

1968

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Recommended Citation

Del Cotto, Louis A., "The Constitutional Problem of Taxing Gifts as Income: A Reply to Professor Mullock" (1968). *Minnesota Law Review*. 1847.

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The Constitutional Problem of Taxing Gifts as Income: A Reply to Professor Mullock†

Louis A. Del Cotto*

Having been characterized as an angel, perhaps I should react with appropriate docility to Professor Mullock's kind effort to clarify and explain my position on the subject of income taxability of gifts. My instincts toward scholarly inquiry, however, have so overcome whatever angelic qualities I may have that I feel constrained to reply, albeit briefly, to Mullock's paper.

I.

I have some difficulty with what Professor Mullock means by the "ordinary language meaning" of the word income. If common understanding is to determine the meaning of the word "incomes" as used in the sixteenth amendment, then surely we must look for the understanding which was prevalent in 1913 at the time of the adoption of the sixteenth amendment.¹ Any "common understanding" which prevails today, some 55 years after the sixteenth amendment, will almost certainly be colored by subsequently developed notions. For example, hourly workers generally seem to think that nothing is income upon which there is no tax withheld, and employer supplied meals and lodging are generally thought to be non-taxable without regard to convenience of the employer. Similarly, and more correctly, gifts may not be commonly regarded as income, but this is probably because they have not been treated as such since the adoption of the modern income tax. Since 1913, gifts, bequests, and inheritances have been specifically exempted from gross income by section 102 of the 1954 Code, section 22(b)(3) of the 1939 Code and their counterparts in the various revenue acts. Thus, any attempt to apply an "ordinary language" test to solve the problem of whether a gift is within the sixteenth amendment concept of "incomes" requires an inquiry into the common understanding prevalent in the past. Since I have recently written a good deal on this subject,² I will refrain from repeating myself here. I

† See this volume, *supra* at 247.

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1. *Merchants Loan & Trust Co. v. Smietanka*, 255 U.S. 509, 519 (1920); *Lynch v. Hornby*, 247 U.S. 339, 343-44 (1918).

2. Del Cotto, *The Trust Annuity As Income: The Constitutional Problem of Taxing Gifts and Bequests As Income*, 23 TAX L. REV. 231 (1968).

would much rather address myself to two other points made by Professor Mullock.

II.

Professor Mullock agrees that *Simmons v. United States*³ is authority for the proposition that an income tax on receipt of a gift is an indirect tax and thus valid without regard to the sixteenth amendment, even though not apportioned. He does, however, disagree with the Court's reasoning process. For purposes of accuracy, let me quote Professor Mullock:⁴

The argument, taken from the court's opinion in *Simmons v. United States*, is as follows:

1. The estate, gift and inheritance tax law distinguishes between
 - (a) a tax on property imposed solely by reason of its ownership, which is direct, and
 - (b) a tax upon the exercise of some, but not all, of the rights adhering to ownership, such as use or transfer of property, which is indirect and therefore not subject to the requirement of apportionment.
2. A tax upon the donor of an *inter vivos* gift is indirect, being merely a tax upon the exercise by the donor of the right to transfer the property.
3. If a tax on giving property is indirect, so is a tax on receiving it, regardless of the source.
4. An income tax on the recipient of a gift is a tax upon the receipt of property rather than upon the ownership of property, and therefore is indirect.

So far as step (3) is concerned it may be doubted . . . that it follows from steps (1) and (2). While we may agree that giving is one of the attributes of ownership, it is not so clear that the same can be said of receiving. One second before a gift is made the donor, as owner, has the right to make the gift; but at that point in time the prospective donee is not the owner of the subject matter of the gift and so does not have a right to receive it based on ownership.

Mullock would appear to conclude, therefore, that because a tax on receiving property is not a tax on an attribute of its ownership, it is not an indirect tax.

Professor Mullock's analysis appears sound, except for the conclusion that the tax is not indirect. Here Professor Mullock, whose analytical style depends so much upon the syllogism, seems to have committed the common syllogistic fallacy of the undistributed middle: to say that *all* taxes on the exercise of less than all of the numerous rights in property are indirect is not to say that *only* such taxes are indirect and that *all other*

3. 308 F.2d 160 (4th Cir. 1962).

4. Footnotes are omitted.

taxes are direct. Indeed, the very cases cited by Professor Mullock in the course of his analysis indicate there is a class of indirect tax *in addition* to a tax on the exercise of less than all ownership rights, and that tax is a tax on the receipt of property.

