

such taxes have been universally upheld. They are valid, because, when the burden is indirect, even a large burden upon interstate commerce does not render a tax void. See *Southern Ry. Co. v. Watts*, 260 U. S. 519, 530; *Hump Hairpin Co. v. Emmerson*, 258 U. S. 290.

It would be unfortunate to hold that merely because a foreign corporation, doing a local business does also interstate business, the State may not lay upon it a reasonable, non-discriminatory excise, necessarily limited to a reasonable amount, to which all domestic corporations similarly situated are subject and which can affect interstate commerce only indirectly, if at all. To hold such a tax void seems to me to ignore the wise rule of decision declared in *Postal Telegraph Cable Co. v. Adams*, 155 U. S. 688, 698: "The substance and not the shadow determines the validity of the exercise of the [taxing] power."

Mr. JUSTICE HOLMES joins in this opinion.

TAFT *v.* BOWERS, COLLECTOR OF INTERNAL REVENUE.

GREENWAY *v.* SAME.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Nos. 16 and 17. Argued April 26, 1928. Reargued October 9, 1928.—Decided February 18, 1929.

1. Under par. (2), § 202 of the Revenue Act of 1921, where one who purchased shares of stock after February 28, 1913, gave them to another after December 31, 1920, when their market value had increased over the investment, and the donee afterwards sold them at a price still higher, the gain taxable to the donee is the difference between the price realized by him and the price paid by the donor. P. 481.

2. In such case, Congress has power under the Sixteenth Amendment to treat the entire increase in value, when separated from the investment by the sale, as income of the donee. P. 482.
20 F. (2d) 561, affirmed.

CERTIORARI, 275 U. S. 520, to judgments of the Circuit Court of Appeals reversing judgments in favor of the present petitioners, 15 F. (2d) 890, in actions against the Collector to recover money paid as income taxes.

Mr. Henry W. Taft, with whom *Mr. Clarence Castimore* was on the brief, for petitioner in No. 16.

“Income” has been defined to mean “the gain derived from capital, labor, or from both combined, provided it is understood to include profit gained through a sale or conversion of capital assets.” *Eisner v. Macomber*, 252 U. S. 189. In order to apply this definition, we must determine first what is profit or gain to the taxpayer. The value of the gift itself is not profit or gain, but capital in the hands of the donee. *Edwards v. Cuba R. R. Co.*, 268 U. S. 628; *United States v. Oregon-Washington R. R. Co.*, 251 Fed. 211. Indeed the statute itself specifically provides that a gift is not to be included in the gross income of the donee.

Prior to the year 1921, there was no specific provision in the various Revenue Acts which fixed the basis for determining gain or loss on the sale of property acquired by gift, devise or bequest. The statute provided that the basis to determine gain on the sale of assets was cost or March 1, 1913 value. The uniform rule of the Treasury Department under those prior statutes was that the basis to be used for determining gain upon the sale of an asset acquired by gift, devise or bequest, was the value of such property when acquired. In other words, until the Revenue Act of 1921 became effective, the Department laid down the rule

that gain on the sale of property acquired by gift could be computed only by taking into consideration the value of the gift when it was acquired. This was an express recognition by the Treasury Department that a gift is a capital transaction, as pointed out in *Edwards v. Cuba R. R. Co.*, and *United States v. Oregon-Washington R. R. Co.*, *supra*, and that the donee can have "gain" only to the extent that the proceeds in his hands exceed the value of his capital at the time of acquisition. These rulings are entitled to great weight. *United States v. Hill*, 120 U. S. 169.

In *Goodrich v. Edwards*, 255 U. S. 527, this Court held that the Income Tax Act of 1916 taxed "gains" only, and that a taxpayer could have no gain until the proceeds of the sale exceeded his cost, even though the proceeds may have exceeded the March 1, 1913, value. In *Lynch v. Turrish*, 247 U. S. 221, this Court passed upon the question as to whether an increase in the value of capital assets which has accrued prior to March 1, 1913, was income to a taxpayer when realized after that date at a very great increase over the cost price. In passing upon the question this Court said that there was "no increase subject to tax," allowing the taxpayer to recover his capital investment on March 1, 1913. See also *Doyle v. Mitchell Bros.*, 247 U. S. 179.

