No. 02-648

In the Supreme Court of the United States

FREDERICK B. CAMPBELL, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the federal income tax may be imposed on the same income that is also subject to state and local income taxes, without affording a deduction for each dollar of state and local income taxes paid by the taxpayer.

2. Whether 26 U.S.C. 68 violates the doctrine of intergovernmental tax immunity by limiting the total amount of itemized deductions available to high-income taxpayers.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A5) is unofficially reported at 2002-2 U.S. Tax Cas. (CCH) ¶ 50,632. The opinion of the district court (Pet. App. A6-A18) is unofficially reported at 2001-2 U.S. Tax Cas. (CCH) ¶ 50,716.

JURISDICTION

The judgment of the court of appeals was entered on September 6, 2002. The petition for a writ of certiorari was filed on October 28, 2002. The jurisdiction of the Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a self-employed attorney and a free-lance writer who lives and works in New York City. He pays income taxes on his earnings to the State and City of New York. Pet. App. A7. On his federal income tax returns for the years 1996, 1997 and 1998, taxpayer reported his professional earnings as his income and itemized his deductions.

For taxpayers who itemize deductions, state and local income taxes are ordinarily deductible in their full amount under 26 U.S.C. 164(a)(3). There is an "overall limitation on itemized deductions," however, that applies to individuals, such as petitioner, whose adjusted gross income exceeds an annual income threshold. 26 U.S.C. 68(a). That threshold, for most taxpayers, is $100,000 plus a cost-of-living adjustment for years after 1990. 26 U.S.C. 68(b).[1] When this limitation provision applies, the amount of itemized deductions otherwise allowable for the taxable year is reduced by the lesser of (i) 3 percent of the excess of the taxpayer's adjusted gross income over the annual income threshold or (ii) 80 percent of the amount of the itemized deductions otherwise allowable for such taxable year. 26 U.S.C. 68(a).[2]

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[1] This statutory limit on deductions is gradually phased out for taxable years beginning after 2005 and is terminated for taxable years beginning after 2009. 26 U.S.C. 68(f), (g). Under the "sunset" provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 901, 115 Stat. 150, however, Section 68 is then reinstated in its current form for years after 2010.

[2] A few specific itemized deductions (such as medical expenses) are not within the scope of this provision. See 26 U.S.C. 68(c).

Because petitioner's adjusted gross income exceeded the statutory threshold amount in each year in question, his otherwise allowable itemized deductions were reduced under 26 U.S.C. 68(a).[3] Based upon his itemized deductions, as thus limited by the statute, he reported and paid taxes due of $191,762.91 for 1996, $168,844.44 for 1997 and $166,379.68 for 1998. C.A. App. 115.

Petitioner claims that, under Section 68, his state and local income tax deductions were reduced by a total of $11,679 for these three years. C.A. App. 9. Petitioner filed a timely administrative refund claim with the Internal Revenue Service in which he argued that the reduction of his state and local income tax deductions under Section 68 was unconstitutional. He sought tax refunds of $9,702 for 1996, $9,325 for 1997 and $8,445 for 1998, plus interest in each case.[4] Pet. App. A7.

2. When the Service did not grant his refund claim, petitioner brought this suit for refund in the United States District Court for the Southern District of New York. Petitioner contended that, to the extent that federal income tax is imposed on "amounts taken by State and local income taxes, the federal tax is not a tax

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[3] For most taxpayers, the statutory threshold amount was $117,950 in 1996, $121,200 in 1997 and $124,500 in 1998. For married taxpayers who filed separate returns (see 26 U.S.C. 68(b)(1)), it was $58,975, $60,000 and $62,250 for those years. See Rev. Proc. 95-53, 1995-2 C.B. 445, 448; Rev. Proc. 96-59, 1996-2 C.B. 392, 396; Rev. Proc. 97-57, 1997-2 C.B. 584, 586.

