

LEGAL STATUS OF CAPITAL GAINS

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HISTORICAL PERIOD PRIOR TO THE 16TH AMENDMENT

The power of the Congress to subject capital gains to an income tax is now fully established by decisions of the Supreme Court. Even in our first income tax statute (act of 1861, 12 Stat. 292) Congress used language broad enough to warrant the taxation of "annual capital gains." This first act levied an income tax to be paid upon the "annual income" derived from certain sources, including income "derived from any kind of property" and contained a catchall provision sweeping in "income derived from any other source whatever" with certain exceptions having no relation to capital gains. This act was never put into effect and was superseded by the act of 1862 (12 Stat. 432), which was similar in this respect to the 1861 act except that the basis of the tax was changed from "annual income" to the longer phrase "annual gains, profits, or income." It was not until the act of 1864 (13 Stat. 223) that income derived from sales of property was specifically mentioned. This last act contained the same general definition of income referred to in the prior acts, with an additional proviso—

that net profits realized by sales of real estate purchased within the year for which income is estimated, shall be chargeable as income; and losses on sales of real estate purchased within the year for which income is estimated, shall be deducted from the income of such year.

The law then provided that in estimating the annual gains, profits, or income, there shall be included—

all income or gains derived from the purchase and sale of stocks or other property, real or personal, and the increased value of livestock, whether sold or on hand, and the amount of sugar, wool, butter, cheese, pork, beef, mutton, or other meats, hay and grain, or any other vegetable or other productions of the estate of such person sold—

not including any part thereof unsold or on hand during the year next preceding. It will be noted that in this act an attempt was made to tax the income derived from the "increased value of livestock on hand," even though such income was not realized through a sale. However, before this act was put into operation, an amendatory act (13 Stat. 78) was passed which did not require the amount of livestock to be reported as income unless sold. The act of 1867 (14 Stat. 471) levied a tax "annually" upon the "gains, profits, and income" whether derived from property or from any source whatever and then provided that in estimating the "gains, profits, and income" there shall be included—

profits realized within the year from sales of real estate purchased within the year, or within two years previous to the year for which income is estimated * * * and all other gains, profits and income derived from any source whatever.

The specific provision relating to income from the purchase and sale of stocks or other property, real or personal, was omitted from the 1867 act, but the provisions relating to the sale of livestock, etc., were

continued. However, despite this omission, the Commissioner of Internal Revenue continued to assess a tax on gains from sales of personal property. His right to do this was questioned and a test case on this point (*Gray v. Darlington*, 15 Wall. 63) was taken to the Supreme Court. In that case Mr. Darlington owned certain U.S. Treasury notes, which he exchanged in 1865 for U.S. 5-20 bonds. In 1869 he sold these bonds at an advance of \$20,000 over the cost of the Treasury notes, and upon this amount the tax was assessed. The Court said:

The question presented is whether the advance in the value of the bonds, during this period of 4 years, over their cost, realized by their sale, was subject to taxation as gains, profits, or income of the plaintiff for the year in which the bonds were sold. The answer which should be given to this question does not, in our judgment, admit of any doubt. The advance in the value of property during a series of years can, in no just sense, be considered the gains, profits, or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property. The statute looks, with some exceptions, for subjects of taxation only to annual gains, profits, and income * * *. The rule adopted by the officers of the revenue in the present case would justify them in treating as gains of 1 year the increase in the value of property extending through any number of years, through even the entire century. The actual advance in value of property over its cost may, in fact, reach its height years before its sale; the value of the property may, in truth, be less at the time of sale than at any previous period in 10 years, yet, if the amount received exceed the actual cost of the property, the excess is to be treated, according to their views, as gains of the owner for the year in which the sale takes place. We are satisfied that no such result was intended by the statute.

The last act of the Civil War series was that of 1870 (16 Stat. 256) which was substantially the same in this respect as the act of 1867 as interpreted by the Supreme Court.

The next act imposing an income tax was that of 1894 (28 Stat. 553). It followed the Civil War acts to a large extent. Profits realized from the sale of real estate purchased within 2 years previous to the close of the year for which the income was estimated were taxed as well as the amount of sales of livestock, sugar, cotton, wool, butter, cheese, pork, beef, mutton, or other meats, hay, and grain, or other vegetables or other productions, being the growth or produce of the estate of such person, less the amount expended in the purchase or production of said stock or produce, and not including any part thereof consumed directly by the family. This act was subsequently held unconstitutional in *Pollock v. Farmers' Loan & Trust Co.* (157 U.S. 429). From the legislation during this period may be drawn the following conclusions:

(1) The law as construed during this period did not tax accrued appreciation as income. It was only when the gain was separated from the capital through a sale or conversion that it was treated as income.

