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# Federal Taxation of Exempt Income

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# FEDERAL TAXATION OF "EXEMPT" INCOME

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A DECADE has elapsed since the sixteenth amendment was adopted as a part of the federal constitution. Congress has, during that period, imposed general income taxes under five distinct acts, and so-called war and excess profits taxes under three. It has in each instance specifically excluded from gross income the interest derived from the obligations of the states, and their political subdivisions. This exemption did not materially affect the direction of investments as long as the rates were comparatively low. The exigencies of war and post-war governmental finance have, however, completely changed the situation. The surtax rates levied under the War Income Tax Act of 1917, and the Revenue Acts of 1918 and 1921, were and are exceedingly high. It is apparent that, other things being equal, an investor will select that investment which yields him the maximum net, as distinguished from the greatest nominal, return. If the nominal return of one class of investments is subject to reduction on account of taxes, while the same is not true of another class, the nominal return on the former will have to be greater than that on the latter, if the former is to compete successfully with the latter. The differential will vary with the amount of the reduction, that is with the tax rate. Since the total effective tax rate varies with the tax payer's total taxable net income (due to the fact that the sur-tax rates vary with that item) it follows that no single differential applies to all taxpayers.[1] The difficulty

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[1]The following concrete examples may serve to make these matters somewhat plainer. The computations are based on the tax rates for 1923 under the Revenue Act of 1921. Assume that A, with a present taxable net income of $200,000, has a choice of investing in "non-exempt" or "exempt" securities. If he select the former, the tax on every dollar of income received will be 58 cents (8% normal tax; 50% surtax), leaving him a net of 42 cents. If he select the latter, he retains net 100 cents out of every dollar of income. It follows that, for him, an investment in a "non-exempt" security bearing a nominal rate of 1% is on a par with an investment in an "exempt" security bearing a nominal rate of .42%. The rate on the "non-exempt" security is to that on the "exempt" security as 1 to .42 or 2.38 to 1. If these two types of security are to compete on an equality for A's funds, the "non-exempt" must bear a nominal return 2.38 times that of the "exempt." If the rate on the "exempt" is 6%, that on the "non-exempt" must be slightly in excess of 14%. If, however, A's

of successful competition is enhanced if the investment, whose income is taxed, normally bears a higher nominal rate than the exempt security. In the light of this analysis, it is clear why the high surtax rates that have been in force since 1917 have driven persons with large incomes to invest in so-called exempt securities. The supply of these has consisted largely of the obligations of the states and their various political subdivisions. The exemption of this income has rested on the theory that its taxation would be unconstitutional. The same applies to the exemption of the compensation paid their officers and employees by states and their political subdivisions.[2] It is the purpose of this article to examine the correctness of that position.

Whatever power the federal government at present has to tax this exempt income[3] must be derived from the sixteenth amendment. It is not conferred by the grant of the general power to lay and collect taxes under section 8 of article I. This was determined in 1871 as to the compensation received by state officials in the case of *Buffington v. Day*;[4] and as to the interest on state and municipal obligations in 1895 in *Pollock v. Farmers Loan & Trust Company*.[5] Whatever may be one's opinion as to the validity of the reasoning by which the principles of *McCulloch v. Maryland*[6] were applied to the situation in which the positions of the federal and state governments were reversed,[7] and whatever one's view on the extension of those principles to the exemption of income received by private persons, it is now

present taxable net income had been but $6,000, the tax on additions thereto until the total amounted to $10,000, would be but 9 cents out of every dollar. In that case, an investment in a "non-exempt" security bearing a nominal rate of 1% is on a par with that in an "exempt" security bearing a .91% rate; the relation between the nominal rates is as 1.098 to 1; and a "non-exempt" security bearing a nominal rate of 6.58 would be on a competitive equality with a 6% "exempt" security. The amount of the "exempt" security's advantage, therefore, depends on the "taxable net income" position of the person who is called upon to make the selection. The amount of $200,000 was taken because it is the lower limit of the highest surtax bracket; that of $6,000, because it is the lowest to which surtaxes apply; and it is the existence of surtaxes that has made the problem acute.

