

Boris I. Bittker
James S. Eustice

**Fundamentals
of
Federal
Income
Taxation
of
Corporations
and
Shareholders**



WARREN, GORHAM & LAMONT

Fundamentals of Federal Income Taxation of Corporations and Shareholders

Boris I. Bittker
*Sterling Professor of Law
Yale University*

James S. Eustice
*Professor of Law
New York University*

Edited for Student Use by
Peter T. Joseph
Member of the New York Bar



WARREN, GORHAM & LAMONT
Boston and New York

Copyright © 1980 by Warren, Gorham & Lamont, Inc.

210 South Street
Boston, Massachusetts 02111

First Printing, July 1980

Second Printing, October 1980

Third Printing, October 1981

Fourth Printing, May 1984

Fifth Printing, June 1986

ALL RIGHTS RESERVED

No part of this book may be reproduced in
any form or by any means without permission
in writing from the publisher.

ISBN 0-88262-467-9

Library of Congress Catalog Card No.: 80-50916

Printed in the United States of America

Preface

In response to a gratifying demand for a student version of *Federal Income Taxation of Corporations and Shareholders*, Peter T. Joseph, with our cooperation, has prepared this abridgement of the professional edition. He has pruned the professional edition with care and skill—sentence by sentence and footnote by footnote—in order to present students of law, accounting, and business with a distillation that stresses the structure of the applicable law and the principal issues, both theoretical and practical. By focusing on pedagogical needs, he has succeeded in eliminating masses of detail that, however important to practitioners, create unnecessary hurdles and detours for even the most serious student.

Boris I. Bittker
James S. Eustice

March 1980

Table of Contents

Chapter 1

INTRODUCTORY

	<i>Page</i>
¶ 1.01 The Corporate Income Tax	1 - 1
¶ 1.02 Undistributed Corporate Income	1 - 3
¶ 1.03 Distributed Corporate Income	1 - 5
¶ 1.04 Exchanges of Corporate Stock and Securities	1 - 8
¶ 1.05 The Corporation as an Entity	1 - 9
¶ 1.06 Special Classes of Corporations	1 - 15
¶ 1.07 The Corporation vs. the Partnership	1 - 17
¶ 1.08 Current Proposals: Integration of Corporate and Individual Taxes	1 - 19

Chapter 2

DEFINITION OF A CORPORATION

¶ 2.01 Introductory	2 - 1
¶ 2.02 “Associations” in General	2 - 4
¶ 2.03 Trusts as “Associations”	2 - 5
¶ 2.04 Partnerships as “Associations”	2 - 7
¶ 2.05 Syndicates, Joint Ventures, Etc., as “Associations”	2 - 10
¶ 2.06 Professional Associations and Professional Corporations	2 - 11
¶ 2.07 Disregard of the Corporate Entity: Nominee and Dummy Corporations	2 - 12
¶ 2.08 Successor Corporations	2 - 13

Chapter 3

ORGANIZATION OF A CORPORATION: SECTION 351 AND RELATED PROBLEMS

¶ 3.01 Introductory	3 - 1
¶ 3.02 Potential Abuses of §351: Indirect Exchanges	3 - 4

CONTENTS

	<i>Page</i>
¶ 3.03 Transfer of "Property"	3 - 6
¶ 3.04 "Exchange" for "Stock or Securities": Problems of Classification	3 - 8
¶ 3.05 "Stock or Securities": The Continuity-of-Interest Doctrine	3 - 11
¶ 3.06 "Solely" in Exchange: The Receipt of "Boot"	3 - 12
¶ 3.07 Assumption of Liabilities	3 - 13
¶ 3.08 "Control": The 80 Percent Rule	3 - 17
¶ 3.09 Two or More Transferors	3 - 18
¶ 3.10 Control "Immediately After the Exchange"	3 - 19
¶ 3.11 The Transferor's Basis	3 - 21
¶ 3.12 The Transferee Corporation's Basis	3 - 23
¶ 3.13 Corporate Gain or Loss on Issue or Sale of Stock: §1032	3 - 25
¶ 3.14 Contributions to Capital	3 - 25
¶ 3.15 Transfer Under §351 vs. "Sale"	3 - 28
¶ 3.16 Transfer Under §351 vs. Dividend	3 - 31
¶ 3.17 "Midstream" Transfers of Potential Income Under §351	3 - 32
¶ 3.18 Relation of §351 to Reorganization Provisions	3 - 35
¶ 3.19 Reincorporations	3 - 35
¶ 3.20 Transfers Under §351 to Foreign Corporations	3 - 36

Chapter 4

THE CORPORATION'S CAPITAL STRUCTURE

PART A. CAPITAL STRUCTURE

¶ 4.01 Introductory	4 - 1
¶ 4.02 Stock vs. Debt: Major Litigation Areas and Stakes	4 - 3
¶ 4.03 Stock vs. Debt: Formal Characteristics; Hybrid Securities	4 - 4
¶ 4.04 Stock vs. Debt: Classification of Nonhybrid Securities	4 - 5
¶ 4.05 Stock vs. Debt: Treasury Authority to Issue Regulations	4 - 8
¶ 4.06 Equity-Flavored Securities: Convertibles, Options, etc.	4 - 8
¶ 4.07 Stock vs. Debt: Capital Asset Status	4 - 16
¶ 4.08 Stock vs. Debt: Repayment of "Loan," Redemption of "Stock," or Dividend?	4 - 17
¶ 4.09 Stock vs. Debt: Character of Investor's Loss on Sale or Worthlessness	4 - 19
¶ 4.10 Outside Loans Guaranteed by Shareholders	4 - 22
¶ 4.11 Loss on "Section 1244 Stock"	4 - 23

