



11350 Random Hills Road, Suite 800, Fairfax, Virginia 22030 Phone (703) 934-6101 Fax (703) 352-3678

fff@fff.org www.fff.org

Thank You, Congress, for Not Taking It All by Sheldon Richman

If the government isn't taking 100 percent of your income, you should be grateful for Congress's generosity. Because in the eyes of the Bush administration, that's exactly what it is, generosity. You have no right to what you earn or any other money you might get hold of. In principle it all belongs to the state, although it may be merciful enough to let you keep some to live.

Think that's an exaggeration? Then have a look at the Bush Justice Department's petition in a recent tax case, *Murphy v. IRS*.

Marrita Murphy was awarded \$70,000 in compensatory damages for the mental distress and loss of reputation she claimed to have suffered in recrimination after she blew the whistle on some environmental behavior by her employer, the New York Air National Guard. She paid about \$20,000 in federal income taxes on that money, but then asked for a refund on grounds that the damage award should have been excluded from her gross income under §104(a)(2) of the Internal Revenue Code (Title 26 of the U.S. Code). The section states that gross income does not include, among other things, "the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal *physical* injuries or *physical* sickness." (Emphasis added.)

The IRS turned her down because her injuries were nonphysical. She took her case to federal district court but lost. Next Murphy appealed to the U.S. Court of Appeals for the District of Columbia Circuit. She argued that the compensation was covered by §104(a)(2), but if it wasn't, then the section is unconstitutional because it would permit the taxation of money that is not included in the constitutional and statutory meaning of "income."

Last August a three-judge panel declared §104(a)(2) *unconstitutional*:

[The] framers of the Sixteenth Amendment would not have understood compensation for a personal injury — including a nonphysical injury — to be income.

Unhappy with having part of the tax code declared unconstitutional, the Justice Department in October petitioned to have the case heard by the circuit court's entire complement of judges (*en banc*). However, before the court could rule on the petition, the original three judges took the unusual step of announcing they would rehear the case themselves. Tax watchers wondered whether the panel decided it had erred and wanted to reverse itself rather than *be* reversed. The case was to be reheard in April.

What's so disturbing about the case is the government's 19-page petition for rehearing, which offers rare insights into how the state views the people's right to their income.

The Justice Department sought to convince the court that the judges had defined "income" too narrowly. The judges said that compensatory damages for injuries are intended to make a victim whole, or restore something not in itself taxable. Since the damage award was not a replacement for, say, lost wages, the judges said, the award should not be taxable. (Note that the judges' premise is that wages *are* taxable under the income-tax law.)

What is ominous about the petition is how broadly the Justice Department views the government's power to tax. These views are hardly consistent with limited government and low taxes, but unfortunately they are consistent with what U.S. courts have held since the country was founded.

Here's a sample of what the Justice Department argued (internal quotes are from previous court opinions, citations are excised, and all emphasis is added):

"Congress's power to tax income, like its power to levy non-direct taxes generally, is indeed '*expansive.*' In *Brushaber [v. Union Pacific Railroad, 1916]*, the Supreme Court emphasized that Congress's taxing power is '*exhaustive and embraces every conceivable power of taxation.*' It referred to the constitutional limitations as '*not so much a limitation upon the complete and all-embracing authority to tax, but in their essence ... simply regulations concerning the mode in which the plenary power was to be exerted.*'"

"In [*Commissioner v. Glenshaw Glass [1955]*], the Court reviewed the '*sweeping scope*' of the predecessor to §61(a) [the beginning of the section of the law defining "gross income"] and observed that it had '*given a liberal construction to this broad phraseology in recognition of the intent of Congress to tax all gains except those specifically exempted.*' The Court held that income includes '*undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.*' The Court explained that the definition contained in [*Eisner v. Macomber [1920]*] had, in the context of that case, '*served a useful purpose,*' but cautioned that the definition '*was not meant to*

provide a touchstone to all future gross income questions.” (*Eisner* and earlier courts had defined income as “the gain derived from capital, from labor, or from both combined.”)

The department’s petition then quotes earlier opinions on the broad range of the government’s power to tax:

“We have repeatedly emphasized the ‘*sweeping scope*’ of [§61, the code section that defines “gross income”] and its statutory predecessors.” (*Commissioner v. Schleier*, 1995)

“The definition of gross income under the Internal Revenue Code *sweeps broadly*” (including all income), subject only to the exclusions specifically enumerated elsewhere in the Code.” (*U.S. v. Burke*, 1992)

“[Income] *extends broadly* to all economic gain not otherwise exempted.” (*Commissioner v. Banks*, 2005)

“[The Court has] emphasized the corollary to §61(a)’s *broad construction*, namely, the ‘default rule of statutory interpretation that exclusions from income must be narrowly construed.’” (*Schleier* quoting *Burke*)

Omnipotent power to tax

Then, most startlingly, the government emphasizes that the decision *not* to tax something belongs to Congress alone:

“Any determination to exclude such damages from income is not required by the Constitution or driven by tax considerations, but is one of policy based upon value judgments.... Such determinations are the sole province of Congress, and in amending §104(a)(2) in 1996 to cover only damages received on account of a physical injury or physical sickness, Congress established its clear intent to tax the type of award (for nonphysical damages) taxpayer here received.”

In this connection, the petition quotes the 1996 Supreme Court case *O’Gilvie v. U.S.*, which attributed the exclusion from gross income of compensatory damages for personal injury to — “*congressional generosity*”!

You read that right. If Congress chooses not to tax something, it is being generous.

The Justice Department concludes by claiming that even if the damage award is not considered income, *the government may still tax it*:

“[The] constitutional restrictions on Congress’s taxing power deal only with how to tax, not what to tax. To conclude that the tax here is unconstitutional, the panel had to determine that it is either a direct tax requiring apportionment, or an indirect excise that is not uniform.... The panel wholly failed to perform this critical part of the analysis.”

In other words: Congress may tax whatever it wants.

Political officials may talk a low-tax, limited-government game, but let a judge suggest there’s something they *can’t* tax and they show their true colors.

We shouldn’t be shocked by this because in 1787 the anti-federalist writer Robert Yates (alias Brutus) warned his fellow Americans about the proposed Constitution, which gave Congress the power to tax. (It had no such power under the first constitution, the Articles of Confederation.) Wrote Yates,

[This] power therefore is neither more nor less, than a power to lay and collect taxes, imposts, and excises at their pleasure; not only the power to lay taxes unlimited, as to the amount they may require, but it is perfect and absolute to raise them in any mode they please.

Our ancestors should have listened to this prophet.

*Sheldon Richman is senior fellow at The Future of Freedom Foundation, author of **Tethered Citizens: Time to Repeal the Welfare State**, and editor of [The Freeman](#) magazine.*

This article was originally published in the April 2007 edition of *Freedom Daily*.