whether the taxpayer has become richer during the relevant period of analysis.[384] This question—whether the object of taxation has generated economic income—is both conceptually prior to the language of realization and decisive of Congress's power to tax.

C. *The Business-Transaction Reading of* Bruun

This Article has argued that the lease-improvement cases, culminating in *Helvering v. Bruun*,[385] have eliminated the formal-severability and the disposition models of *Macomber*.[386] Some scholars, however, have argued that *Bruun* merely narrowed the realization rule to require the presence of a business transaction.[387] That is, at the end of its opinion in *Bruun*, the Court stated: "Here, *as a result of a business transaction*, the respondent received back his land with a new building on it, which added an ascertainable amount to its value."[388] The Court then reiterated that formal severability is not part of the constitutional taxability analysis: "It is not necessary to recognition of taxable gain that he should be able to sever the improvement begetting the gain from his original capital."[389] *Bruun*'s reference to a business transaction could therefore be read as sustaining a narrow form of the realization requirement. And this realization rule—requiring only a business transaction of the underlying asset held by the taxpayer—does not appear to conflict with the corporate-reorganization cases. After all, those cases revolve around a business transaction: the reorganization.[390] One might thus argue that the income-centric model does not control: the *Macomber* realization model is alive and well, and requires the presence of a business transaction. This modified version of a disposition model could bar federal

384 Brief and Argument for Defendant-in-Error, *supra* note 363, at 62; Supplemental Brief for the United States, *supra* note 365, at 129.

385 *See* 309 U.S. 461 (1940).

386 *See supra* Section II.A.

387 *See* Jensen, *supra* note 47, at 1143; *see also* Brooks & Gamage, *supra* note 19, at 131 ("[T]he *Bruun* holding might still be interpreted as just narrowing the realization rule to requiring only that there be some 'business transaction'; for instance, Jensen has argued that the *Bruun* Court did not repudiate *Macomber*'s realization requirement but rather just 'interpreted its scope narrowly.'").

388 *Bruun*, 309 U.S. at 469 (emphasis added).

389 *Id.*

390 *See supra* Section II.B.

accrual taxation, and taxation of wealth as imputed income, unless there has been a business transaction involving the taxed asset.

Three responses are due here. First, it is inconsistent with *Macomber* to read *Bruun* as holding a business transaction *sufficient* for Congress's power to tax income. That is, in *Macomber*, there was without question a business transaction: the company declared a stock dividend, and the stockholder-taxpayer received those dividends proportionate to her ownership interests in the company.[391] If the presence of a business transaction involving the underlying asset is sufficient to trigger Congress's taxing power under the Sixteenth Amendment, *Macomber* would have been wrongly decided. Unless *Bruun* overruled *Macomber*, and it did not, the presence of a business transaction alone cannot be enough to trigger Congress's income-tax power. That is, the business-transactions reading of *Bruun* at most posits an "income-plus" model. This model allows Congress to exercise its Sixteenth Amendment power where (1) the taxpayer has received economic income *and* (2) there has been some kind of business transaction.

Second, as this Article has suggested, *Bruun* cannot be read to require a business transaction as a *necessary predicate* to Congress's power under the Sixteenth Amendment.[392] In *Bruun*, the Court referred to the taxpayer's factual stipulation "that the sum of $51,434.25 was the measure of the resulting enhancement in value of the real estate at the date of the cancellation of the lease."[393] The Court then concluded that "[e]ven upon this assumption"—that is, the sole assumption that the taxpayer experienced an accretion in wealth in the form of enhanced property value—Congress had the power to tax the gain of $51,434.25 as income.[394] To be sure, the Court mentioned in this discussion "the cancellation of the lease."[395] But it did so only to describe the timing and the date of the taxpayer's gain and in no way suggested that the cancellation of the lease itself was required. The Court did say, explicitly, that the taxpayer's stipulation as to the presence of economic income was sufficient for Congress's power to tax under the Sixteenth Amendment.[396]

Third, even if we adopt a business-transactions reading—i.e., an income-plus model—of *Bruun*, such a requirement might not impose a serious constraint on Congress's taxing capacity. The so-called business transaction in *Bruun* was atypical. The government assessed, and the Supreme Court sustained, a tax deficiency based on the enhancement

391 *See* Eisner v. Macomber, 252 U.S. 189, 200–01.

