

from

Was Grandpa Really a Moron?
Critical Inquiries for a New American Century

by

Peter E. Hendrickson

**Only The Nominal "Profit" Portion Of "Income" Is Taxed,
But That Doesn't Mean All Profit Is "Income"**

Chinking Up Another Cognitive Crack



A little confusion has arisen in some quarters due to the nominally "profitable" characteristic of what qualifies as "taxable" under the "income" tax laws, and a certain casual use of the term 'profit' in some court cases and Congressional records.

Congress HAS provided that it will only tax what it deems to be the "profit" portion of the larger class of what qualifies as "gross income":

"... 'income', as used in the statute should be given a meaning so as [not] to include everything that comes in. The true function of the words 'gains' and 'profits' is to limit the meaning of the word 'income'."

So. Pacific v. Lowe, S. D. New York, (1917); 247 U.S. 330, (1918)

Indeed, it is that distinction that constitutes the substance of most of the tax-related litigation over the years. In such cases, the litigants don't dispute that any revenues involved are "income", but simply disagree over what portion of it is taxable

based on either the idiosyncratic specifications in the statutes or the issue of what has actually been realized as bona fide "gains and profit".

The distinction is, of course, only nominal and highly arbitrary. For instance, all "income" received as "wages" over the statutory exemption amount is generally deemed to be "profit" in the context of the tax, and always has been. The exemption and percentages have changed over the years, but the general construction has not.

"The statute looks, with some exceptions, for subjects of taxation only to annual gains, profits, and income. Its general language is 'that there shall be levied, collected, and paid annually upon the gains, profits, and income of every person,' derived from certain specified sources, a tax of five per cent., and that this tax shall be 'assessed, collected, and paid upon the gains, profits, and income for the year ending the 31st of December next preceding the time for levying, collecting, and paying said tax.' This language has only one meaning, and that is that the assessment, collection, and payment prescribed are to be made upon the annual products or income of one's property or labor, or such gains or profits as may be realized from a business transaction begun and completed during the preceding year."

United States Supreme Court, *Gray v. Darlington*, 82 U.S. 63 (1872)

Nonetheless, this distinction helps illuminate the wording in the statutory definition of "gross income" as "gains, profits and income". To qualify, any given receipt must represent a profitable gain, as provided by statute, as well as being within the overall class of "income".

However, the distinction regarding 'profit' drawn within the context of the tax does not serve to draw profit which has NOT proceeded from the conduct of a taxable activity (and is thus already within the class of "income") into the ambit of the tax. (Merely realizing profit is not, itself, a taxable activity, even if it is realized as dividends or in some other "unearned" form.)

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Unfortunately, overly casual use of the term "profit" in reference to what is taxed under the "income" tax, without the clarifying particulars, can mislead those unschooled in the true nature of the tax to the erroneous conclusion that any revenue which is greater than mere compensation, or represents a gain on an initial investment, qualifies as "income". Indeed, there has been an entire book written endeavoring to argue that the "income" tax applies to all "profit" of whatever provenance, based on this misunderstanding.

Not only is this plainly wrong, but it is "politically" disastrous, as well. Want to know how to alienate the entire business community from any interest in, and support for, the "tax honesty" movement? Encourage them to imagine that the law, even when properly understood and applied, holds all profit-- whether federally-connected or not-- to be inherently taxable...

At the same time, casual use of "profit" in this fashion will also lead the unschooled to the dangerous conclusion that anything anyone reasonably deems to not constitute 'profit' is thus untouched and untouchable by the tax, all other considerations and factors notwithstanding. Everyone should undertake to correct this error-- and those who promote it out of ignorance of the true nature of the tax-- whenever encountered.

"The 'Government' is an abstraction, and its possession of property largely constructive. Actual possession and custody of Government property nearly always are in someone who is not himself the Government but acts in its behalf and for its purposes. He may be an officer, an agent, or a contractor. His personal advantages from the relationship by way of salary, profit, or beneficial personal use of the property may be taxed..."

United States Supreme Court, *United States v. County of Allegheny*, 322 US 174 (1944)

(For more on this subject, see the second half of 'The Supreme Court And The Meaning Of "Income"' in CtC.)