Similar computations could be made to show how the differential would vary with an entire readjustment of the surtax schedule.

[2]See regulations 62, art. 88.

[3]The terms "exempt income" will be hereinafter used to designate both the compensation of officers and employees of the states and their political subdivisions, and the interest on their obligations.

[4](1871) 11 Wall. (U.S.) 113, 20 L.Ed. 122.

[5](1895) 157 U. S. 429, 39 L. Ed. 759, 15 S.C.R. 673.

[6](1819) 4 Wheat. (U.S.) 316, 4 L. Ed. 579.

[7]See on this point the dissenting opinion of Bradley J. in Buffington v. Day, (1871) 11 Wall. (U.S.) 113, 20 L. Ed. 122.

too late to expect any judicial modification thereof. The question of the taxability of exempt income thus becomes a problem in construing the scope of the sixteenth amendment.

The sixteenth amendment reads as follows:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

It is a matter of general information that this amendment was adopted in order to remove certain limitations and inhibitions upon the federal taxing power. Its purpose was remedial, and its scope is to be determined in the light of that fact. It is essential, therefore, to ascertain the limitations and inhibitions that existed at the time of its adoption. The constitution expressly confers upon Congress the power to lay and collect taxes, duties, imposts and excises.[8] This power is expressly subjected to two limitations upon the manner of its exercise, and one inhibition as to what subjects may be taxed. Duties, imposts and excises are required to be uniform throughout the United States;[9] and direct taxes must be apportioned among the several states according to their population as fixed by the last census enumeration.[10] Neither taxes nor duties may be levied on articles exported from a state.[11] There had been from time to time frequent controversies as to what taxes were direct as various kinds were levied by the federal government. The issue was squarely raised in the *Pollock cases*[12] as to those levied under the Income Tax Act of 1894 on the income from real and personal property. Both were held to be direct taxes; and, since the law did not provide for their apportionment among the states on the basis of population, invalid. The cases establishing the exemption of the compensation of state officers and the

[8]Art. I, sec. 8.

[9]Art. I, sec. 8.

[10]Art. I. sec. 2; and Art. I, sec. 9. These two provisions differ somewhat in their language. Sec. 2 provides that "direct taxes shall be apportioned among the several states. . . . according to their respective numbers"; the remainder clearly shows that the "respective numbers" intended are the decennial census figures. Sec. 9 provides that "no capitation, or other direct tax, shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken." Observe that section 9 does not in terms refer to an apportionment among the states. For reasons that are subsequently discussed I have interpreted the two together in the manner indicated in the text.

[11]Art. I, sec. 9.

[12](1895) 157 U.S. 429, 39 L. Ed. 759, 15 S.C.R. 673; (1895) 158 U.S. 601, 39 L. Ed. 1108, 15 S.C.R. 912.

interest on state and municipal obligations have already been referred to.[13]

There is a marked difference between the principles on which the taxes on the income from real and personal property were declared invalid, and those on which the non-taxability of exempt income was based. The former were declared unconstitutional because the law, in imposing them, did not follow the rule of apportionment;[14] the latter because of a want of power in the federal government to tax such income.[15] The federal power to tax did extend to the levy of income taxes that were direct, but in exercising that power the constitutional limitation must be observed. This proposition has been vigorously denied.[16] It has been contended that the *Pollock cases* decided that income taxes on incomes from all sources, except those that could be sustained as excises, were impossible because they could not be apportioned as income taxes. Since the construction of the sixteenth amendment may be affected according as one or the other of these conflicting views of the *Pollock cases* is adopted, it is necessary to consider this contention somewhat at length. It is clear from the excerpts already set out[17] that the court which decided the cases did not so construe its decisions. It is also opposed to the views expressed by the court in subsequent cases involving income tax laws enacted under the sixteenth amendment.[18] The position, therefore, rests on the assumption that the actual decision was other than what the court conceived it to be. The ultimate reason for the thesis is that, since an income tax is one apportioned according to income it is a logical im-

[13]See notes 4 and 5.

