

Chapter 13:
Amendment 16 *Post Mortem*

The documented failure of the 16th Amendment to be ratified is a cause for motivating all of us to isolate the precise effects of this failed ratification. In previous chapters, a careful analysis of the relevant case law revealed two competing groups of decisions. One group puts income taxes in the category of direct taxes. Another group puts them in the category of indirect taxes. One group argues that the 16th Amendment *did* amend the Constitution by authorizing an unapportioned direct tax, but only on income, leaving the apportionment rule intact for all other direct taxes. Another group argues that the 16th Amendment *did not* really amend the Constitution; it merely clarified the taxing power of Congress by overturning the "principle" on which the Pollock case was decided. By distilling the cores of these two competing groups, we are thereby justified in deciding that a ratified 16th Amendment produced one or both of the following two effects:

1. Inside the 50 States, it removed the apportionment restriction from taxes laid on income, but it left this restriction in place for all other direct taxes.
2. It overturned the principle advanced in the Pollock case which held that a tax on income is, in legal effect, a tax on the source of that income.

Federal courts did not hesitate to identify the effects of a ratified 16th Amendment. Now that the evidence against its ratification is so overwhelming and incontrovertible, the federal courts are evidently unwilling to identify the effects of the failed ratification. These courts have opted to call it a "political" question, even though it wasn't a "political" question in years immediately after Philander C. Knox declared it ratified.

It is difficult to believe that the federal courts are now incapable of exercising the logic required to isolate the legal effects of the failed ratification. Quite simply, if a ratified 16th Amendment had effect X, then a failed ratification proves that X did not happen. What is X? Their "political" unwillingness to exercise basic logic means that the federal courts have abdicated their main responsibility -- to uphold and defend the U.S. Constitution -- and that we must now do it for them instead (see Appendix W concerning "Direct Taxation and the 1990 Census"). At a minimum, the value of X is one or both of the two effects itemized above.

Some people continue to argue, even now, that the 16th Amendment doesn't even matter at all. Soon after The Federal Zone began to circulate among readers throughout America, the flow of complimentary letters grew to become a steady phenomenon. As of this writing, no substantive criticisms have been received of its two major theses, *i.e.*, territorial heterogeneity and void for vagueness. Occasional criticisms did occur, but most of them were minor, lacking in substance, or lacking authority in law. The following is exemplary of the most serious of these criticisms:

I fail to understand the harping on the invalid ratification of the 16th Amendment. It really doesn't matter whether the amendment was ratified or not -- Brushaber ruled "no new powers, no new subjects", and further went on to tell us that Congress always had the power to tax what the 16th Amendment said could be taxed.

[private communication, June 1, 1992]

It *does* matter whether the amendment was ratified or not, for several reasons. One obvious reason is that the Federal Register contains at least one official statement that the 16th Amendment is the federal government's general authority to tax the incomes of individuals and corporations (see Chapter 1 and Appendix J). If the amendment failed, then **it cannot be the government's general authority to tax the incomes of individuals and corporations**. There may be some *other* authority, but that authority is definitely not the 16th Amendment. The official statement in the Federal Register is further evidence of fraud and misrepresentation, *even if* its author was totally innocent.

Another reason is that, contrary to Brushaber, other decisions of the Supreme Court, as well as lower federal courts, have ruled that taxes on incomes are direct taxes, and the 16th Amendment authorized an unapportioned direct tax on incomes. Author Jeffrey Dickstein has done a very thorough job of demonstrating how the Brushaber ruling stands in stark contrast to the Pollock case before it, and to the Eisner case after it. The Brushaber decision is an anomaly for this reason, and for this reason alone. It ruled that income taxes are indirect *excise* taxes (which necessarily must be uniform across the States of the Union). However, the Brushaber court failed even to mention "The Insular Cases" and the doctrine of territorial heterogeneity that issued therefrom (see Appendix W).