(2) As a general rule, a capital gain was not taxed unless the asset was purchased within the year in which the asset was sold. If the asset was purchased prior to the taxable year but sold during the taxable year, the realized gain was not subject to tax. In other words, the legislation during this period taxed only the gains from assets held for not more than 1 year or the so-called "1-year gains." Exceptions to this general rule were made in the case of gains from sales of real estate and sales of goods by merchants or traders. In the case of sales of real estate, the capital gain was taken into account if the real estate was purchased not only within the taxable year but also within 2 years

prior to the taxable year. In the case of merchants and traders, there was no express exception in the statute but the Court in *Gray v. Darlington* stated that an exception was implied from the catchall provision requiring income to be reported from any source whatever. It was pointed out that this embraced gains and profits from trade and commerce, and these, for their successful prosecution, often require property to be held over a year; that is, the result of many transactions have to be taken into account which originated in a prior year. Therefore, it was stated that the trader or merchant will often be compelled to include in income the amount received upon goods sold over their cost, which were purchased in a previous year. This last exception had the effect of subjecting the income of traders and merchants to the full income tax, regardless of the period they held the property sold for their customers. In this respect, it may be compared to the provisions of existing law providing special treatment in the case of gains from capital assets but excepting from the special treatment—

stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(3) The Court decisions during this period did not turn upon the power of Congress to tax capital gains but whether the language of the statute was broad enough to include them. In *Gray v. Darlington*, the Court stated:

The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase in capital.

Those who hold to the theory that increases in capital value accruing prior to the taxable year are not income, even though realized by a sale within the taxable year, rely to a large extent upon this decision. However, this decision was confined to a statute which taxed only "annual gains" and its doctrine was held not to apply to some of the subsequent statutes.

STATUS OF CAPITAL GAINS UNDER THE 1909 ACT

The 1909 act:—In holding that a dividend in common stock to a common stockholder was not income under the Constitution, the Supreme Court in *Eisner v. Macomber* (252 U.S. 206), stated:

After examining dictionaries in common use, we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909: "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, to which it was applied in the *Doyle* case.

The 1909 act is, therefore, the nucleus upon which the present definition of income is predicated. The 1909 act did not refer specifically to capital gains but laid a tax upon the doing of business in corporate form, measured by the entire net income of the corporation in excess of \$5,000 received by the corporation during the year. Since the basis of the tax was income received "from all sources," the Supreme Court held the language required the taxation of capital gains. This was

in the case of *Doyle v. Mitchell Brothers Company* (247 U.S. 179). In that case, the Mitchell Brothers Co. acquired timberland in 1903 at a cost of approximately \$20 per acre. On December 31, 1908, the timberland had increased to \$40 per acre. Prior to making its returns under the 1909 act, which was effective as of January 1, 1909, the company revalued its timber stumpage at approximately \$40 per acre, as of December 31, 1908. In making its returns for the years 1909, 1910, 1911, and 1912, it deducted in each instance the market value as of December 31, 1908, of the stumpage cut and converted during the year covered by the tax. The Court upheld the position of the taxpayer stating:

In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.

In answering the contention that capital gains were not income under the statute, the Court said:

The suggestion that the entire proceeds of the conversion should be still treated as the same capital, changed in one form and containing no element of income, although including an increment of value, we reject at once as inconsistent with the general purpose of the act. Selling for profit is too familiar a business transaction to permit us to suppose that it was intended to be omitted from consideration in an act for taxing the doing of business in corporate form upon the basis of the income received "from all sources."

In comparing this decision with the concept of capital gains under the Civil War acts, we find little distinction. The Court in holding that the taxpayer was not required to compute the gain upon the basis of what the property cost in 1903 but could use as the basis the market value as of December 31, 1908, injected a new concept, but its importance is minimized by the fact that it was predicated upon the Court's interpretation of the 1909 act rather than a limitation upon congressional power. Since the income in the *Doyle* case was a profit arising from the trade or business of a corporation, the decision in holding such income subject to tax, even though the property was acquired prior to the beginning of the taxable year, was in harmony with the decision of the Supreme Court in *Gray v. Darlington* interpreting the Civil War Act of 1867.