392 *See supra* notes 257–61 and accompanying text.

393 *Bruun*, 309 U.S. at 468; Transcript of Record, *supra* note 259, at 14.

394 *Bruun*, 309 U.S. at 468.

395 *Id.*

396 *See id.*

of the taxpayer's property value in 1933.[397] Importantly, 1933 was the year when the lessee defaulted on the lease and the taxpayer-lessor regained control of the premises which he could again lease to other interested parties.[398] The "business transaction" that enabled Congress's taxing power in *Bruun* must have been the lessee's default and the unexpected end of the lease. That is, the transaction was a decision over which the taxpayer had no control and in which he could have played no role. Further, the transaction did not dispose of the taxpayer's ownership of the underlying asset. The taxpayer held the premises before and after the lessee's default. The business transaction changed only an aspect of his ownership interest: the lessee no longer paid rent, and the taxpayer could rent out the premises to other parties. In the language of this Article, *Bruun* would have narrowed the disposition model to require a disposition not of the underlying asset but only an aspect of the taxpayer's ownership interest in the underlying asset.

The business-transactions reading of *Bruun* thus posits the following: under the Sixteenth Amendment, Congress can tax where (1) the taxpayer received economic income and (2) as a result of an act by another party over which the taxpayer has no control, an aspect of the taxpayer's ownership interest in the underlying asset has changed. This income-plus model does not revive what most traditionally think of as a realization requirement. For example, under this income-plus model, Congress could well tax appreciation in stocks of most companies: unrealized gains are economic income, and the companies surely have engaged in many business transactions over a taxable year to change an aspect of the stockholder-taxpayer's ownership interest. The same is true for unrealized gains in many forms of real estate: any transaction, even if uninitiated by the taxpayer, that changes an aspect of the taxpayer's ownership interest—e.g., a decision to refinance, a decision by one of the tenants to vacate a unit, or as in *Bruun*, a tenant's default—would trigger Congress's taxing power. To be clear, I do not think that *Bruun* warrants the business-transactions reading.[399] But even if it does, an income-plus model is not fatal to most forms of structural tax reform.

D. Valuation and Legislative Discretion

One final clarification: a feature of the income-centric model is that Congress could tax under the Sixteenth Amendment an object or transaction generative of an accretion to wealth. This Article has argued that valuation is left to legislative discretion: economic income opens the door to constitutional income taxation, but the amount taxed need not

397 *See id.* at 465.

398 *See id.* at 364.

399 *See supra* Section II.A, notes 392–96 and accompanying text.

correspond to precisely the amount of accretion to wealth generated by the object of taxation. However, this is *not* to say that Congress has *complete* discretion over valuation. The Sixteenth Amendment, after all, authorized Congress to tax *income*. And a federal regime that taxes unrealized gains but does not provide for loss recovery is arguably not an *income* tax, at least for volatile assets. For example, suppose that a taxpayer holds a stock X which has a price of 100 in year one, a price of 200 in year two, a price of 50 in year three, and a price of 100 in year four. A regime that taxes unrealized gains but provides no loss recovery would tax the stockholder for the gain of 100 in year two and the gain of 50 in year four, even though the taxpayer is in the same economic position in year four as year one. Thus, while the caselaw largely commits valuation to legislative discretion, the language of the Sixteenth Amendment constrains this discretion. Congress cannot stretch its latitude in valuation to such a degree that the tax imposed is no longer on income. As a result, federal accrual taxation may have to provide for loss recovery. And as the next Part will discuss, federal taxation of wealth as imputed income may have to build in limitations for substantially depreciated property.