[4] Portions of the refunds sought by petitioner were attributable to claims challenging (i) the limitation on deduction of health insurance premiums by self-employed persons imposed by 26 U.S.C. 162(*l*) and (ii) the deduction for home mortgage interest under 26 U.S.C. 163(h). Petitioner has now abandoned these claims. Pet. 4 n.1.

on income and is beyond the authority granted to Congress by the Sixteenth Amendment." C.A. App. 8. Petitioner further contended that, by applying the federal income tax to the portion of income paid to state and local governments as taxes, the United States "infringes on the reserved rights of the States and their citizens in violation of the Tenth Amendment to the United States Constitution." *Id.* at 9.[5]

The district court, however, agreed with the United States that the limitations on deductions established in 26 U.S.C. 68 are constitutional. Pet. App. A6-A18. The court first rejected petitioner's contention that it was unconstitutional to tax amounts paid as state and local income taxes. It noted that the Sixteenth Amendment gives Congress the "power to lay and collect taxes on incomes, from whatever source derived" (Pet. App. A10 (quoting U.S. Const. Amend. XVI)) and that, in exercising this broad power, Congress "defines gross income as 'all income from whatever source derived'" (Pet. App. A10) quoting 26 U.S.C. 61(a)). The court noted that this statutory definition of income properly reaches "all 'undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.'" Pet. App. A10 (quoting *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955)).

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[5] Petitioner also asserted in the district court that, to the extent that federal income tax on amounts paid as state and local income taxes are "direct" taxes, they are void under Article I, § 2, cl. 9 of the Constitution for lack of apportionment and, alternatively, to the extent that such taxes are "indirect" taxes, they are void under Article I, § 8 for lack of uniformity. Those arguments were properly addressed and rejected by the district court. Pet. App. A12-A14. Petitioner abandoned these claims on appeal. Resp. C.A. Br. 12.

The district court rejected as "meritless" the claim of petitioner that earnings used to pay state and local income taxes are not "income" to him because they are received under an obligation of "repayment" that is analogous to a loan. Pet. App. A11. The court explained that the "profit [that petitioner] generated from his private business as an attorney and free lance writer * * * comes from clients who do not intend that [he] return the money to them in the future." *Id.* at A11-A12. The court further emphasized that petitioner's "profits cannot be characterized as a loan because the state and local governments are not lending the money to him in the first instance." *Id.* at A12. Moreover, unlike a borrower who "never has 'complete dominion' over the money," "the recipient of business income * * * is able to use that money immediately as his own." *Ibid.*

The district court also rejected petitioner's contention that the limitation on deductions of state and local income tax payments under 26 U.S.C. 68 violates the Tenth Amendment. The court explained that, "because Congress has the express power to tax income, the Tenth Amendment is not applicable here." Pet. App. A13.

3. The court of appeals affirmed in a summary order, "for substantially the reasons set forth in the District Court's opinion."[6] Pet. App. A5.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any

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[6] Petitioner does not renew the contention first raised on appeal that he should be allowed to amend his complaint to seek injunctive relief. Pet. App. A5.

other court of appeals. Further review is therefore not warranted.

1. The power to tax wages and other income derives from the broad grant of taxing power in Article I, § 8, of the Constitution, which authorizes Congress "To lay and collect Taxes, Duties, Imposts, and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States * * * ." U.S. Const. Art. I, § 8. That power "is exhaustive and embraces every conceivable power of taxation." *Brushaber* v. *Union Pacific R.R.*, 240 U.S. 1, 12 (1916). Thus, even before the adoption of the Sixteenth Amendment, it was well established that Congress was empowered to impose a tax on wages or other compensation for services without apportionment among the States. And when, before the adoption of the Sixteenth Amendment, the Court invalidated an early version of the income tax in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U.S. 429 (1885), on rehearing, 158 U.S. 601 (1895), it did so on the ground that the tax *as applied to income from real property* was tantamount to an impermissible direct tax on ownership of such property. While concluding that the entire tax must fall due to the invalidity of that part of it, the Court did not doubt that Congress had power under Article I to impose an unapportioned tax on income received from "business, privileges, employments, and vocations." 158 U.S. at 637.

Because a tax on amounts received as compensation for services is thus authorized under the broad powers of Article I—without regard to the adoption of the Sixteenth Amendment—petitioner's inquiry into whether the tax imposed in this case is imposed on "income" within the meaning of that Amendment is not ultimately relevant.