We see no reason for distinguishing between a case where the increase occurred prior to the passage of the taxing statute and a case where the increase occurred prior to ownership by the present taxpayer. If a taxpayer in the former case is entitled to recover his capital investment before he can have any gain, *a fortiori*, a taxpayer in the latter case should be entitled to recover his capital investment which he acquired at the date of the gift. We submit that the above decisions lay down definitely the principle that a taxpayer is entitled to recover his cost or capital investment before he can have

gain or income. If then a taxpayer's capital investment at the time of acquisition is not "income," as it is usually understood, a statute which seeks to make it such is invalid. *Eisner v. Macomber*, 252 U. S. 189.

The provisions in question are capricious and arbitrary and contrary to the Fifth Amendment. That the results of the application of the statute here under consideration are arbitrary and capricious is plain. Let us illustrate: A bought stock for \$10. He makes a bona fide gift of it to B after December 31, 1920, when it is worth \$100, and B sells the stock for \$200. The statute provides that B has a gain of \$190. Thus B is given no benefit whatsoever of the capital which he received at the commencement of his period of ownership, and the indirect effect of the statute is that he is taxed on a part of the value of the gift, which the statute provides in another section, § 213 (b) (3), shall not be taxed as income. So far as B is concerned, he has an actual economic gain of \$200, but it has long ago been settled that an economic gain is not necessarily a taxable gain in the constitutional sense. *Gould v. Gould*, 245 U. S. 151; *Southern Pacific Co. v. Lowe*, 247 U. S. 330; *United States v. Oregon-Washington R. R. Co.*, 251 Fed. 211.

Let us reverse the above example: A bought stock for \$200. He gives it to B after December 31, 1920, when it is worth \$100, and B, after a year, sells for \$10. The statute provides that B has a loss of \$190. This is absurd and unreal, because B never had anything worth \$190.00 to lose. It was just this sort of unreality and disregard of actual facts that this Court refused to sanction in *Goodrich v. Edwards*, *supra*, and in the later case of *United States v. Flannery*, 268 U. S. 98.

Congress must not use its taxing power in such an arbitrary and capricious manner as to invade the rights of citizens under the Fifth Amendment. *Frew v. Bowers*, 12 F. (2d) 625; *Coolidge v. Nichols*, 274 U. S. 531; *Blodgett v. Holden*, 275 U. S. 142.

The provision is not a legitimate and necessary exercise of the power ancillary to the power to levy taxes. To attempt to remedy a supposed weakness in the statute by adopting a basis for determining gain which is inherently fallacious does not answer the argument that the amount so included is not income. *Eisner v. Macomber*, *supra*. Nor is it sufficient to justify the means that the omission might have been closed by other methods of taxation, as, for example, an excise tax on the gift, as suggested by the learned Judges below.

Nor is the means justified by saying that the donee took the property impressed with a tax liability. First of all, no income tax liability with respect to the property attached to the donor at any time prior to or at the time of the gift, *People ex rel. Wilson v. Wendell*, 196 N. Y. (App. Div.) 596; so there was no liability to pass on. Secondly, the argument has been effectively answered in *Miles v. Graham*, 268 U. S. 501. There it was held that a federal judge could not be taxed on his salary contrary to the provisions of the Constitution, even though he took the judgeship after the passage of the Revenue Acts and with the knowledge that the Act attempted to tax his salary.

Furthermore, from the inception of our federal income tax laws, a clear and distinct cleavage has been made between different taxpayers. Such has become settled practice, both in the wording of the laws and in the decisions that have been made under them. The person acquiring property can never tell what liability he assumes in the way of income tax if any basis entirely foreign to him can be arbitrarily adopted for determining his gain. It is this fact that no doubt underlies the attempt in the statute and the trend in the decisions, always to draw a distinct line between separate taxpayers. If a decedent and his executor, or a decedent and his legatees, must be dealt with separately, surely there is no justification for con-

fusing the identity of a donor and a donee and treating them as one.