[14]Pollock v. Farmers' Loan & Trust Co., (1895) 158 U.S. 601, 637, 39 L. Ed. 1108, 15 S.C.R. 912. "Our conclusions may, therefore, be summed up as follows: . . . Third. The tax imposed by sections twenty-seven to thirty-seven, inclusive, of the Act of 1894, so far as it falls on the income of real estate and of personal property, being a direct tax within the meaning of the constitution, and, therefore, unconstitutional and void because not apportioned according to representation, all those sections, constituting one entire scheme of taxation, are necessarily invalid." See also Hyde v. Continental Trust Co., (1895) 157 U.S. 586.

[15]Pollock v. Farmers' Loan & Trust Co., (1895) 157 U.S. 429, 39 L. Ed. 759, 15 S.C.R. 673.

[16]The sixteenth amendment: Harry Hubbard, 33 Harvard L. Rev. 794.

[17]See footnote 14.

[18]See Brushaber v. Union Pacific Railroad Company, (1915) 240 U.S. 1, 13, 18, 60 L. Ed. 493, 36 S.C.R. 236, in which the power to levy income taxes in the generic sense is expressly stated to be included in the general power to tax.

possibility to apportion it on a population basis. This is perfectly correct if the same act of apportionment is meant in both instances. However, the apportionment which is to be made on a population basis is one among the states; that which is to be made on an income basis is one among the units of the taxable class within each state. The logical incongruity thus disappears. The legal correctness of the thesis, therefore, depends on whether the constitution permits this double, or more accurately, combination apportionment. Whatever doubt exists as to this arises from the absence of express authorization of a second apportionment after that on a population basis;[19] and from the possibility that the provision that "no capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken,"[20] prescribes a rule for the distribution of the tax among the individuals in the taxable group. If no second apportionment is permitted, it would prevent any direct tax, except a head tax, for even a direct tax on land would have to be apportioned on an ad valorem or some other basis. It has, however, never been doubted that the federal taxing power comprehended taxes on land based on its value. Furthermore, this view would reduce to mere verbiage the language "or other direct, tax." The adoption of the second alternative is certainly opposed to the general view consistently adopted by the Court, which has been that the apportionment referred to in article I, section 9, is the same as that required by article I, section 2. If they refer to two different acts of apportionment based on the same rule, even then a head tax is the only conceivable direct tax permitted, since it alone can be both apportioned among the states, and distributed within each state, on the basis of population. This again reduces to mere verbiage the language "or other direct, tax." Either alternative would convert a limitation upon the mode in which a power shall be exercised into a denial of the power to do the act in conformity with the limitation. It follows that the method contemplated by the constitution in levying direct taxes was: (1) to apportion the amount levied among the states according to population; and (2) to distribute the amount thus apportioned to each state over the taxable units in such state on the basis applicable to the form of the direct tax; i.e., on an ad valorem basis for property taxes, and on an income basis for

[19]Art. I, sec. 2; art. I, sec. 9.
[20]Art. I, sec. 9.

income taxes.[21] This is exactly the course followed by Congress in levying direct taxes shortly after the adoption of the constitution.[22] It is a cumbersome process, leads to frequent absurdities, and is almost certain to result in gross inequality in the tax burden as between the individual taxpayers in the different states.[23] These considerations might well make resort to direct taxation impracticable, but clearly not impossible. The court's own view as to its decision in the *Pollock cases* is clearly the correct one, and that decision is, on the point in question, in perfect accord with the constitution.