IV. *Macomber* and Structural Tax Reform Today

This Part of the Article analyzes the implications of *Macomber* for structural tax reform today. Scholars and policymakers have proposed various structural tax reforms to address record inequality and concentration of wealth.[400] Popular among those proposals are wealth and accrual taxes. The constitutionality of these two taxes is also, unsurprisingly, the subject of intense dispute: opponents to wealth and accrual taxes have relied on *Macomber* as a central building block of their arguments.[401] This Part examines *Macomber*'s implications for contemporary proposals for wealth and accrual taxes, respectively. It concludes that under the theoretical and doctrinal framework developed in Parts I

400 *See, e.g.*, Batchelder & Kamin, *supra* note 152 (surveying and evaluating options for taxing the rich, including dramatic increases in top marginal income tax rates, accrual taxation, wealth taxation, and financial transactions taxation); Glogower, *A Constitutional Wealth Tax*, *supra* note 10; David Kamin, *How to Tax the Rich*, 146 Tax Notes 119 (2015); Matthew Smith, Owen Zidar & Eric Zwick, *Top Wealth in America: New Estimates Under Heterogeneous Returns*, 138 Q.J. Econ. 515 (2023); Reuven S. Avi-Yonah, *Why Tax the Rich? Efficiency, Equity, and Progressive Taxation*, 111 Yale L.J. 1391 (2002) (reviewing Does Atlas Shrug? The Economic Consequences of Taxing the Rich (Joel B. Slemrod ed. 2000)); Emmanuel Saez & Gabriel Zucman, *Progressive Wealth Taxation*, Brookings Papers on Econ. Activity, Fall 2019, at 437; Brian Galle, David Gamage & Darien Shanske, *Solving the Valuation Challenge: The ULTRA Method for Taxing Extreme Wealth*, 72 Duke L.J. 1257 (2023); *see also* Deborah H. Schenk, *Saving the Income Tax with a Wealth Tax*, 53 Tax L. Rev. 423 (2000); Shakow, *supra* note 34.

401 *See infra* notes 407, 424.

and II, *Macomber* does not stand as a serious barrier to Congress's power to enact either a wealth or an accrual tax.

A. *Wealth Taxes*

This Section addresses wealth tax proposals. To use a prominent example, Senator Elizabeth Warren has introduced a wealth tax called the "Ultra-Millionaire Tax."[402] Citing the "hyper concentration of wealth," Senator Warren's wealth tax plan would impose a 2% annual tax on the net worth of households between $50 million and $1 billion, and a 3% tax on the net worth of households above $1 billion.[403] It would also include antievasion provisions like a statutory minimum audit rate and stronger enforcement of valuation rules by the Internal Revenue Service.[404] While Senator Warren's wealth tax is not earmarked for any particular expenditure program, it could provide crucial funding for universal Medicare and student loan relief.[405] Other proposals of wealth taxation, such as by Senator Bernie Sanders, feature variation in tax brackets and rates, but present similar structures as to the question of constitutionality.[406] As already discussed, some commentators, as well as Judge Bumatay in his dissent from the denial of rehearing en banc in *Moore*, have cast doubt on the constitutionality of a federal wealth tax based on *Macomber*.[407]

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402 *See* S. 510, 117th Cong. (2021); Press Release, Sen. Elizabeth Warren, Warren, Jayapal, Boyle Introduce Ultra-Millionaire Tax on Fortunes Over $50 Million (Mar. 1, 2021), https://www.warren.senate.gov/newsroom/press-releases/warren-jayapal-boyle-introduce-ultra-millionaire-tax-on-fortunes-over-50-million [https://perma.cc/QV75-NXLA].

403 *See* Press Release, Sen. Elizabeth Warren, *supra* note 402 (quoting Congressman Brendan Boyle); S. 510, § 2.

404 *See* S. 510, §§ 2, 4.

405 *See* Thomas Kaplan, Abby Goodnough & Margot Sanger-Katz, *Elizabeth Warren Proposes $20.5 Trillion Health Care Plan*, N.Y. Times (Nov. 22, 2019), https://www.nytimes.com/2019/11/01/us/politics/elizabeth-warren-medicare-for-all.html [https://perma.cc/BF89-9LEB].

406 For example, Senator Bernie Sanders has proposed to tax "extreme wealth" with the following structure for married couples: 1% on net worth between $32 million and $50 million; 2% on net worth between $50 million and $250 million; 3% between $250 million and $500 million; 4% between $500 million and $1 billion; 5% between $1 billion and $2.5 billion; 6% between $2.5 billion and $5 billion; 7% between $5 billion and $10 billion; and 8% on wealth over $10 billion. *Tax on Extreme Wealth*, Bernie, https://berniesanders.com/issues/tax-extreme-wealth [https://perma.cc/6MTN-3S24].