In the interest of clarity and completeness, perhaps we should begin near the beginning. In *Scholey v. Rew*⁵ the Supreme Court held that the Civil War federal inheritance tax, levied on the person who received the inheritance, was an indirect tax that did not require apportionment. The Court said that an inheritance tax was the same as a tax on the receipt of income, which had previously been held to be an indirect tax.⁶ This statement became questionable after the Court decided in *Pollock v. Farmers' Loan & Trust Company*⁷ that a tax on the income from property was a direct tax on the property itself, although the Court did not question the imposition of the income tax upon personal service income.⁸ Any question that an inheritance tax was indirect was removed, however, by *Knowlton v. Moore*,⁹ where the Supreme Court held that the federal inheritance tax of 1898 was an indirect tax in the nature of a duty or excise, which was outside the requirement of apportionment.¹⁰ Also, the Court pointed out that "the thing forming the universal subject of taxation upon which inheritance and legacy taxes rest is the transmission or *receipt*"¹¹ of property, and went to great lengths to reaffirm *Scholey v. Rew*.¹²

Thus, it seems clear that a tax on the exercise of less than all ownership rights in property is not the only form of indirect tax. A tax on the receipt of property is similarly indirect. Indeed, in the sense that both taxes are upon the exercise of a privilege there is nothing at all inconsistent or even different about them. The Supreme Court discussed this point in *New York Trust Company v. Eisner*¹³ where the taxpayer attacked the federal estate tax as unconstitutional, arguing that it was direct and unapportioned. *Knowlton* was distinguishable, con-

5. 90 U.S. (23 Wall.) 331 (1874).

6. *Id.* at 347, 348.

7. 157 U.S. 429 (1895), *on rehearing*, 158 U.S. 601 (1895).

8. 158 U.S. at 637.

9. 178 U.S. 41 (1900).

10. Although the *Knowlton* Court was not concerned with any distinction between transmission and receipt, it nevertheless concluded that the tax was really on the legatee and not on the mass of the estate. *Id.* at 66-69.

11. *Id.* at 59 (emphasis added).

12. *Id.* at 78-82.

13. 256 U.S. 345 (1921).

tended the taxpayer, because it involved an inheritance tax which was indirect because it could be avoided by disclaiming the legacy, whereas in *New York Trust Company* an estate tax was imposed on the passage of property at death and therefore could not be avoided. The Court held that *Knowlton* controlled as to both types of taxes;¹⁴ that a tax on the transmission of property at death was quite the same as a tax on the privilege of receiving property, both being in the nature of an excise tax which is indirect. In *Bromley v. McCaughn*¹⁵ the Court upheld the constitutionality of the federal gift tax as an indirect tax on a single incident of ownership, the power to give property to another, and could find no distinction between the gift tax and the taxes on receipt of property involved in *Knowlton* and *Scholey v. Rew*.¹⁶ And again, in *Fernandez v. Weiner*,¹⁷ which upheld as an indirect tax the federal estate tax on community property at the death of one spouse,¹⁸ it was stated that:

If the gift of property may be taxed, we cannot say that there is any want of constitutional power to tax the receipt of it, whether as a result of inheritance, [citation omitted] or otherwise, whatever name may be given to the tax. . . . Receipt in possession and enjoyment is as much a taxable occasion within the reach of the federal taxing power as the enjoyment of any other incident of property.¹⁹

The reasoning of the *Simmons* court, which is criticized by Professor Mullock, is based squarely on the reasoning and authority of the above cases.

III.

Professor Mullock also states that my position—that a tax upon the receipt of a gift is indirect—is so *only if* Congress extends section 61(a) of the Internal Revenue Code to cover gifts [and repeals the gift exemption of section 102(a)], *and if* Congress repudiates its position that the section 61(a) meaning of “income” is limited by the meaning of “incomes” in the sixteenth amendment.

Assuming the validity of Mullock’s position that “incomes” in the sixteenth amendment, and hence in section 61(a), must be

14. *Id.* at 348-49.

15. 280 U.S. 124 (1929).

16. *Id.* at 137.

17. 326 U.S. 340 (1945).

18. *Id.* at 361-62.

19. *Id.* at 353. This language was not used directly in support of the Court’s holding, but it does indicate the Court’s view of the nature of the tax.

given an "ordinary language" meaning, I am still puzzled by what he says. I take it that the correctness of my position can be argued and established *whether or not* Congress chooses to impose a tax on the receipt of gifts. If Congress does not so choose, then my position I suppose is academic, but its accuracy is in no way dependent upon a contrary choice by Congress.

Moreover, if Congress does choose to tax the receipt of a gift under the income tax, I take it that an extension of section 61(a) to do so is at the same time a repudiation of whatever position it may have taken regarding the "ordinary meaning" of the word "income." More importantly, and contrary to Mullock's implication, Congress may impose this very tax by way of a section other than section 61(a). Some items not mentioned specifically in section 61(a) are taxed by other sections of the Code. For example, section 74 requires the inclusion in gross income of certain prizes and awards and section 111, by implication, includes recoveries of items previously deducted which are not within the "recovery exclusion." Indeed, the very article in which I took the position that Mullock here criticizes, contains an analysis of another such example which is the taxation of the trust annuity under sections 102(b) and 662(a) of the Code. Such sections treat trust distributions made in satisfaction of a gift or bequest of a fixed dollar annuity as a distribution of income to the extent of the distributable net income of the trust and hence impose an income tax upon the receipt of a distribution of *principal, i.e.*, on the receipt of a gift of principal through the medium of a trust. In response to the Court's holding in *Burnet v. Whitehouse*²⁰ that a fixed dollar annuity is not in the nature of income since it is a charge on the whole estate and does not depend on the presence of income, Congress has in fact carved an exception out of the exemption from tax contained in section 102(a) for gifts of principal, and has done it by way of sections 102(b) and 662(a), without resort to section 61(a).²¹

20. 283 U.S. 148 (1931).

21. See Del Cotto, *supra* note 2.