At the time of the proposal and adoption of the sixteenth amendment, the federal power to tax incomes thus suffered from two patent defects. The holding in the *Pollock cases* that taxes on the income from real and personal property were direct made the incorporation of a general income tax into the fiscal policy of the government a practical, though not a legal, impossibility. The requirement of their apportionment among the states on the population basis effectually blocked its adoption. The legal necessity for exempting a considerable body of income constituted another drawback. The *Pollock cases* had called attention to both. If, therefore, the language of the sixteenth amendment can, without doing it violence, be construed to reach both the limitation upon the manner of exercising an existing power, and the want of power, the rule that the scope of remedial legislation should be determined in the light of the evils to be cured clearly warrants the adoption of that interpretation. No one denies that it has freed such income taxes as are direct from the requirement of the apportionment rule. The sole question is as to whether it has operated to confer a power to tax that did not theretofore exist.

The sixteenth amendment is in form a grant of power. In this respect it differs essentially from those constitutional pro-

[21]See 33 Harvard L. Rev. 794, 808, footnote (18); in which this view is rejected as entailing absurd results. It is a sufficient answer that the possibility of such results is a slender foundation on which to base an emendation of the federal constitution, especially when Congressional action practically contemporaneous with its adoption indicates that the provisions in question were construed in precisely the manner indicated. This is the more true where such emendation is ultimately based on an alleged logical incongruity.

[22]See 1 Stat. at L. 597 (1798); also the acts cited in Veazie Bank v. Fenno, (1869) 8 Wall. (U.S.) 533, 542, 19 L. Ed. 482.

[23]See Pollock v. Farmers' Loan & Trust Co., (1895) 157 U.S. 429, 39 L. Ed. 759, 15 S.C.R. 673; wherein Chief Justice Fuller remarks at pp. 582, 583, that: "This inequality must be held to have been contemplated."

visions that impose the requirement of apportionment. If the sole intention had been to abolish that limitation on the existing taxing power, the form selected is a rather confusing way of expressing it. It is a familiar canon of interpretation that the natural meaning of the language used governs. The existing limitation could have been removed by a simple statement that: "Direct taxes on income shall not be required to be apportioned among the several states, nor according to any census or enumeration." Had this, or some similar, form been adopted, the limited end would have been fully secured, and that without any ambiguity. Framing it as a grant of power has certainly created uncertainty of meaning if so narrow a scope was intended. The choice is, therefore, between imputing some rational significance to this fact, and considering it as an unfortunate and confusing selection of language. The latter alternative involves a repudiation of the rule that, if possible, effect should be given to every term in a written document, a principle which is certainly not less applicable in the construction of constitutional amendments than in interpreting ordinary legislation. The most reasonable view, therefore, is that casting the amendment in terms of a grant of power had some purpose; and that, if possible, some meaning must be attached to it.

It was hereinbefore stated that the construction of the sixteenth amendment might depend upon which view of the *Pollock cases* were adopted. If those cases are held to have decided that the federal power did not extend to the taxation of incomes, except in the form of an excise, then, at the time of the adoption of the amendment, there existed a want of power in respect of both income taxes that were direct and such taxes on exempt income. In that case a grant of power would be necessary even before direct income taxes could be levied. It could then be argued that the form of language used in the amendment was adopted to cure that particular defect of power, and was to be thus limited. In that case proponents of a liberal construction of its terms would be compelled to rely chiefly on the language, "from whatever source derived."[24] If, however, the *Pollock cases* are construed as having decided that direct income taxes must conform to the apportionment rule, as the court itself has interpreted its own decision, then the only want of power that existed to tax income was that to levy on exempt income. If, then, the language used has any

[24]The significance of this phrase will subsequently be more fully discussed.