Neither in "common speech" nor in the "ordinary sense" (*Eisner v. Macomber, supra*; *Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509; *United States v. Oregon-Washington R. R.*, 251 Fed. 211) is a gift income. Income, as defined by lexicographers, comes to a person "within a specified time" or "regularly," or is the "periodical produce" or the "annual, or periodical receipts." This language would exclude a gift or a legacy or an inheritance, all of which are casual and come without regularity. It must be "as payment for services, interest from investment; revenue," or "produce of one's work, business, lands, or investments."

While the definition of income has been extended by the Income Tax Law and the decision of this Court in *Merchants Loan & Trust Co. v. Smietanka, supra*, so as to include accretion to capital, that decision was rendered with reference to an accretion which was a realized "gain or profit," "produced by" or "derived from" an investment; but the words used in *Stratton's Independence v. Howbert*, 231 U. S. 399, and applied in *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179, which were approved as to the Income Tax Law in *Eisner v. Macomber*, 252 U. S. 189, and *Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509, do not affect the essential features of an income that it (1) must be the product of invested capital or labor or services, and (2) must be reckoned for regular periods (annually, if not specified otherwise), or within some definite or specified period, as, for instance, the period during which a realized gain upon an investment is to be measured.

It was not the intention of Congress to give to the amended § 202 (b) (3) of the Revenue Act a retroactive effect so as to take account of increase in the value of the gift accruing prior to the passage of the law.

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Mr. Hiram C. Todd, with whom *Mr. Roger S. Baldwin* was on the brief, for petitioner in No. 17.

The gist of the Government's contention is that a gift constitutes income to the donee; and that the Government could, if it saw fit, tax the entire proceeds of a sale of the gift as income of the donee; from which it follows that it can tax as income of the donee, the difference between the cost of the gift to the donor and the proceeds of the sale of the gift by the donee.

We believe this argument ignores the fundamental fact that income is derivative and complementary. It has no existence independent of the source from which it is derived and is dependent upon capital in some form or upon labor for its very existence. Citing *Eisner v. Macomber*, 252 U. S. 189, and definitions of "income" from various dictionaries.

If the entire proceeds of the sale of a gift constitute income to the donee, where is the capital from which the income is derived? The answer must be that the corpus of the gift is capital in the hands of the donee at the time of its receipt. But the mere conversion of such capital into money does not constitute income. *Lynch v. Tur-rish*, 247 U. S. 221.

An amount sufficient to restore the capital value that existed at the commencement of the taxing period must be withdrawn from the gross proceeds in order to determine whether there has been a gain or loss, and the amount of the gain, if any. *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179.

The popular conception of the meaning of "income" excludes property or money received by way of gift. The ordinary layman would not think of including, as a part of his income, money or property which he had received as a gift.

Assistant Attorney General Mabel Walker Willebrandt and Mr. Edwin G. Davis, with whom Solicitor General Mitchell, and Messrs. Sewall Key and J. Louis Monarch were on the brief, for respondent.

The word "income" is to be construed in its ordinary sense. *Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509.

Congress, in the various Revenue Acts, has consistently treated gifts as income; one time, as in § 4 of the Revenue Act of 1916, specifically referring to gifts as "income," but generally by exempting them from inclusion in gross income. The legislatures of certain States have regarded gifts as income.

The sale of purchased property separates income from capital. The income is measured by the difference between the investment and the selling price. If this rule be applied to the sale of property acquired by gift, the value of the gift, i. e., its selling price, will appear as income, since the donee's investment therein is zero. This conception of income is not inconsistent with the definition of income in *Eisner v. Macomber*, 252 U. S. 189; but in any event, that definition, as the Court there intimated, does not represent the uttermost limits of what can be regarded as income.

Congress assumed the gift of a corpus which is exempted from taxation, but it taxed the income from the gift. *Irwin v. Gavit*, 268 U. S. 161. In the cases at bar, the corpus was the shares of stock conveyed by gift. The increment in the value of these shares when realized by sale was income. *Eisner v. Macomber, supra*. That part of the increase which accrued while the stock was still held by the donor was inherently income. It was intrinsically a gift of income to the donee, and, when separated from capital and realized in the hands of the

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donee by the sale of the gift, may constitutionally be taxed as income to him for the year in which realized.

