

## Sample Supreme Court Case Brief

[Comment - everything needed to write up this brief is contained in the text of the case itself.]

### ***Eisner v Macomber*, 252 U.S. 189, 1 USTC ¶32 (1920)**

#### Doctrine

Income means something *derived* from labor or capital. To be “derived” means something of exchangeable value separated from the capital.

#### Issue

Does Congress have the power under the 16th Amendment to tax shareholders on stock dividends received? Are stock dividends considered income or capital?

#### Facts

Mrs. Macomber owned 2,200 share of Standard Oil Company of California stock. In January, 1916, the company declared a stock dividend and Mrs. Macomber received an additional 1,100 shares of stock. Of these shares, 198.77 shares, par value \$19,877, represented surplus earned by the company after March 1, 1913. The IRS treated the \$19,877 as taxable income under the Revenue Act of 1916 which provided that a stock dividend was considered income to the amount of its cash value. Mrs. Macomber argued that that provision in the Revenue Act of 1916 was unconstitutional because it was a direct tax not apportioned per population; since a stock dividend was not income, a legislative provision subjecting it to income tax was not constitutional under the 16th Amendment. The District Court held that the stock dividend was not income.

#### Law

- 1) 16th Amendment - "The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."
- 2) Revenue Act of 1916 - a "stock dividend shall be considered income, to the amount of its cash value."
- 3) *Brushaber v Union Pacific R.R. Co.*, 1 USTC ¶41 (USSC) - in this case, the Supreme Court stated that the 16th Amendment "did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the State of taxes laid on income." *Macomber*, 1 USTC ¶32, page 1079. Thus, the item must be income in order for Congress to tax it.
- 4) The Court suggested that "income," which is not defined in the 16th Amendment, was something derived from capital or labor, or from both.

## Analysis

If a stock dividend is not considered income, it can not be subject to income tax under the 16th Amendment. In applying the 16th Amendment, it is important to distinguish between capital and income, as only income is subject to income tax.

A stock dividend reflects the corporation transferring an amount from "surplus" (retained earnings) to "capital stock." Such a transaction is merely a bookkeeping entry and "affects only the form, not the essence, of the "liability" acknowledged by the corporation to its own shareholders ... it does not alter the preexisting 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" (*Macomber*, p. 1081). An increase to the value of capital investment is not income. Nothing of value has been taken from the corporation and given to the shareholder as is the case with a cash dividend.

In addition, since the shareholder receives no cash, in order to pay any tax on a stock dividend, he might have to convert the stock into cash - he has no wherewithal to pay from the nature of the transaction. "Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax" (*Macomber*, p. 1082).

## Conclusion

The Supreme Court affirmed the District Court holding for the taxpayer that a stock dividend is not income. The Revenue Act of 1916 provision subjecting stock dividends to tax was held unconstitutional.