If the 16th Amendment authorized an unapportioned direct tax on incomes, per Eisner, Peck, Shaffer and Richardson, then such a tax is not required to be either uniform or apportioned. Therefore, this group of decisions did interpret the 16th Amendment differently from Brushaber; they conclude that it did amend the Constitution and that it did create a new power, namely, the power to impose an unapportioned direct tax. Contrary to the private communication quoted above, Congress has not always had the power to impose an unapportioned direct tax on the States of the Union. In view of the evidence which now proves that the 16th Amendment was never ratified, it is correct to say that Congress has never had the power to impose an unapportioned direct tax on the States of the Union. The Pollock decision now becomes a major hurdle standing in the government's way, because the Pollock Court clearly found that all taxes on income are *direct* taxes, and all direct taxes levied inside the 50 States *must* be apportioned. The Pollock decision is most relevant to any direct tax which Congress might levy against the incomes and property of State Citizens, as distinct from citizens of the United States**. (Each has citizens of its own.)

Put in the simplest of language, a ratified 16th Amendment either changed the Constitution, or it did not change the Constitution. If it changed the Constitution, one change that did occur was to authorize an unapportioned direct tax on the incomes of State Citizens. If it did not change the Constitution, the apportionment restriction has always been

operative within the 50 States, even now. Either way, the failed ratification proves that Congress must still apportion all direct taxes which it levies upon the incomes and property of Citizens of the 50 States.

Corporations, on the other hand, are statutory creations, whether they are domestic or foreign. As such, they enjoy the privilege of limited liability. Congress is free to levy taxes on the exercise of this privilege and to call them indirect excises. Within the 50 States, such an excise must be uniform for it to be constitutional; within the federal zone, such an excise need not be uniform. In the context of statutory privileges, the apportionment rule is completely irrelevant. Therefore, the status of "United States** citizens" is also a statutory privilege the exercise of which can be taxed with indirect excises, regardless of *where* that privilege might be exercised. The *subject* of such indirect taxes is the exercise of a statutory privilege; the *measure* of such taxes is the amount of income derived from exercising that privilege.

Justice White did all of us a great disservice by writing a ruling that is tortuously convoluted, in grammar and in logic. If he had taken The Insular Cases explicitly into account, and if he had distinguished Frank Brushaber's *situs* from the *situs* of Brushaber's defendant, the principle of territorial heterogeneity would have clarified the decision enormously. Specifically, according to the doctrine established by Downes v. Bidwell in 1901, Congress is not required to apportion direct taxes within the federal zone, nor is Congress required to levy uniform excise taxes within the federal zone. However, within the 50 States of the Union, all direct taxes must still be apportioned, and all indirect excise taxes must still be uniform. Now that we know the 16th Amendment never became law, these restrictions still apply to any tax which Congress levies inside the 50 States. Quite naturally, a problem arises when one party is inside the federal zone, and the other party is outside the federal zone. That was the case in Brushaber.

The Downes doctrine defined the "exclusive" authorities of 1:8:17 and 4:3:2 in the U.S. Constitution to mean that Congress was not subject to the uniformity restriction on excise taxes levied inside the federal zone. By necessary implication, Congress is not subject to the apportionment restriction on direct taxes levied inside the federal zone. It is important to realize that the Union Pacific Railroad Company was a domestic corporation, incorporated by Congress, inside the federal zone. A tax on such a corporation was a tax levied within the federal zone, where the apportionment and uniformity restrictions simply did not exist.

Instead of making this important territorial distinction, Justice White launched into an exercise of questionable logic, attributing statements to the Pollock court which the Pollock court did not make, adding words to the 16th Amendment that were not there, hoping his logic would persuade the rest of us that the Pollock principle was now overturned. According to White, the principle established in Pollock was that a tax on income was a tax on the source of that income. In this context, White is distinguishing income from source, in the same way that interest is distinguished from principal. This same distinction was made by a federal Circuit court in the Richardson case as late as the year 1961. In light of the overriding importance of the Downes doctrine, it is difficult and also unnecessary to elevate the

importance of this distinction any higher; it is also important to keep it in proper perspective. Within the federal zone, Congress can tax interest and principal (income and source) without any regard for apportionment or uniformity. Therefore, within the federal zone, the distinction is academic.