2. a. In any event, the tax challenged in this case is plainly imposed on "income" within the meaning of the Sixteenth Amendment. That Amendment specifies that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. Amend. XVI. Pursuant to that broad grant of authority, Congress specified in 26 U.S.C. 61(a) that "gross income means all income from whatever source derived," and includes "[c]ompensation for services, including fees, commissions, fringe benefits, and similar items" (26 U.S.C. 61(a)(1)) as well as all "[g]ross income derived from business" (26 U.S.C. 61(a)(2)). As this Court has often emphasized, the sweeping language of this statute reflects that Congress intended to exert "the full measure of its taxing power." *Helvering* v. *Clifford*, 309 U.S. 331, 334 (1940); *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955); *James* v. *United States*, 366 U.S. 213, 218 (1961); *HCSC-Laundry* v. *United States*, 450 U.S. 1, 5 (1981). Section 61(a) therefore brings within its scope all "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 431. The statutory definition of gross income thereby broadly encompasses "all gains except those specifically exempted." *Id.* at 430; see *Commissioner* v. *Kowalski*, 434 U.S. 77, 83 (1977); *Bingler* v. *Johnson*, 394 U.S. 741, 751-752 (1969); *Commissioner* v. *Jacobson*, 336 U.S. 28, 48-49 (1949).

b. The courts below correctly held that petitioner's earnings are includible in his gross income even though they are subject to state and local income taxes. Section 61 "is broad enough to include in taxable income any economic or financial benefit conferred * * * as

compensation, whatever the form or mode by which it is effected." *Commissioner* v. *Smith*, 324 U.S. 177, 181 (1945). See *Commissioner* v. *LoBue*, 351 U.S. 243, 247 (1956); *United States* v. *Basye*, 410 U.S. 441 (1973). There is no merit to petitioner's contention (Pet. 10-12) that, because he had an obligation to pay state and local income taxes on his earnings, his earnings were not "undeniable accessions to wealth, clearly realized, and over which [he has] complete dominion." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 431. Unlike amounts received as proceeds of a loan—which are not treated as income because they are received under an obligation to repay the same amounts to the lender (*Commissioner* v. *Tufts*, 461 U.S. 300, 307 (1983))—the income received by petitioner "comes from clients who do not intend that [he] return the money to them in the future." Pet. App. A11-A12. The fees that petitioner earns from practicing law are not burdened with any offsetting obligation to repay his clients. His right to receive and retain these fees was not "contingent upon any condition other than * * * the performance of the prescribed * * * services." *United States* v. *Basye*, 410 U.S. at 449. As the courts below properly emphasized, the "fact that [petitioner] owes taxes to state and local governments does not change the fact that the money he received was business income." Pet. App. A12.

Petitioner's contention (Pet. 12-14) that he lacked "complete dominion" over the income he used to pay the nondeductible portion of his state and local income taxes is foreclosed by *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716 (1929). In that case, this Court held that an employer's payment of an employee's federal income tax represents additional "income" to be included in the employee's gross income.

The fact that the taxpayer in *Old Colony* had a legal obligation to pay federal income taxes did not mean that he lacked "complete dominion" over amounts that he received solely for that purpose. Because these amounts were received "in consideration of the services rendered" by the taxpayer, the Court concluded that those payments constitute "income" even if, when they were made, their sole purpose was to pay taxes. *Id.* at 729. That same reasoning and conclusion apply directly here.

3. The courts below correctly rejected petitioner's contention (Pet. 21-30) that it is constitutionally impermissible for 26 U.S.C. 68 to restrict, for high-income taxpayers, the availability of the deduction for state and local income taxes. For the reasons described above, the constitutional definition of income includes amounts that a taxpayer receives and thereafter pays as state and local income taxes. When, under Section 68, a taxpayer does not receive a deduction for the full amount of state and local taxes paid, the consequence is simply that *both* governments have imposed a tax on that same income—it does not mean that no income was received. As this Court held in *Frick* v. *Pennsylvania*, 268 U.S. 473, 499-500 (1925) (emphasis added):[7]

> This [taxing] power in the two governments is generally so far concurrent as to render it admissible for both, each under its own laws and for its own purposes, to tax the same subject at the same time. * * * With this understanding of the power in virtue of which the two taxes are imposed, we are

[7] In *Frick*, the Court held that the federal estate tax applies to the entire value of a decedent's estate and that a deduction for the amount of state death taxes paid by the estate is not constitutionally required. 268 U.S. at 501.