significance, it can be found only by connecting it with that defect of power. It is, therefore, less difficult to establish the present taxability of exempt income if the court's own view of the *Pollock cases* is adopted. It is possible, on either view, to find some purpose and meaning in the fact that the amendment is framed as a grant of power; the adoption of the court's own theory makes it absolutely necessary to find that purpose and meaning in the removal of an incapacity to tax exempt income, for it would be absurd to confer upon the federal government a power that it already possessed. Correct principles of construction require the adoption of that one of the possible views which will give effect and attach significance to every term used, and which gives them their natural and usual meaning. It is scarcely reasonable to treat as inconsequential the fact that Congress, in proposing the amendment, chose to frame it in terms of a grant of power; it would be even less so to consider it as an inexact use of language by the legislative body, when a different explanation is possible. The preceding discussion has shown that another is available. It is, therefore, preferable to accept the view that the amendment constitutes a grant of power to tax that income to which the federal taxing power did not extend at the time of its adoption, viz., the so-called exempt income.

The power to tax exempt income is frequently supported by a reference to the language "from whatever source derived," which forms a part of the amendment. That language, standing by itself, clearly could not become a source of power. If, for example, the amendment had read: "Direct taxes on income, from whatever source derived, shall not be required to be apportioned among the several states, nor according to any census or enumeration," no one would contend that any power to tax exempt or any other income was thereby conferred. The language under discussion is, however, important in determining the extent of the power granted, assuming that some power is conferred. The crux of the problem is whether there is any such grant, a matter which has already been discussed. The use of this language raises two questions: (1) Does it afford any evidence in support of the view that the amendment was intended as a grant of power;[25] and (2) assuming that there is such grant, how is its scope affected thereby? While it would be difficult to find in it any affirmative argument to establish a grant of power, its presence increases

[25]It will no doubt be conceded that it could not be rationally construed as evidence that no grant of power was intended.

the difficulties of those who base the restriction of the amendment's scope on the reasoning that it confers no power to tax. That view limits the operation of the amendment to removing the requirement of apportioning direct income taxes among the states according to population. It necessarily treats as unimportant the fact that it reads: "The Congress shall have the power, etc." Admitting the correctness of that position, the conclusion by no means follows. The limited purpose imputed to the amendment could equally well have been attained by having it read: "The Congress shall have the power to lay and collect taxes on incomes without apportionment among the states, and without regard to any census or enumeration." This would have removed the requirement of apportionment as to every income tax to which it constitutionally applied with less probability than now exists that it would be construed as having intended to accomplish something more. The very addition of the expression "from whatever source derived" does suggest that something more was intended. It may be mere surplusage; if so, its only effect has been to create confusion. Or it may have been put in from an excess of caution to guard against possible danger that, without it, the amendment might be held not to relieve from the apportionment rule some income taxes to which it applied; if so, it seems entirely superfluous since the term "incomes" without qualification seems as inclusive as possible. The language in question acquires real significance only if it be construed as intended to accomplish some positive result. Its importance is rather negative in relation to the purpose to abolish the apportionment rule as to income taxes. The most reasonable explanation is that it constitutes a part of some other principle embodied in the amendment. Considering the fact that certain income was at the time exempt because of its source, the language is exactly adapted to emphasize the inclusion of that income within the taxing power conferred. It is undeniable that it might be more difficult to maintain the broad view of the amendment's scope if the language had been omitted; it is equally clear that its inclusion makes that purpose practically certain. On the one view it is explicable only as surplusage or as due to an excess of caution; on the other it acquires positive meaning and emphasizes what might otherwise have been ambiguous. The latter is clearly preferable as being the more reasonable. The presence of the language, therefore, reinforces the considerations already adduced in warranting an inference that the sixteenth amendment is a

grant of power; and, since the power to tax all but exempt incomes already existed, that this grant applies to it.