407 *See supra* notes 10–16 and accompanying text; Moore v. United States, 53 F.4th 507, 513–15 (9th Cir. 2022) (Bumatay, J., dissenting from the denial of rehearing en banc) ("*Macomber* remains the seminal case establishing the realization requirement for 'income' under the Sixteenth Amendment. . . . Divorcing income from realization opens the door to new federal taxes on all sorts of wealth and property without the constitutional requirement of apportionment."). *But see, e.g.*, Ari Glogower, David Gamage & Kitty Richards, *Why a Federal Wealth Tax Is Constitutional*, Roosevelt Inst. (Feb. 2021), https://rooseveltinstitute.org/wp-content/uploads/2021/02/RI_Wealth-Tax-Constitutionality-Brief-202102-2.pdf [https://perma.cc/YS78-5F5U]; Letter from Tax Law Scholars to Sen. Elizabeth Warren (Feb. 25, 2021) (on file with author).

This Article's analysis provides two insights into wealth taxation. First, it shows that the *core reasoning* of *Macomber* does not pose a serious obstacle to federal taxation of wealth at uniform rates. The implicit reasoning on which the Court must have relied to reach its holding is a separate story, which this Section addresses later.[408] A true wealth tax is an ad valorem property tax—that is, one imposed on the *full value* of both real property and personal property. *Macomber* and its doctrinal progeny concerned income taxation under the Sixteenth Amendment—that is, Congress's power to impose taxes on an *accretion* to or *increase* in the value of real or personal property.[409] To be sure, *Macomber* limits Congress's taxing power under the Sixteenth Amendment by, for example, empowering Congress to tax only objects constitutive of an actual accretion to wealth.[410] But the Court's explicit reasoning in *Macomber* is about what Congress can tax *as income*, not what Congress can tax *as property*.

However, this is not to say that *Macomber*'s *holding* has no impact on Congress's ability to tax wealth. Recall that scholars have argued that *Macomber*'s explicit reasoning is incomplete.[411] Showing that stock dividends are not taxable as income *under the Sixteenth Amendment* does not get the *Macomber* Court to its conclusion that stock dividends are not taxable *simpliciter* under the Constitution.[412] In other words, even though stock dividends are not "income," a tax on them might still be an indirect or excise tax—a tax on the use or the exercise of privileges in connection with property—that need not be apportioned.[413] While the majority offers no explicit justification, it must have reasoned that stock dividends are not taxable as excise under the Constitution. This means that *Macomber* overlooked the Excise Tax Canon: when faced with a tax that could be characterized either (1) as a direct tax on property or (2) as an indirect excise on the privilege or use of property, the Court would no longer entertain the presumption that the tax is an excise. The wealth tax as proposed by Senator Warren, for example, could of course be characterized as a tax on the privilege and use of vast amount of wealth. *Macomber*'s implicit rejection of the Excise Tax Canon therefore cast shadows on the constitutionality of a traditional wealth tax.[414] Further, citing *Macomber* for its perceived endorsement

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408 *See infra* notes 411–15 and accompanying text.

409 *See* Daniel Hemel & Rebecca Kysar, *The Big Problem with Wealth Taxes*, N.Y. Times (Nov. 7, 2019), https://www.nytimes.com/2019/11/07/opinion/wealth-tax-constitution.html [https://perma.cc/Z3F6-M9ME].

410 *See supra* Sections I.B.1, II.D.

411 *See supra* notes 49–55 and accompanying text.

412 *See* Brooks & Gamage, *supra* note 19, at 127–28.

413 *See id.* at 82 n.32, 127–28.

414 To be sure, the *Macomber* majority offers no explanation for its rejection of the Excise Tax Canon. This might be reason enough not to read *Macomber* as overruling the Court's careful

of *Pollock*, Chief Justice Roberts wrote recently in *Sebelius* that "we continued to consider taxes on personal property to be direct taxes."[415] This statement does not inspire confidence in the odds of survival in federal courts of a true, full-fledged federal wealth tax.