Since the authority to tax given by the Sixteenth Amendment is an authority to tax "income," not "persons," a change in ownership of what is inherently income after its accrual and before realization by sale, can not affect the right of Congress to impose a tax thereon. *Atlantic Coast Line v. Daughton*, 262 U. S. 413; *United States v. Phellis*, 257 U. S. 156; *McKinney v. United States*, 62 Ct. Cls. 180; *Irwin v. Gavit*, 268 U. S. 161; *Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509.

If the corpus of the gift in these cases be construed as including the increment in the value of the shares of stock while held by the donor, still the sale of the gift resulted in a realized gain which may be constitutionally measured by taking the cost of the latest actual capital investment in the gift as a basis.

Section 202 (a) (2) of the Revenue Act of 1921 does not prescribe a capricious or arbitrary scheme of taxation, nor is it in violation of the Fifth Amendment. It is a necessary part of a complete scheme of taxation whose purpose was to prevent tax evasion or avoidance in respect to a particular type of gain.

It is not capricious to put property acquired by gift in a special class and to tax it differently from property acquired by purchase. *Bowman v. Continental Oil Co.*, 256 U. S. 642; *Brushaber v. Union Pacific R. R.*, 240 U. S. 1; *Thomas v. United States*, 192 U. S. 363.

Mr. JUSTICE McREYNOLDS delivered the opinion of the Court.

Petitioners, who are donees of stocks, seek to recover income taxes exacted because of advancement in the market value of those stocks while owned by the donors. The facts are not in dispute. Both causes must turn upon the effect of paragraph (2), § 202, Revenue Act, 1921, (c. 136,

42 Stat. 227) which prescribes the basis for estimating taxable gain when one disposes of property which came to him by gift. The records do not differ essentially and a statement of the material circumstances disclosed by No. 16 will suffice.

During the calendar years 1921 and 1922, the father of petitioner Elizabeth C. Taft, gave her certain shares of Nash Motors Company stock then more valuable than when acquired by him. She sold them during 1923 for more than their market value when the gift was made.

The United States demanded an income tax reckoned upon the difference between cost to the donor and price received by the donee. She paid accordingly and sued to recover the portion imposed because of the advance in value while the donor owned the stock. The right to tax the increase in value after the gift is not denied.

Abstractly stated, this is the problem—

In 1916 A purchased 100 shares of stock for \$1,000 which he held until 1923 when their fair market value had become \$2,000. He then gave them to B who sold them during the year 1923 for \$5,000. The United States claim that, under the Revenue Act of 1921, B must pay income tax upon \$4,000, as realized profits. B maintains that only \$3,000—the appreciation during her ownership—can be regarded as income; that the increase during the donor's ownership is not income assessable against her within intendment of the Sixteenth Amendment.

The District Court ruled against the United States; the Circuit Court of Appeals held with them.

Act of Congress approved November 23, 1921, Chap. 136, 42 Stat. 227, 229, 237—

“Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

“(1) . . .

“(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner. In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss from a sale or other disposition thereof shall be the fair market price or value of such property at the time of such acquisition; ”

“Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term ‘gross income’—

“(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

“(b) Does not include the following items, which shall be exempt from taxation under this title;

“(1) . . . (2) . . .

“(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income); . . .”

We think the manifest purpose of Congress expressed in paragraph (2), Sec. 202, *supra*, was to require the petitioner to pay the exacted tax.

The only question subject to serious controversy is whether Congress had power to authorize the exaction.

It is said that the gift became a capital asset of the donee to the extent of its value when received and, therefore, when disposed of by her no part of that value could be treated as taxable income in her hands.

The Sixteenth Amendment provides—

“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.”

Income is the thing which may be taxed—income from any source. The Amendment does not attempt to define income or to designate how taxes may be laid thereon, or how they may be enforced.

Under former decisions here the settled doctrine is that the Sixteenth Amendment confers no power upon Congress to define and tax as income without apportionment something which theretofore could not have been properly regarded as income.

Also, this Court has declared—“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.” *Eisner v. Macomber*, 252 U. S. 189, 207. The “gain derived from capital,” within the definition, is “not a gain accruing to capital, nor 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, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal.” *United States v. Phellis*, 257 U. S. 156, 169.