It will be remembered that in the last case the Court in construing the Civil War Act held that as a general rule it did not tax gains from the sale of property acquired before the beginning of the taxable year but stated an exception to this rule was implied in the case of merchants or traders who frequently were forced to sell goods purchased prior to the beginning of the taxable year. However, in another decision under the 1909 act, the Court applied an entirely different rule from that applied under the Civil War acts. This was in the case of *Hays v. Garley Mountain Coal Company* (247 U.S. 189). The facts were that the coal company purchased in 1902 shares of stock in another coal company, which it sold in 1911, realizing a profit of \$210,000. This was a casual transaction and had nothing to do with the business of the company, which was the mining and selling of coal. Nevertheless, the Court held that so much of the profit from this sale as accrued after December 31, 1908, the effective date of the 1909 act, was taxable income under the 1909 act. The same conclusion was reached in the case of *United States v. Cleveland, Cincinnati, Chicago & St. Louis Railway Company*, in which a railway company

purchased in 1900 shares of stock in another railway company, which it sold in 1909, realizing a profit of \$814,000. The part of the profit which accrued after January 1, 1909, was held to be income received during the year 1909. In these last two decisions, we find a complete departure from the theory of the Civil War acts, which would not have taxed such casual sales because the property was not purchased within the taxable year in which sold. While the Court justified this departure upon the difference in the wording of the acts, it is hard to reconcile this conclusion with the statement in *Gray v. Darlington* that that mere advance in property between the date of acquisition and sale does not constitute income but is merely an increase of capital.

In summarizing the status of capital gains under the 1909 act, and comparing it with the prior acts, we find the following:

(1) In the case of casual sales of personal property, the profits were treated as income, and subject to the tax, regardless of whether the property had been acquired prior to the close of the taxable year or not. In this respect, the 1909 act differed from the prior acts.

(2) In the case of sales of property in the carrying on of a trade or business, the profits were treated as income and subject to tax, even though the property was acquired prior to the beginning of the taxable year. In this respect the treatment was similar to that applied under the Civil War Act of 1867 as interpreted by the Supreme Court in *Gray v. Darlington*.

(3) In the case of sales of real property, the Civil War acts did not treat the profits therefrom as income unless the property was acquired within 2 years prior to the beginning of the taxable year. No such distinction was made under the 1909 act.

(4) In computing the gain from the sale of property, under the 1909 act, the basis in the case of property acquired prior to December 31, 1908, was the fair market value of the property, as of December 31, 1908, instead of the cost of the property. This was because the 1909 act was not effective until January 1, 1909, and the Court construed the act to mean that the Congress did not intend to tax appreciation accrued prior to that date.

(5) Both the 1909 act and the Civil War acts taxed only realized gains, that is, gains realized through a sale or conversion of the property. No attempt was made to tax accrued gains which had not been realized.

(6) Losses actually sustained during the taxable year were allowed as deductions under the 1909 act. Under the prior acts, losses incurred in trade were allowed as a deduction.

STATUS OF CAPITAL GAINS AFTER THE 16TH AMENDMENT AND THROUGH THE 1934 ACT

To overcome the effect of the *Pollock* decision holding that the income tax on property was a direct tax and subject to the rule of apportionment, the 16th amendment to the Constitution was adopted giving the Congress the power to levy a tax on income without apportionment among the several States, and without regard to any census or enumeration. This amendment was ratified on February 25, 1913, but was not made effective by the Congress until March 1, 1913. As a result of this amendment, the Congress enacted the Revenue Act of

1913. This act was passed in October of 1913, but was made effective as of March 1, 1913, the effective date of the 16th amendment. The Revenue Act of 1913 specifically taxed—

gains, profits, and income derived from * * * sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property.

Capital losses were allowed to individuals if incurred in trade to the extent that they were sustained during the taxable year and not compensated for by insurance or otherwise. They were also allowed to corporations, but in the case of corporations the limitation that the losses had to be incurred in trade was omitted. The Revenue Act of 1916 contained practically the same provisions relating to capital gains as the Revenue Act of 1913. However, individuals were allowed certain losses under the Revenue Act of 1916 which they were denied under the Revenue Act of 1913. The 1916 act allowed to individuals capital losses actually sustained during the year in transactions entered into for profit even though not connected with their trade or business. But losses of this character were allowed to individuals only to the extent of the gains from similar transactions. The Revenue Act of 1918 was practically identical with the Revenue Act of 1916 so far as capital gains or capital losses are concerned. The individual taxpayer received additional relief under this act by having the limitation removed on capital losses from transactions entered into for profit and not connected with a trade or business. Under the Revenue Act of 1921 capital gains and capital losses were, in the case of sales of property by corporations, treated in the same way as under the Revenue Act of 1918. However, a different rule was applied to capital gains or capital losses sustained by individuals. Under this act, capital gains and capital losses were divided into two groups. The first group consisted of the following:

(a) Gains or losses from property held for the personal use or consumption of the taxpayer or his family.