Given this doctrinal landscape, this Article provides a second insight: if legislators have sufficient doubt about the constitutionality of a traditional wealth tax, they could draft the wealth tax as an imputed income tax to survive constitutional scrutiny and achieve all the redistributive vision of wealth taxation. This Article has argued that *Macomber* is best read as a case turning on the absence of economic income. Under the income-centric model, Congress could tax under the Sixteenth Amendment any object or transaction that was constitutive or generative of an accretion to wealth. Importantly, the strictures of the Constitution as read by *Macomber* do not constrain valuation: the presence of economic income opens the door to constitutional income taxation, but the amount taxed need not correspond to precisely the amount of accretion to wealth generated by the object of taxation.[416] The federal government thus has full power to tax wealth *as imputed income*. That is, suppose that a taxpayer holds $100 of wealth. A true wealth tax of 3% is equivalent to an imputed income tax of 30% with an assumed 10% return on capital: each would impose exactly a $3 tax on the taxpayer's $100 net worth. Scholars have proposed imputed income taxation as a more practical version of wealth taxation.[417] This Article shows that imputed income taxation has a constitutional advantage: under the income-centric model of *Macomber*, Congress has the authority to tax any object or transaction generative of economic income,

deference, before *Macomber*, to Congress's designation of a tax as an excise. But the majority's conclusions still create "uncertainties and potential risks." *Id.* at 128.

415 Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 571 (2012) (citing Eisner v. Macomber, 252 U.S. 189, 218–19 (1920)). In the immediate aftermath of the Sixteenth Amendment, the Court in *Brushaber v. Union Pacific Railroad Co.* held that the Amendment overruled *Pollock* insofar as it characterized taxes on income from property as a direct tax on property, but that it *affirmed Pollock* insofar as it characterized taxes on real or personal property as direct taxes. 240 U.S. 1, 18–19 (1916).

416 *See supra* Section II.D.

417 *See* Glogower, *A Constitutional Wealth Tax*, *supra* note 10, at 746–47; Schenk, *supra* note 400, at 446–47; Noël B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: A "Revolutionary" Approach to Ownership*, 47 Tax L. Rev. 725, 735–36 (1992). It is important to note that commentators often propose an imputed income tax, as opposed to a wealth tax, to avoid the administrative problems like valuation. That is, instead of requiring annual valuations of all property owned by the taxpayer, the government could impose a tax on the initial cost—basis—of the property, estimate the value of the property in a year using a risk-free rate of investment return, and then assess the wealth tax on the estimated value of the property in the next year, and so on. *See, e.g.*, Schenk, *supra* note 400, at 446–47. This Article's proposal of an imputed income tax is not meant to solve the valuation challenge. It simply suggests that Congress *frame* the wealth tax as an income tax to resolve any constitutional doubt.

and valuation is left to legislative discretion. An imputed income tax is imposed on an object generative of economic income—even wealth locked up in checking accounts generates income, however small.[418] And the amount taxed is left to legislative discretion—Congress is free to impose a tax rate that would make the imputed income tax a mathematical equivalent of a wealth tax.

This form of imputed income taxation can mirror the effects of wealth taxation, and it might take two forms. First, Congress may impute a fixed rate of return to the assessed value of an asset. To use the previous example, suppose that Congress aims to tax wealth at 3%. An imputed income tax would impose a 30% tax rate on a fixed rate of return of 10%. A taxpayer with $100 in wealth would then be taxed $3 on an imputed return of $10. Second, Congress may vary the tax rate on the basis of the ratio between the actual, not imputed, economic income received by the taxpayer and the assessed value of the asset. That is, again suppose that Congress aims to tax wealth at 3%. Suppose also that the taxpayer holds $100 in cash, and has received economic income in the form of enhanced liquidity, with a value of $1. An imputed income tax would then impose a 300% tax on the actual economic income of $1, resulting in the same $3 tax liability. The imputed income tax rate under this second regime can be expressed as the following:

$$\text{Imputed Income Tax Rate} = \frac{\text{Asset Value}}{\text{Actual Economic Income}} \times \text{Desired Wealth Tax Rate}$$

The second method entails more administrative and compliance costs than the first method. For under the first method, the calculation of tax liability requires only an assessment of the value of the underlying asset subject to the wealth tax.

