"Congressional Generosity"

BY SHELDON RICHMAN

Every now and then we get a glimpse into what government officials really think about our rights to life, liberty, and property. The U.S. Justice Department recently provided such a glimpse in a controversial tax case, *Murphy v. IRS*.

How revealing it is! Did you know that if the government abstains from taxing *all* your income, you should be grateful for this "congressional generosity"?

To recap the case, Marrita Murphy was awarded $70,000 in compensatory damages for the mental distress and loss of reputation she claimed to have suffered after she acted as a whistleblower against her employer, the New York Air National Guard. She paid about $20,000 in federal income taxes on that money, but later 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), which states: "gross income does not include—. . . (2) 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 . . . ."

The IRS rejected the request because her injuries were nonphysical and the section specifies "physical injuries." When she sued in federal district court she lost.

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 not, 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."

The government rebutted that Murphy's injuries were *nonphysical*—and hence not included in §104(a)(2)—and that IRS policy was consistent with the concept of "income" as used since the Sixteenth Amendment was ratified in 1913.

In August a three-judge panel stunned the government by ruling in Murphy's favor that §104(a)(2) is *unconstitutional*: "[T]he framers of the Sixteenth Amendment would not have understood compensation for a personal injury—including a nonphysical injury—to be income." (Point of historical fact: the Amendment did not delegate to the government the power to tax wages and other income. Under the Constitution, it *always* had that power.)

In October the Department of Justice 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 announced they would rehear the case themselves. The case was to be reheard this month.

The petition is revealing—and chilling. The Justice Department's task in the petition was to convince the court that the judges had defined "income" too narrowly, allowing them to exclude compensation for nonphysical injury from gross income. The judges had ruled that compensatory damages for injuries are intended to make a victim whole—that is, to restore something that is not taxable. Since the damage award was not a replacement for something taxable, such as wages, the judges said, the award itself should not be taxable.

What is ominous about the petition is how broadly the Justice Department views the government's power to tax. Unfortunately, the Department has the Constitution and a long line of cases to back up its position.

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*

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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 Department's petition proceeds to quote earlier court opinions on the broad range of the government's power to tax, for example, "We have repeatedly emphasized the '*sweeping scope*' of [§61, the code section that defines gross income] and its statutory predecessors" and "[Income] *extends broadly* to all economic gain not otherwise exempted."

The government's petition also emphasizes that the decision *not* to tax something belongs to Congress—and 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 . . . Congress established its clear intent to tax the type of award (for nonphysical damages) taxpayer here received."

In this connection, the petition quotes a 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*"!

The petition closes with the Justice Department's claim that even if the damage award is not construed to be income "within the meaning of the Sixteenth Amendment," *the government may still tax it*:

"[T]he 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."

To boil the petition down to the fewest words: Congress may tax whatever it darn well pleases, thank you. If it abstains from taxing a type of revenue (be it income or not), just be thankful for its generosity. But don't go thinking you have a right *not* to have it taxed.

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.

To be sure, Murphy's attorney, David Colapinto, responded to the petition. (All the documents are online at www.kkc.com/major_cases.jsp.) He too is able to cite Supreme Court cases but in support of Murphy's position that the three appellate judges were correct.

The Constitution Doesn't Interpret Itself

Eventually the Supreme Court will pick the winner. But it would be a mistake to think there is an objectively "right" answer. In the constitutional game, "right" (in the sense of what gets enforced) is whatever the courts decide. Constitutions and laws don't interpret themselves. People interpret them.

As Georgetown University law professor John Hasnas has written, "Because the legal world is comprised of contradictory rules, there will be sound legal arguments available not only for the hypothesis one is investigating, but for other, competing hypotheses as well."

We really have no reason to be shocked by the government's extravagant claim because we were warned 220 years ago. In 1787 the Anti-federalist Robert Yates ("Brutus"), objecting to Congress's power to tax under the proposed Constitution, wrote, "[T]his 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."