(b) Gains or losses from stock in trade of the taxpayer or other property which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(c) Gains or losses from property of the taxpayer not held for profit or investment.

(d) Gains or losses from all property held for 2 years or less.

Capital gains and losses from property falling in this group were treated in the same manner as under the Revenue Act of 1918.

The second group consists of all property held for more than 2 years not included in the first group. Under the second group the excess of capital gains over capital losses, or the capital net gain arising from the sale of property held over 2 years could, at the option of the taxpayer, be omitted from his ordinary net income and taxed separately at a flat rate of 12½ percent. This afforded considerable relief from taxation. Even under this group a capital net loss was allowed in full in spite of the fact that a capital net gain was not taxed at a rate of more than 12½ percent.

The Revenue Act of 1924, while retaining the same system of taxation in the case of a capital net gain, included a provision which treated capital net losses consistently. That is, it was provided that capital net losses could not thereafter be deducted from ordinary income if the result was to reduce the normal and surtax by more

than 12½ percent of the amount of such net loss. When such a result did occur, the taxpayer was entitled to a tax credit of 12½ percent of the amount of his capital net loss. It also brought into the second group, subjecting capital gains and losses to special treatment, gains or losses from sales of residential property or other property not held for profit or investment as well as property held for the personal use or consumption of the taxpayer or his family, if such property had been held for more than 2 years. This type of property was included in the first group under the Revenue Act of 1921. It also excluded from the second group "property held primarily for sale" in the course of the trade or business of the taxpayer. This last change prevented dealers in real property coming under the special "capital gain and loss provisions."

The Revenue Acts of 1926 and 1928 made no substantial changes in the method of treating capital gains and losses, but the Revenue Act of 1932 did make a substantial change in the treatment of losses on the sale of stocks and bonds held for 2 years or less. This change was brought about by the need of revenue and the practical situation resulting from the depression. Section 23(r) of the Revenue Act of 1932 provided that losses arising from the sale of stocks and bonds held for 2 years or less should be allowed only to the extent of the gains arising from the sale of stocks and bonds held for 2 years or less. In other words, any excess of these losses over gains resulting from short-term investments could not be charged off against the other income of the taxpayer. The section did permit such excess, however, to be carried forward 1 year and applied against short-term gains in such year. The National Recovery Act of June 16, 1933, however, took away the right of carrying over to the subsequent year this excess of short-term losses over short-term gains.

The Revenue Act of 1934 entirely changed the treatment of capital gains and capital losses arising from the sale of capital assets. In the first place, the definition of capital assets was changed so that the 2-year limitation was eliminated. In the second place, the flat rate of 12½ percent was abolished. The new plan provided for taking into account in computing the net income of individuals a percentage of the capital gain or loss realized, such percentage becoming less according to the length of time for which the asset had been held, i.e., while including capital gains and losses with other income subject to normal and surtax, it gave a reduction in tax on the gains by including only a percentage of such gain in net income when the capital asset had been held for more than 1 year. The percentage of such gains to be returned as taxable income diminished according to the length of time the asset had been held. However, the deduction of capital losses was severely limited, such losses being allowed only to the extent of the capital gains, plus \$2,000. The percentages provided for in the law were as follows:

One hundred percent if the capital asset has been held for not more than 1 year;

Eighty percent if the capital asset has been held for more than 1 year but not for more than 2 years;

Sixty percent if the capital asset has been held for more than 2 years but not for more than 5 years;

Forty percent if the capital asset has been held for more than 5 years but not for more than 10 years;

Thirty percent if the capital asset has been held for more than 10 years.

It also inserted in the exclusion from the definition of capital assets "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." This had the effect of applying the special treatment to many items of real estate or securities which were not treated as capital assets under the prior acts.