The position that the sixteenth amendment should be broadly construed ultimately rests on two propositions: (1) That it constitutes a grant of power to tax; and (2) that, as such, it confers, not a power that the federal government already possessed, but a new one, viz., to levy incomes taxes on exempt income. The discussion thus far has definitely established the former. Is it, however, possible to maintain that it does not confer a new power, but merely regrants an existing one? It is in this connection that the phrase "from whatever source derived" becomes of greatest importance. It defines the scope of the power conferred by designating the incomes comprehended within it. No language could be more inclusive. It savors of logical absurdity to convert language so sweeping in character into a source of restrictions. To do so would violate almost every recognized canon of interpretation. It would be opposed to the natural meaning of the language, and reduce it to mere surplusage. If, even in the case of ordinary statutes, courts will if possible construe them so as to give meaning to every term, a fortiori is that true when a constitutional amendment is involved. The most reasonable inference is that the expression was intended to accomplish some result which would not be as certainly secured if the phrase had been omitted. The regrant of the power to levy direct income taxes, and their relief from existing qualifications, are adequately and more certainly secured by its omission. However, a doubt might remain as to whether more was intended, which would be removed by the language in question. This view gives it significance, and is for that reason alone preferable to that which reads into it a restrictive character. But the only other purpose which it could have been intended to realize was to subject exempt income to the taxing power. The language is fully adequate and completely adapted to secure that result. It follows that the most reasonable construction is to consider the expression as giving to the power granted a scope sufficiently broad to include the taxation of exempt income. The sixteenth amendment is not a mere regrant of a power already possessed, nor yet a mere freeing of an existing power from a cumbersome limitation; it also confers a power to tax theretofore not belonging to the federal government, viz., the power to lay income taxes on exempt income.

Congress has never yet given the Supreme Court an opportunity to pass on the specific question whether exempt income is

taxable under the sixteenth amendment. The Court has, however, frequently indicated that it does not adopt the construction contended for in the preceding discussion. In the first important case arising under the amendment, it stated that:

"It is clear on the face of this text that it [the Amendment] does not purport to confer power to levy income taxes in a general sense,—an authority already possessed and never questioned, —or to limit or distinguish between one kind of income taxes and another, but that the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived."[26]

These expressions of opinion are, however, pure dicta on the problem of the taxability of exempt income. Are they equally such on the question whether the amendment extends the federal taxing power to new subjects? They clearly purport to deny that proposition. Before the amendment that power extended to the taxation of incomes from professions, personal services, and property, excluding only exempt income and salaries constitutionally exempted from diminution. The income tax laws since enacted have, with the exception hereinafter noted, taxed only such incomes as were within the power prior to its adoption. All cases arising under those laws, except *Evans v. Gore*,[27] have involved the taxability of income of those classes. There has, therefore, been no occasion to pass on this matter except in that single case. That involved the taxability of the salary of a federal judge whose appointment to office ante-dated the amendment. The action was one for the recovery of taxes alleged to have been illegally collected. The plaintiff's contention was that the imposition of a tax on his judge's salary amounted to a reduction of that salary contrary to the provisions of article III, section 1.[28] A divided court upheld this position. In the course of its opinion, it expressed the view that "the purpose of the amendment was to eliminate all occasion for such an apportionment because of the source from which the income came;"[29] and stated that:

"The genesis and words of the amendment unite in showing that it does not extend the taxing power to new or excepted

[26]Brushaber v. Union Pacific Railroad Co., (1916) 240 U.S. 1, 18, 60 L. Ed. 493, 36 S.C.R. 236.

[27](1920) 253 U.S. 245, 64 L. Ed. 887, 40 S.C.R. 550.

[28]Art. III, sec. 1. "The judges, both of the supreme and inferior courts, . . . shall, at stated times receive for their services, a compensation, which shall not be diminished during their continuance in office."