By contrast, under the second method, the calculation of tax liability requires both an assessment of the value of the underlying asset and an assessment of the actual economic income accrued during the taxable period. The advantage of the second method is that it hews more closely to the constitutional income-centric model. That is, it relies on actual accretion to the taxpayer's wealth, as opposed to imputed economic income. But there are reasons to think that the first method could be just as effective in dispelling any constitutional doubt. As discussed earlier in this Article, the income-centric model allows Congress to tax any accretion to wealth.[419] The point is that the presence of economic income is sufficient to trigger the Sixteenth Amendment, and the precise amount taxed need not correspond to the precise amount

418 *See supra* notes 352–53 and accompanying text.

419 *See supra* Section I.B.1.

of income generated by the object of taxation.[420] Because valuation is left to legislative discretion, imputed economic income is likely equally legitimate as actual economic income in assessing tax liability. After all, many areas of income taxation, whose constitutionality has never been doubted, rely on rough estimates rather than precise valuation.

Thus, while *Macomber*'s implicit rejection of the excise tax canon might cast doubt on the constitutionality of a traditional wealth tax, its core reasoning suggests other, constitutional avenues to uniform taxation of wealth. In particular, the approach of imputed income taxation preserves the redistributive potential of wealth taxation while avoiding constitutional problems.

B. Accrual Taxes

Further, scholars and commentators have proposed accrual taxation to raise revenue and ameliorate inequality.[421] Congress currently taxes gains in assets—e.g., appreciation in Apple stocks—upon disposition. Under an accrual-tax, or a mark-to-market regime, taxpayers would have to pay income taxes on unrealized gains—e.g., appreciated Apple stocks that have not been sold—each year, not only upon disposition. Because the realization requirement allows the ultra-wealthy to defer and then completely evade federal income taxation, President Biden has, for example, proposed an accrual tax regime called the Billionaire Minimum Income Tax.[422] Under President Biden's proposal, households worth more than $100 million would be subject to a minimum effective tax rate of twenty percent on an expanded measure of income that includes *unrealized* gains.[423] As discussed, opponents have relied on *Macomber* to insist that federal accrual taxation is unconstitutional.[424]

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420 *See supra* Section II.B.

421 *See* Batchelder & Kamin, *supra* note 152, at 211–15; Shakow, *supra* note 34.

422 *See* Press Release, Rep. Steve Cohen, Billionaire Minimum Income Tax, Proposed by President Biden, Introduced by Reps. Cohen and Beyer (July 28, 2022), https://cohen.house.gov/sites/evo-subsites/cohen-evo.house.gov/files/BMIT%20One%20Pager.pdf [https://perma.cc/T2V9-8XDD]; Alan Rappeport, *Biden Proposes a Tax on Billionaires as He Looks to Fund His Economic Agenda*, N.Y. Times (Mar. 28, 2022), https://www.nytimes.com/2022/03/28/us/politics/biden-billionaire-tax.html [https://perma.cc/Y2D2-YQSK]; Garrett Watson & Erica York, *Proposed Minimum Tax on Billionaire Capital Gains Takes Tax Code in Wrong Direction*, Tax Found. (Mar. 30, 2022), https://taxfoundation.org/blog/biden-billionaire-tax-unrealized-capital-gains [https://perma.cc/B4XS-RQJS]. *See generally* Edward J. McCaffery, Fair Not Flat 29–31 (2002) (describing the ultra-rich's strategies to dodge the income tax).

423 Press Release, Rep. Steve Cohen, *supra* note 422.

424 *See, e.g.*, Phillip W. Magness, *The Unconstitutional Tax on 'Unrealized Capital Gains*,*'* Indep. Inst. (Mar. 14, 2023), https://www.independent.org/news/article.asp?id=14450 [https://perma.cc/3SPM-R4WQ] ("A tax on 'unrealized capital gains' cannot be a tax on income, as no income is generated in the process, only an estimated increase in valuation. It is 'unrealized' by definition. Indeed, post-16th Amendment jurisprudence has generally held that money must be 'realized' and received in order to qualify as income, most notably the 1920 case of *Eisner v.*

This Article shows that *Macomber* and its doctrinal framework do not present any serious barrier to most forms of accrual taxation. It is easy to see why opponents to accrual taxation rest their case on *Macomber*. Under the formal-severability model, Congress would have no power to tax unrealized gains, because the holder of unrealized gains would not have received any separate property for her own benefit. Likewise, under the disposition model, the holder of unrealized gains by definition would not have disposed of her property. The control model is more complicated: some taxpayers—e.g., sole or majority stockholders of corporations—would have exercised full control over the underlying property interest, while others—e.g., most individual investors in large public companies—would not have. And an accrual-tax regime centered on the issue of control would invite strategic evasion. But as this Article has shown, *Macomber*'s doctrinal progeny has repudiated the formal-severability, disposition, and control models.[425] Commentators' reliance on those interpretive models to argue for the unconstitutionality of federal accrual taxation is thus mistaken.

