from

Was Grandpa Really a Moron?

Critical Inquiries for a New American Century

by

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"Income" Doesn't Mean "Corporate Profit"

There is a long-standing misinterpretation of several Supreme Court case declarations which concludes that "income" means nothing more than 'corporate profit'. This conclusion arises from taking language from these rulings either out of context or incompletely, and from reading "only" where the word is actually not found. The key phrase misconstrued in service to this error is the line from Merchants Loan & Trust Co. v. Smietanka, 255 US 509, (1921):

> *"The word (income) must be given the same meaning in all of the income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act of 1909, and what the meaning is has now become definitely settled by decisions of this court."*

Deriving from this language the meaning desired by the "income only means corporate profit" advocates is a truly gross disregard of its context, for just prior to making the above declaration, the court has listed the "definition" to which it refers:

> *"Income may be defined as a gain derived from capital, from labor, or from both combined, provided it be*

> *understood to include profit gained through sale or conversion of capital assets."*

Nothing in that definition is confined to corporate activity, and in fact, the context of this definition itself (which is quoted from Eisner v. Macomber, 252 U.S. 189, 207 (1921)) involves nothing but a question as to when receipts do and do not have the necessary character of 'gains'-- without regard as to the nature of the recipient. Indeed, in 'Merchants Loan' itself, the recipients involved were a woman and her four children (through a trustee)-- **not a corporation**.

Snippets of language from other cases are similarly misconstrued in service to this conceptual error. Prominent among these are the following cites from Flint vs. Stone Tracy Co. 220 U.S. 107 (1911):

> *"...when imposed in this manner it is a tax upon the doing of business, with the advantages which inhere in the peculiarities of corporate or joint stock organization of the character described. As the latter organizations share many benefits of corporate organization, it may be described generally as a tax upon the doing of business in a corporate capacity."*

and,

> *"The tax under consideration, as we have construed the statute, may be described as an excise upon the particular privilege of doing business in a corporate capacity, i. e., with the advantages which arise from corporate or quasi corporate organization; or, when applied to insurance companies, for doing the business of such companies. As was said in the Thomas Case, 192 U. S. supra, the requirement to pay such taxes involves the exercise of privileges, and the element of absolute and unavoidable demand is lacking. If business is not done in the manner described in the statute, no tax is payable."*

What is missed by those whose seize upon this language is that the issue here was not the definition of

"income" generally, but only what "income" the Corporate Excise Tax Act specifically taxed-- which was that realized by corporations and a certain short list of other types of artificial entities. Certain other types of artificial entities were excluded from this list, which was the basis for the challenge which led to the language cited above.

The court rules that Congress is within its latitude in choosing to tax only "income" enjoyed by the listed recipients, and not others-- just as Congress is able to selectively impose a tariff on imports of a certain type, or from certain countries, and not others. Thus, the references in this language to corporate activity merely reiterate the distinctions drawn in the act itself.

As the Harvard Law Review observes in its 1910 publication “Federal Income Tax On Corporations”:

> *“The new federal tax is expressed to be on corporations* doing business*, and is measured by the* net income *of such corporations. There are therefore three factors which determine whether the tax shall be levied,-- (1) existence as a corporation, (2) doing business, (3) the receipt of a certain income. Unless all of these three are present in a given case, no tax is levied; if they are all present, a tax is levied.*
>
> *Therefore according to the rules laid down above, this is a tax upon those several factors. The Tax can be avoided by ridding oneself of any one of these factors.”*

"Income is only corporate profit" advocates, however, read an "only" into this language of the rulings where one does not exist. (The most substantial issue in Flint vs. Stone Tracy, by the way, was whether corporations chartered by union state governments could be subjected to the federal government's tax, even insofar as they enjoyed profits from federally-connected activities ["income"]. The court declares that they can, excepting only those engaged in activities of a strictly state governmental character-- and thus intimately related to, and partaking of, the sovereignty of the state.)

Another example of an oft-cited but misunderstood snippet is the following from Doyle v. Mitchell Bros. Co., 247 US 179 (1918):

> *"Whatever difficulty there may be about a precise and scientific definition of 'income,' it imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities."*

As in the errors observed above, this line is misconstrued due to a disregard of its context. Doyle v. Mitchell Bros. Co. is also a case arising under the 'Corporate Excise Act of 1909'. Consequently, the phrase *"corporate activities"* at the end of this quote could be replaced with, *"activities of the entities taxed under the act"* and convey precisely the same meaning as that of the language used. What the court is really and merely distinguishing in this phrase is "gain" as against "capital on hand". The following paragraph of the opinion makes this clear:

> *"Understanding the term in this natural and obvious sense, it cannot be said that a conversion of capital assets invariably produces income. If sold at less than cost, it produces rather loss or outgo. Nevertheless, in many if not in most cases there results a gain that properly may be accounted as a part of the 'gross income' received 'from all sources'; and by applying to this the authorized deductions we arrive at 'net income.' In order to determine whether there has been gain or loss, and the amount of the gain if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."*

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The most egregious clash between plain reality and the advocacy of the "income only means corporate profit" argument can be seen by examining the "income" tax provisions reflected in Subtitle C of 26 USC. These provisions clearly declare

themselves to be taxes on, or provisions involving, the same "income" taxed under Subtitle A; and many are just as clearly imposed exclusively upon, or related exclusively to, individual workers, rather than corporations. As an example, look at the surtax imposed under chapter 21 of Subtitle C:

> *"In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))"*

Similarly, withholding under chapter 24 in Subtitle C is nothing but a prepayment against the tax imposed under Subtitle A, which arises by virtue of, and is measured exclusively by, the receipt of the "wages" from which the withholding takes place:

> *Section 6401- Amounts treated as overpayments*
> *(b) Excessive credits*
> *(1) In general*
> *If the amount allowable as credits under subpart C of part IV of subchapter A of chapter 1 (relating to refundable credits) exceeds the tax imposed by subtitle A (reduced by the credits allowable under subparts A, B, D, and G of such part IV), the amount of such excess shall be considered an overpayment.*
> *(c) Rule where no tax liability*
> *An amount paid as tax shall not be considered not to constitute an overpayment solely by reason of the fact that there was no tax liability in respect of which such amount was paid.*
> *("Subpart C of part IV of subchapter A of chapter 1", to which 6401(b)(1) refers, is:*
> *Sec. 31 -Tax withheld on wages*
> *(a) Wage withholding for income tax purposes*
> *(1) In general*
> *The amount withheld as tax under chapter 24 shall be allowed to the recipient of the income as a credit against the tax imposed by this subtitle.)*

Even those provisions in Subtitle C that involve or relate to more (or other) than individual workers don't confine their application to corporations. Because all of this contradicts the "income only means corporate profit" premise, Subtitle C is either denied any place on the radar screen of those advocating this 'theory', or is wildly distorted by being imagined as dealing with a whole different class of tax known as "employment taxes" (conveniently assisted in this misconception by the tax-code-compiler's use of that phrase when the various "income" taxes applying to, and measured by, activity as a federally-connected worker were consolidated into Subtitle C).

A huge volume of subsidiary nonsense, such as that all Americans have been assigned corporate status at birth, has grown out of the original "corporate-profit-only" error. Still, the vigor and creativity behind them, and behind the original error as well, are heartening indicators of the depth and breadth of opposition to the mis-administered tax. I salute those who have had the courage to take this path, even while I hope that they expand the depth and breadth of the research that led them to it.