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If, instead of giving the stock to petitioner, the donor had sold it at market value, the excess over the capital he invested (cost) would have been income therefrom and subject to taxation under the Sixteenth Amendment. He would have been obliged to share the realized gain with the United States. He held the stock—the investment—subject to the right of the sovereign to take part of any increase in its value when separated through sale or conversion and reduced to his possession. Could he, contrary to the express will of Congress, by mere gift enable another to hold this stock free from such right, deprive the sovereign of the possibility of taxing the appreciation when actually severed, and convert the entire property into a capital asset of the donee, who invested nothing, as though the latter had purchased at the market price? And after a still further enhancement of the property, could the donee make a second gift with like effect, etc.? We think not.

In truth the stock represented only a single investment of capital—that made by the donor. And when through sale or conversion the increase was separated therefrom, it became income from that investment in the hands of the recipient subject to taxation according to the very words of the Sixteenth Amendment. By requiring the recipient of the entire increase to pay a part into the public treasury, Congress deprived her of no right and subjected her to no hardship. She accepted the gift with knowledge of the statute and, as to the property received, voluntarily assumed the position of her donor. When she sold the stock she actually got the original sum invested, plus the entire appreciation; and out of the latter only was she called on to pay the tax demanded.

The provision of the statute under consideration seems entirely appropriate for enforcing a general scheme of lawful taxation. To accept the view urged in behalf of petitioner undoubtedly would defeat, to some extent, the

purpose of Congress to take part of all gain derived from capital investments. To prevent that result and insure enforcement of its proper policy, Congress had power to require that for purposes of taxation the donee should accept the position of the donor in respect of the thing received. And in so doing, it acted neither unreasonably nor arbitrarily.

The power of Congress to require a succeeding owner, in respect of taxation, to assume the place of his predecessor is pointed out by *United States v. Phellis*, 257 U. S. 156, 171—

“Where, as in this case, the dividend constitutes a distribution of profits accumulated during an extended period and bears a large proportion to the par value of the stock, if an investor happened to buy stock shortly before the dividend, paying a price enhanced by an estimate of the capital plus the surplus of the company, and after distribution of the surplus, with corresponding reduction in the intrinsic and market value of the shares, he were called upon to pay a tax upon the dividend received, it might look in his case like a tax upon his capital. But it is only apparently so. In buying at a price that reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought ‘dividend on’ as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon. In short, the question whether a dividend made out of company profits constitutes income of the stockholder is not affected by antecedent transfers of the stock from hand to hand.”

There is nothing in the Constitution which lends support to the theory that gain actually resulting from the increased value of capital can be treated as taxable income in the hands of the recipient only so far as the increase occurred while he owned the property. And *Irwin v. Gavit*, 268 U. S. 161, 167, is to the contrary.

The judgments below are

Affirmed.

The CHIEF JUSTICE took no part in the consideration or decision of these causes.

SALOMON ET AL. *v.* STATE TAX COMMISSION OF NEW YORK.

SIMONSON ET AL. *v.* SAME.

ERROR TO THE SURROGATES' COURT OF NEW YORK COUNTY,
STATE OF NEW YORK.

Nos. 79 and 80. Argued November 28, 1928.—Decided February 18, 1929.

1. A state law imposing a graduated tax on the transfer of contingent remainders measured by the value at the testator's death of the estate transferred, undiminished by the value of the intervening life estate, and requiring the executor to deposit security for the payment of the tax, but postponing the definitive assessment and the payment of the tax until after the death of the life tenant—*held* consistent with due process of law. P. 489.
2. The due process clause places no restriction on a State as to the time at which an inheritance tax shall be levied or the property valued for purposes of such tax. P. 490.
3. The graduation of the tax and the impossibility of forecasting exactly the duration of life estates may cause a lack of equivalency of tax burden as between a contingent remainder, when taxed as above stated, and a like vested remainder when the tax on the latter is based on its value separate from the intervening life estate and is paid at the testator's death; but such differences do not amount to an unjustifiable discrimination against the contingent remainderman violative of the equal protection clause. *Id.*