Whatever the merits of this distinction between income and source, White was wrong to ignore the key Pollock holding that income taxes are *direct* taxes. The Pollock decision investigated the relevant history of direct taxes *in depth*. White was also wrong to ignore the clear legislative history of the 16th Amendment, the stated purpose of which was **to eliminate the apportionment restriction** which caused the Pollock court to overturn an income tax Act in the first place. That Act was found to be unconstitutional precisely because it levied a direct tax on incomes without apportionment. Finally, White was wrong to launch into his lengthy discussion of the 16th Amendment without even mentioning The Insular Cases, when these cases were relatively recent authority for the proposition that Congress did not need an amendment to impose taxes without apportionment or uniformity inside the federal zone. This may be hindsight, but hindsight is always 20/20.

The relevance of the 16th Amendment to the tax on Frank Brushaber's dividend is another matter. Two schools of thought have emerged, with opposing views of that relevance. One school relies heavily on the key precedents established by Pollock. Specifically, the original investment is the "source" of Brushaber's income. A tax on the source is a direct tax. Pollock found that a tax on income is a tax on the source. Therefore, a tax on income is a direct tax. Without a ratified 16th Amendment, such a tax must be apportioned whenever it is levied inside the 50 States. With a ratified 16th Amendment, such a tax need not be apportioned whenever it is levied inside the 50 States. This school argues that Brushaber's dividend was taxable because the 16th Amendment removed the apportionment requirement on such a tax. But, is the tax really levied "inside the 50 States", if the *activity* which produced the income was actually inside the federal zone? The importance of the Pollock principle now comes to the fore.

The competing school argues that a ratified 16th Amendment was not strictly necessary for Congress to impose a direct tax on Brushaber's dividend without apportionment. Granted, he was a State Citizen who lived and worked within one of the States of the Union. For this reason, the government found that he was a "nonresident alien" under their own rules. If White's ruling did anything else, it held that Brushaber's dividend was also taxable without apportionment and without uniformity because its "source" was inside the federal zone, and that "source" was a taxable activity (profit generation by a domestic corporation). In this context, it does make sense to jettison the Pollock "principle" and to distinguish interest from principal, dividend from original stock investment. Having done so, Justice White could argue that the "source" of Brushaber's dividend was domestic corporate activity and *not* Brushaber's original investment. Unfortunately for all of us, however, Brushaber did not challenge the constitutionality of the income tax as applied to his dividend, so this question was not properly before the Supreme Court; Brushaber did challenge the constitutionality of the income tax as applied to his defendant.

Unfortunately for Mr. Brushaber, he thought that the defendant was a foreign corporation. The government was correct to point out that the

defendant was actually a domestic corporation, chartered by Congress. As such, this corporation's profits could be taxed by Congress without apportionment or uniformity, and without an amendment authorizing such a tax. For the same reasons, Brushaber's *share* of those same profits could also be taxed without constitutional restrictions, and without an amendment authorizing such a tax, even though he was outside the federal zone and inside a State of the Union. In this context, it is revealing that the Internal Revenue Code imposes a uniform "flat tax" when such income is received by nonresident aliens, giving it the *appearance* of a uniform indirect tax. However, this "uniformity" is not the consequence of a constitutional requirement; it is the consequence of decisions by Congress acting in its capacity as a majority-ruled legislative democracy.