The cases arising under the revenue acts enacted since the 16th amendment relate to a large extent to the basis for ascertaining the gain or loss from the sale of property acquired prior to March 1, 1913. It will be remembered that under the 1909 act, the court had held that in measuring the gain from property acquired prior to the 1909 act, the statute only taxed that part of the gain accruing after the effective date of that act and, therefore, the taxpayer should use as the basis for computing such gain the fair market value of the property as of December 31, 1908. But in applying this rule to cases arising since the 16th amendment, difficulty was encountered where the March 1, 1913, value was greater than the cost of the property. In such cases, if the selling price was less than the cost but greater than the March 1, 1913, value of the property, there was no actual gain upon which a tax could be levied. The limitations in this respect are discussed in the following taken from the report to the Joint Committee on Taxation by its staff on "The Taxing Power of Federal and State Governments."

In *Southern Pacific Co. v. Lowe* the Supreme Court held that income had no broader meaning under the 1913 act than it had under the act of 1909. As already pointed out, the 16th amendment became effective on March 1, 1913. Therefore, in determining what is "income" under the 16th amendment, it is necessary to exclude capital values attributable to any period prior to March 1, 1913, just as it was necessary under the act of 1909 to exclude capital value attributable to any period prior to January 1, 1909, the effective date of the 1909 act. As stated in *Lucas v. Alexander*, such portion of a gain realized by a taxpayer as is attributable to and accrued during the period antedating March 1, 1913, must, for income-tax purposes, be deemed an accretion to capital not taxable by the income-tax acts enacted under the 16th amendment. In other words, to determine whether there is income under the 16th amendment, it is necessary to substitute for the original capital investment of the taxpayer who held property on March 1, 1913, the fair market value of the property as of that date in cases where the capital investment is less than such value. A case involving this point, namely, *Goodrich v. Edwards*, arose under the Revenue Act of 1916. In that case the taxpayer purchased 1,000 shares of stock in a mining company, for which he paid \$500. The stock was worth \$695 on March 1, 1913, and it was sold on March 1, 1916, for approximately \$14,000. The Commissioner assessed a tax on the difference between the March 1, 1913, value and the selling price. The Court upheld the assessment, saying: "It is plain that this assessment was on the part accruing after March 1, 1913, the effective date of the act, realized to the owner by the sale after deducting his capital investment." In another transaction involved in the same case the taxpayer owned stock in one corporation which in 1912 he exchanged for stock in a reorganized company of the then value of about \$291,000. The market value of such stock on March 1, 1913, was about \$148,000. The taxpayer sold the stock in 1916 for \$269,000, being \$22,000 less than its value then acquired, but \$121,000 more than its value on March 1, 1913. The Government assessed taxes on the difference between the March 1, 1913, value and the selling price, notwithstanding the fact that the selling price was less than the cost. The Court held the assessment invalid for the reason that the taxpayer realized no gain from its original capital investment.

A similar conclusion was reached in *Walsh v. Brewster*, where bonds purchased in 1899 were sold in 1916 for more than their March 1, 1913, value, but at the same amount for which they were originally acquired. As no gain was realized on the investment, the tax was held invalid. In a second transaction involved in the same case the taxpayer had purchased certain bonds in 1902 and 1903 for approxi-

mately \$231,000, which he sold in 1916 for about \$276,000. Their market value on March 1, 1913, was \$164,000. The tax was assessed upon the difference between the selling price and the market value of the bonds on March 1, 1913. It was held that the gain of the taxpayer was only the difference between his investment of \$231,000 and the amount realized by the sale—\$276,000. Under authority of *Goodrich v. Edwards*, he was taxable only on \$45,000, the difference between the purchase and sale price.

While these cases were decided on statutory grounds, it appears that the acts in question are as broad as the constitutional grant giving the Congress authority to tax income without apportionment. In the case of a loss from the sale or other disposition of capital assets, a different rule seems to apply. There appears to be no constitutional prohibition against the Congress restricting the deductibility of a loss, and the Court's decisions on this point are controlled entirely by statutory provisions. There were two cases involving losses which arose under the Revenue Act of 1918. In one case, *U.S. v. Flannery*, the taxpayer sold stock for more than its cost but for less than its fair market value on March 1, 1913. Therefore, in that case there was no actual loss from the investment. In the other case, *McCaughn v. Ludington*, there was an actual loss for the stock was sold for less than its cost or fair market value as of March 1, 1913; but the fair market value as of March 1, 1913, was also greater than the cost of the stock. The Supreme Court held that under the language of the Revenue Act of 1918 the taxpayer was entitled to a loss only where an actual loss was sustained from the investment.