[29]Evans v. Gore, (1920) 253 U.S. 245, 261, 64 L. Ed. 887, 40 S.C.R. 550.

subjects, but merely removes all occasion otherwise existing for an apportionment among the states of taxes laid on income, whether derived from one source or another."[30]

This is emphatic and unambiguous language; and it would be futile to deny that the question was involved in the case, although only in a very limited manner. The real issue was whether, in view of the express provisions of the judiciary article, the sixteenth amendment could be deemed to confer a power to tax the salaries of federal judges. The language "from whatever source derived" is on its face broad enough to cover it. To so interpret it, however, would effect a repeal by implication of a part of the judiciary article. It is a well recognized principle that repeals by implication are not favored when the supposed repealing act relates to a different subject matter than the act repealed. In such case the fact of a resulting inconsistency is far from conclusive that a repeal was intended. The *Evans case* decided no more than that the sixteenth amendment, which dealt with taxation, did not by implication repeal another express constitutional provision relating to the judiciary;[31] and that whatever power it may confer does not extend to the taxation of a judge's salary not theretofore taxable. This is far from a decision that it confers no new power whatever to tax, and by no means forecloses that question. The doctrine of the non-taxability of exempt income itself rests on implications; it and the sixteenth amendment both deal with the subject of taxation, even though the rule be but a special case of a broader principle. There is more reason to deduce from an inconsistency between them an inference that the former was intended to be repealed than in the case of a judge's salary. There is an inconsistency between continuing the exemption in full force and the language of the amendment that Congress shall have the power to tax incomes "from whatever source derived." It may be that the Court will ultimately decide that this is only an apparent one; the purpose here is merely to show that it has not yet done so. The question is, therefore, still an open one as far as the Court is concerned.

The persistence throughout the cases of the restricted view of the amendment's scope must, however, be taken account of. It is bound to make it more difficult to secure the adoption of the competing view. There are some rather formidable arguments

[30]Idem, pp. 261, 262.

[31]In this discussion of the Evans case, I have assumed the correctness of the Court's position that to tax a judge's salary constitutes a diminution thereof.

supporting the former. The court adverted to one of these in *Evans v. Gore.* Referring to the fact that Governor Hughes of New York, in laying the amendment before the legislature for adoption or rejection, had suggested the possibility of the broad construction, the court remarked:

"But his message promptly brought forth from statesmen who participated in proposing the amendment such convincing exposition of its purpose, as here stated, that the apprehension was effectively dispelled and ratification followed."[32]

This appeal to Congressional intentions is not conclusive,[33] for amending the constitution is not a legislative act of Congress, but of the states; but it would be futile to minimize its importance. Its force will depend almost entirely upon the degree of ambiguity that the language of the amendment reveals. It cannot be resorted to to negative the natural import of the expressions used. There is a possible explanation of the phrase " from whatever source derived" which reduces the force of the arguments heretofore based thereon. The *Pollock cases,* in declaring the income tax law of 1894 invalid (except as exempt incomes were involved) had emphasized the source from which the income was derived. It had stressed the fact that the tax was levied on income from real and personal property. It is conceivable, and even not improbable, that the phrase was used in view of that emphasis to make it absolutely certain that those portions of the *Pollock cases* were being set aside. The combined effect of these considerations and the expressions used in the Congressional debates interpose a formidable obstacle to the easy acceptance of the broad view. The view just stated does not seem as reasonable as those heretofore expressed on the significance of this expression, and in any case furnishes no explanation of the fact that the amendment is phrased as a grant of power. An examination of the entire account shows a credit balance in favor of the liberal construction, but there are items on the debit side.

The argument thus far has aimed solely to discover which construction was logically the more consistent with the usual principles of interpretation. On the assumption most favorable to the restricted view, that method leaves the result in doubt. A con-

[32]Evans v. Gore, (1920) 253 U.S. 245, 261, 64 L. Ed. 887, 40 S.C.R. 550.