> of the opinion that *neither the United States nor the State is under any constitutional obligation in determining the amount of its tax to make any deduction on account of the tax of the other. With both the matter of making such a deduction rests in legislative discretion.*

This Court has long made clear that "[t]he power to tax income * * * is plain and extends to the gross income. Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed." *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440 (1934). See, *e.g.*, *INDOPCO, Inc.* v. *Commissioner*, 503 U.S. 79, 84 (1992); *White* v. *United States*, 305 U.S. 281, 292 (1938). Because deductions are a matter of legislative grace, Congress is not required to grant them in unlimited amounts. It permissibly may reduce them for taxpayers with high incomes to promote the progressive rate structure of the federal income tax. See *Brushaber* v. *Union Pacific R.R.*, 240 U.S. at 25. As the courts below properly concluded, the limitation on deductions established in Section 68 thus "fits squarely within Congress' right to tax income." Pet. App. A13.

4. The courts below also correctly rejected (Pet. App. A13) petitioner's claim (Pet. 25) that Section 68 infringes on the rights of States under the Tenth Amendment. The Tenth Amendment is concerned with powers reserved to the States and the people. Congress does not violate the Tenth Amendment when it exercises a power delegated to the federal government. See *New York* v. *United States*, 505 U.S. 144, 173 (1992); *Sonzinsky* v. *United States*, 300 U.S. 506, 513-514 (1937).

As noted above, both Article I, § 8 and the Sixteenth Amendment to the Constitution expressly grant power to Congress to impose and collect taxes. The Tenth Amendment simply has no application when a taxpayer challenges the *scope* of the authority expressly established in the Constitution for federal taxation. See *United States* v. *Kahriger*, 345 U.S. 22, 31 (1953) ("courts are without authority to limit the exercise of the taxing power"), overruled in part on other grounds, *Marchetti* v. *United States*, 390 U.S. 39 (1968); *Sonzinsky* v. *United States*, 300 U.S. at 514 (rejecting a Tenth Amendment claim because the challenged tax "is within the national taxing power"). See also *Goldin* v. *Baker*, 809 F.2d 187, 191 (2d Cir.), cert. denied, 484 U.S. 816 (1987).

For these same reasons, petitioner errs in asserting (Pet. 25) that Section 68 violates principles of intergovernmental tax immunity. That doctrine is grounded in the need "to avoid interference with the functions of the taxed government or the imposition upon it of the economic burden of the tax." *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466, 480 (1939) (upholding constitutionality of state income tax, as applied to salary of federal official). That doctrine does not apply to spare a government "from tax burdens which are unsubstantial or which courts are unable to discern." *Ibid.* This limiting principle is "exemplified by those cases where the tax laid upon individuals affects the state only as the burden is passed on to it by the taxpayer [and] forbids recognition of the immunity when the burden on the state is so speculative and uncertain that if allowed it would restrict the federal taxing power without affording any corresponding tangible protection to the state government." *Helvering* v. *Gerhardt*, 304 U.S. 405, 419-420 (1938). See also *South Carolina* v. *Baker*,

485 U.S. 505, 517-523 (1988). This Court therefore held more than 60 years ago that federal income taxation of the salaries of state and local government employees does not implicate principles of intergovernmental tax immunity. *Helvering* v. *Gerhardt*, 304 U.S. at 420. In view of the fact that the conceptual burden on States imposed by application of the federal income tax to state officers' salaries is too speculative and uncertain to trigger the intergovernmental immunity doctrine, it can not seriously be contended that Section 68 runs afoul of it.

There is no conflict among the circuits or any other reason to warrant further review of petitioner's claims in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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