One interesting question decided under these later acts related to the taxation of a capital gain derived from the sale of property by a stock fire and marine insurance corporation. Capital gains derived by this class of insurance companies were originally taxed under the income tax acts ending with the Revenue Act of 1918. The 1921, 1924, and 1926 Revenue Acts exempted such gains from tax and provided a new system for taxing insurance companies of this type. However, beginning with the Revenue Act of 1928, this exemption was removed and capital gains derived from sale of property by these companies were made subject to tax. The Alliance Insurance Co., a Pennsylvania stock fire and marine insurance corporation sold at a profit in 1928 some property which it had acquired prior to that year. The company contended it could constitutionally be taxed only upon so much of the gain as accrued after the effective date of the Revenue Act of 1928. In overcoming this contention, the Supreme Court said:

The tax under this and earlier revenue acts was imposed upon net income for stated accounting periods, here the calendar year 1928, and it is only gain realized from the sale or other disposition of property, which is included in the taxable income. Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While increase in value of property not realized as gain by its sale or other disposition may, in an economic or book-keeping sense, be deemed an addition to capital in a later period, it is, nevertheless, a gain from capital investment which, when realized, by conversion into money or other property, constitutes profits which has consistently been regarded as income within the meaning of the 16th amendment and taxable as such in the period when realized.

Here there is no question of a tax on enhancement of value occurring before March 1, 1913, the effective date of the income tax act of that year, for the collector asserts no right to tax such increase in value. The fact that a part of the taxed gain represented increase in value after that date, but before the present taxing act, is without significance. Congress, having constitutional power to tax the gain, and having established a policy of taxing, it may choose the moment of its realization and the amount realized for the incidence and the measurement of the tax. Its failure to impose a tax upon the increase in value in the earlier years, assuming without deciding that it had the power, cannot preclude it from taxing the gain in the year when realized, any more than in any other case, where the tax imposed is upon realized, as distinguished from accrued, gain. If the

gain became capital by virtue of the increase in value in the years before 1928, and so could not be taxed as income, the same would be true of the taxing act, which was realized and taxed in another. But the constitutionality of a tax so applied has been repeatedly affirmed and never questioned. The tax being upon realized gain, it may constitutionally be imposed upon the entire amount of the gain realized within the taxable period, even though some of it represents enhanced value in an earlier period before the adoption of the taxing act.

The casual sale question was again considered in connection with a case arising under the Revenue Act of 1917. It will be remembered that this question arose under the 1909 act in connection with a sale by a corporation. However, the case under the 1917 act related to a sale by an individual. This last case was *Merchants Loan & Trust Company v. Smietanka* (255 U.S. 509) and involved the sale by a trustee of an estate of certain shares of stock in a corporation. The cash value of these shares on March 1, 1913, was approximately \$562,000 and they were sold on February 2, 1917, for over a million dollars. Since this was a casual sale, the taxpayer argued that the gain was not income under the 16th amendment, contending that that amendment applies only to profits from sales by one engaged in buying or selling as a business—a merchant, a real estate agent, or a broker. The Court in disposing of this contention said:

It is sufficient to say of this contention that no such distinction was recognized in the Civil War Income Tax Act of 1867, or in the act of 1894, declared unconstitutional on an unrelated ground; that it was not recognized in determining income under the Excise Tax Act of 1909, as the cases cited, *supra*, show; that it is not to be found, in terms, in any of the income tax provisions of the Internal Revenue Acts of 1913, 1916, 1917, or 1919; that the definition of the word "income" as used in the 16th amendment, which has been developed by this Court, does not recognize any such distinction; that in departmental practice, for now 7 years, such a rule has not been applied; and that there is no essential difference in the nature of the transaction or in the relation of the profit to the capital involved, whether the sale or conversion be a single, isolated transaction or one of many.

It is unfortunate that the Court made reference to the act of 1867 in this connection. While that act did not in terms recognize such a distinction, nevertheless such a distinction was recognized by the Court in construing the 1867 act in the case of *Gray v. Darlington*. In that case, profits from goods sold by merchants and traders were taxed even though acquired prior to the year of sale. However, profits from casual sales not connected with the trade or business were not taxed unless acquired in the same year as that in which sold. This case has definitely settled the question that the Congress has the power to tax profits from casual sales as well as profits from sales arising from a trade or business.