[33]See on the question of the value of Congressional debate as an aid in interpreting legislation the following cases: Maxwell v. Dow, (1900) 176 U.S. 581, 601, 602, 44 L. Ed. 597, 20 S.C.R. 448, 20 S.C.R. 494; Downes v. Bidwell, (1901) 182 U.S. 244, 254, 45 L. Ed. 1088, 21 S.C.R. 770.

sideration of the political, economic and social consequences of the adoption of one or the other of competing views is a legitimate procedure in determining constitutional issues, particularly where the logical method has left the matter uncertain. As long as the exemption exists, states and their political subdivisions enter the capital market with a distinct advantage over private borrowers. The tendency of capital to seek tax-free investment has today become almost notorious. Its owners are rather loudly condemned for acting as enlightened self-interest dictates. The result has been to encourage municipal borrowing, and some observers attribute the prevailing public extravagance largely to this factor. It has undoubtedly diverted capital from more productive fields, and retarded commercial and industrial expansion and development. It constitutes a serious impairment of the full effectiveness of the federal taxing power, and increases the difficulty of fairly distributing the tax burden. On the other hand, it does facilitate state and municipal projects of various kinds; persons with different social theories will reach conflicting conclusions as to whether or not this is desirable. The most serious consideration militating against the broad construction is the danger that the federal government might use its power to injure the interests of the states. This danger is the ultimate reason on which the exemption originally rested. No such injury would result as long as the tax rates on exempt income were no higher than on other classes of income. This would establish equality between the states, the federal government, and private enterprise. The probability that a Congress composed of representatives from the various states will ever discriminate against them in favor of private enterprise is so remote as to be practically impossible; the likelihood that it will discriminate in favor of the federal government is somewhat greater, but such discrimination is not as likely to entail serious consequences. States have survived, and been able to carry on all their functions, even though their securities and the income therefrom are taxable by other states.[34] It seems rather fantastic to find their existence endangered by granting like powers to a government in which they are all represented. The states' police power has not been destroyed because the Supreme Court has held that, if they engaged in the business of dispensing liquors even as a police measure for purposes of controlling that traffic, the business is subject to

[34]Bonaparte v. Appeal Tax Court of Baltimore, (1882) 104 U.S. 592, 26 L. Ed. 845.

federal license taxes.[35] Considerations of political and economic policy had their influence on that decision. If probabilities rather than possibilities are considered, the danger to the states becomes practically infinitesimal. An evaluation of these considerations but reinforces the conclusion that the sixteenth amendment should be construed to extend the federal taxing power to exempt income. The spell long cast over legal reasoning on this problem by the famous dictum that the power to tax is the power to destroy affords but a slender basis on which to predicate a contrary principle.

It is generally recognized that the exemption of a considerable mass of income constitutes a grave defect in the present scheme of federal income taxation. Another constitutional amendment has been suggested as a remedy, even before the Supreme Court has had an opportunity to pass on the necessity therefor. There seems to exist a legislative opinion that the matter has been practically settled by previous adjudications. This discussion has aimed to show that this is an ill-founded assumption. Congressional action taxing this exempt income is not so certainly condemned to futility. On the contrary, the case for its taxability under the sixteenth amendment is stronger than for its continued exemption. That Congressional debates at the time of its submission support the restricted view of its scope is not decisive. The fourteenth amendment has been extended far beyond what its framers had in mind, because its language was broader. than that rather definite purpose. The same is true of the language of the sixteenth amendment. The theory underlying the statutory exemption of interest on the obligations of states and their political subdivisions, and the exemption by official regulation of the salaries of their officers and employees, is probably incorrect. It is at least of doubtful validity. There is no reason why the matter should be allowed to go by default.

[35]South Carolina v. United States, (1905) 199 U.S. 437, 50 L. Ed. 261, 26 S.C.R. 110. In this case the Court admitted that the control of the liquor traffic was an exercise of the police power, a governmental power. It, however, distinguished between duties of a public, and acts of a private, character. "It is reasonable to hold that, while the former [federal government] may do nothing by taxation in any form to prevent the full discharge by the latter [state] of its governmental functions, yet, whenever the state engages in a business which is of a private nature, that business is not withdrawn from the taxing power of the nation." It is interesting to speculate whether this language does not warrant the taxation of income from state and municipal bonds issued to finance such non-governmental functions as municipalities frequently engage in, even apart from the question of scope of the sixteenth amendment.