Moreover, under the authority of the Downes doctrine, Congress is empowered to define domestic corporate profits as "profits before dividends are paid", and to penalize all domestic corporations which attempt to avoid federal taxes by defining their profits as "profits after dividends are paid." Within the federal zone, Congress has the power to assert a superior claim to all profits of domestic corporations, and to define those profits any way it chooses. By "superior claim" we mean that Congress comes before stockholders inside the federal zone, even if the stockholders are outside the federal zone, and even if the money they used to purchase their stock came from a source that was outside the federal zone. A ratified 16th Amendment would have had no effect whatsoever on the power of Congress to levy a tax without any restrictions on any of the assets of domestic corporations. A ratified 16th Amendment would have empowered Congress to tax, without apportionment, dividends paid to State Citizens by *foreign* corporations when both were inside the 50 States, but a ratified 16th Amendment was not strictly necessary for Congress to tax dividends paid to them by *domestic* corporations. Neither was a ratified 16th Amendment necessary for Congress to tax dividends paid by either type of corporation to citizens of other nations like France, since the latter citizens enjoy none of the protections guaranteed by the Constitution for the United States of America. In this context, it is important to make a careful distinction between dividends and corporate profits.

It is clear that the second of these two competing schools of thought has now prevailed. Even though there are serious logical and obvious grammatical problems with Justice White's ruling, in retrospect he was right to question the Pollock principle. The *situs* principle is easier to understand, if only because it dovetails so squarely with the overriding principles of territorial jurisdiction and territorial heterogeneity. Moreover, it is entirely possible for the Pollock principle to yield to the *situs* principle, even though the 16th Amendment was never actually ratified. Remember that Justice White ruled in Brushaber that the *only* effect of the 16th Amendment was to overturn the Pollock principle. If the amendment failed, it could thereby be argued that the Pollock principle has never been overturned. Nevertheless, subsequent case law has confirmed the superiority of the *situs* principle: the source of income is the *situs* of the income-producing activity. Sources are either inside or outside the federal zone.

Finally, like "income", the term "source" is not in the Constitution either, because the amendment failed to be ratified. Recall the Eisner prohibition, whereby Congress was told it did not have the power to define

"income" by any definition it might adopt (see Appendix J). Congress was also told it did not have the power to define any other term in the U.S. Constitution by any definition it might adopt. That prohibition was predicated on a ratified 16th Amendment, the text of which introduced the term "income" to the Constitution for the first time. Although the issue did not arise as *such* and there is no court precedent *per se*, the exact same logic applies to the term "source". The failed ratification means that Congress is now free to legislate any definition it might adopt for the terms "income" and "source", as long as the statutes containing those terms do not otherwise violate the Constitution as lawfully amended. The source of income is the *situs* of the income-producing activity. See Chapter 7.

On a more general level, the exact same logic can extend the Eisner prohibition *per force* to render unconstitutional any and all federal statutes which redefine the term "State" to mean anything *other than* a member of the Union, because this term is used throughout the U.S. Constitution. In the regulations at 31 CFR 51.2 and 52.2, for example, not only are there separate definitions for the terms "State" and a "state"; but also, the Union member is spelled with a small "s" and a *de facto* entity is spelled with a CAPITAL "S" to denote a "State within a state".

Moreover, the case law which surrounds the Buck Act in Title 4 has recognized the legal possibility of such a State within a state. Evidently, the population of federal citizens inhabiting the 50 States of the Union are legally regarded as a separate, inferior class endowed with the privileges of a legislative democracy, as distinct from the fundamental Rights of all State Citizens who inhabit those very same States. This logical reduction of the Downes Doctrine is absurd, because it violates the fundamental principles of equal protection of the law, and the Guarantee Clause. No new "State" shall be erected, ever, without the consent of the States affected. California is a Republic and not a democracy.

The explicit recognition of territorial jurisdiction, and of the status of the parties *with respect to* that territorial jurisdiction, provides much additional clarification to the Brushaber ruling. Such a clarification was definitely needed because the almost incomprehensible grammar of the Brushaber ruling is actually responsible for much of the confusion and controversy that continue to persist in this field, even today. As Alan Stang puts it, Justice White turned himself into a pretzel, and lots of other people got twisted up in the process. A clear understanding of status and jurisdiction, and a proper application of the principle of territorial heterogeneity, together provide an elegant and sophisticated means to eliminate much, if not all, of that confusion and controversy, once and for all.

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Reader's Notes:

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