Instead, the main surviving reading of *Macomber* is the income-centric model, which both the lease-improvement and the corporate-reorganization cases reaffirmed. Under the income-centric model, Congress has the power to tax an object or transaction that constitutes or generates an accretion to wealth or economic income, subject to other constitutional constraints.[426] A gain or increase in the value of an asset, whether realized or not, is by its very nature constitutive of economic income. For example, if the Court adopts the income-centric model in *Moore*, the petitioners' unrealized gains in the Indian company would be taxable by Congress because they experienced an accretion to wealth.[427] Accrual taxation is thus undoubtedly constitutional under the best reading of *Macomber*. Opponents to accrual taxation thus wrongly rely on *Macomber* to argue that the federal government lacks the constitutional power to tax unrealized gains. In fact, the best reading of *Macomber*—the income-centric model—does not present any barrier to federal accrual taxation.

But under this Article's framework, a constitutional scheme of accrual taxation requires careful legislative drafting. For example, Congress must make clear that the basis of its taxation consists in the economic gain inherent in the appreciated asset, even if it exercises its broad discretion in valuation. After all, the income model of *Macomber*

Macomber."); Gene Magidenko, *Is a Broadly Based Mark-to-Market Tax Unconstitutional?*, 143 TAX NOTES 952, 954 (2014).

425 *See supra* Sections II.A, II.B.

426 For example, Congress may have to provide some form of recovery for unrealized losses. *See supra* Section III.D.

427 *See* Petition for a Writ of Certiorari, *supra* note 2, at 4–5.

paves the path for unapportioned taxation of accretions to the taxpayer's wealth. The same applies to other tax reforms. If Congress imposes a wealth tax pursuant to its Sixteenth Amendment powers, it should make clear that the basis of its taxation consists in the economic gain imputed to the property holding. To use another example, scholars have recently proposed the same income-tax treatment for stock buybacks as cash dividends.[428] That is, Congress would tax the amount of the buyback "as a cash dividend paid out to all shareholders on a pro rata basis," and impose dividend taxes on all shareholders.[429] In that scenario, Congress *could* justify the dividend taxation of the redeeming shareholder on the liquidity gains of the transaction.[430] But as to the non-redeeming shareholders, the severability, disposition, and control models of *Macomber* would not permit unapportioned taxation, because those non-redeeming shareholders have not received any separate asset from the buyback transaction. The income model would permit dividend taxation of the non-redeeming shareholders. Again, Congress must carefully draft the statute, and make clear that the basis of its taxation consists in previous appreciation of the stocks through, for example, the accumulation of corporate profits.

Conclusion

This Article reconceptualizes *Eisner v. Macomber*, a central case about the federal government's power to tax income under the Sixteenth Amendment. Most commentators have taken *Macomber* to impose a realization requirement. By contrast, combining careful analysis of *Macomber* in its doctrinal context and close reading of caselaw development in the 1920s to the 1940s, this Article shows that *Macomber* is best read as a case turning on the absence of economic income. This conception of *Macomber* presents no serious barrier to most forms of structural tax reform, and in fact yields insights about how to draft a wealth tax that would survive constitutional scrutiny. It empowers—and encourages—Congress to exercise its broad discretion in tax policymaking to ameliorate record inequality and vindicate our democracy's commitment to distributive justice.

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428 Daniel J. Hemel & Gregg D. Polsky, *Taxing Buybacks*, 38 Yale J. on Reg. 246, 252 (2021); *see also* Marvin A. Chirelstein, *Optional Redemptions and Optional Dividends: Taxing the Repurchase of Common Shares*, 78 Yale L.J. 739 (1969) (articulating the original proposal discussed and refined by Hemel and Polsky).

429 Hemel & Polsky, *supra* note 428, at 250.

430 *See* supra notes 350–52 and accompanying text.