CONTENTS

PART B. DEBT-FINANCED ACQUISITIONS

	<i>Page</i>
¶ 4.20 In General	4 - 27
¶ 4.21 Debt-Financed Corporate Acquisitions: §279	4 - 28
¶ 4.22 Other Aspects of Corporate Debt Securities: §§453, 1232, and 249	4 - 29

Chapter 5

THE CORPORATION INCOME TAX

¶ 5.01 Introductory: Corporate Tax Rates	5 - 1
¶ 5.02 The Corporation's Gross Income	5 - 3
¶ 5.03 Deductions	5 - 3
¶ 5.04 Special Deduction Problems Arising From the Corporate-Shareholder Relationship	5 - 5
¶ 5.05 Nondeductible Items	5 - 9
¶ 5.06 The Dividends-Received Deduction and Related Problems	5 - 11
¶ 5.07 Organization, Reorganization, and Liquidation Expenditures	5 - 13

Chapter 6

CORPORATE ELECTIONS UNDER SUBCHAPTER S

¶ 6.01 Introductory	6 - 1
¶ 6.02 Eligibility to Elect Under Subchapter S	6 - 1
¶ 6.03 Termination of the Election	6 - 4
¶ 6.04 Election After Termination	6 - 7
¶ 6.05 Taxation of Corporate Income to Shareholder	6 - 8
¶ 6.06 Pass-Through of Long-Term Capital Gain	6 - 13
¶ 6.07 Pass-Through of Corporate Net Operating Loss	6 - 15
¶ 6.08 Distributions of Previously Taxed Income	6 - 17
¶ 6.09 Advantages of Subchapter S Election	6 - 19

Chapter 7

DIVIDENDS AND OTHER NONLIQUIDATING DISTRIBUTIONS

PART A. DISTRIBUTIONS IN CASH

¶ 7.01 Introductory	7 - 1
¶ 7.02 "Dividend": A Term of Art	7 - 3

CONTENTS

	<i>Page</i>
¶ 7.03 Earnings and Profits	7 - 6
¶ 7.04 Tax Accounting Principles in Computing Earnings and Profits and Dividend Income	7 - 13
¶ 7.05 Constructive Distributions	7 - 15
¶ 7.06 Dividends-Received Exclusion for Individuals	7 - 23
¶ 7.07 Assignment of Dividend Income and Related Problems	7 - 24

PART B. DISTRIBUTIONS IN KIND

¶ 7.20 Introductory	7 - 27
¶ 7.21 Corporate Income or Loss on Distribution of Property	7 - 28
¶ 7.22 Taxability of Distribution to Individual Distributees....	7 - 33
¶ 7.23 Taxability of Distribution to Corporate Distributees....	7 - 35
¶ 7.24 Distributions in Kind: Effect on Earnings and Profits	7 - 37

PART C. DISTRIBUTIONS OF CORPORATION'S OWN OBLIGATIONS

¶ 7.40 Distributions of Corporation's Own Obligations	7 - 40
---	--------

PART D. DISTRIBUTIONS OF STOCK AND STOCK RIGHTS

¶ 7.60 Introductory and Chronology	7 - 41
¶ 7.61 Stock Distribution Rules, 1969 and Later Years	7 - 44
¶ 7.62 Stock Rights	7 - 52

Chapter 8

ACCUMULATED EARNINGS AND UNDISTRIBUTED INCOME

PART A. THE ACCUMULATED EARNINGS TAX

¶ 8.01 Introductory	8 - 1
¶ 8.02 The Forbidden Purpose: §532	8 - 4
¶ 8.03 "Reasonable Needs of the Business": In General	8 - 7
¶ 8.04 "Reasonable Needs of the Business": Anticipated Needs	8 - 12
¶ 8.05 "Reasonable Needs of the Business": Methods of Financing	8 - 13
¶ 8.06 "Reasonable Needs of the Business": What Is "the" Business?	8 - 14

CONTENTS

	<i>Page</i>
¶ 8.07 “Reasonable Needs of the Business”: Stock Redemptions	8 - 16
¶ 8.08 Presumptions and Burden of Proof Problems	8 - 17
¶ 8.09 Computation of Accumulated Earnings Tax	8 - 19

PART B. PERSONAL HOLDING COMPANIES

¶ 8.20 Introductory	8 - 21
¶ 8.21 Personal Holding Company Income: The 60 Percent Income Test	8 - 24
¶ 8.22 Personal Holding Company Income: §543(a)	8 - 25
¶ 8.23 Definition of “Personal Holding Company”: Stock Ownership	8 - 30
¶ 8.24 Computation of Personal Holding Company Tax	8 - 31

Chapter 9

STOCK REDEMPTIONS AND PARTIAL LIQUIDATIONS

PART A. THE PRE-1954 BACKGROUND

¶ 9.01 Introductory	9 - 1
¶ 9.02 Pre-1954 Law: §115(g) of the 1939 Code	9 - 2
¶ 9.03 The 1954 Changes in Summary	9 - 3

PART B. STOCK REDEMPTIONS UNDER §302

¶ 9.20 Introductory	9 - 4
¶ 9.21 Constructive Ownership of Stock: §318	9 - 5
¶ 9.22 Substantially Disproportionate Redemptions: §302(b) (2)	9 - 10
¶ 9.23 Termination of Shareholder’s Entire Interest: §302(b) (3)	9 - 13
¶ 9.24 Redemptions Not Essentially Equivalent to Dividends: §302(b) (1)	9 - 17
¶ 9.25 Redemptions in Conjunction With Bootstrap Acqui- sitions of Stock: Buy-Sell Plans, etc.	9 - 19

PART C. REDEMPTIONS BY AFFILIATED CORPORATIONS: §304

¶ 9.30 Introductory	9 - 26
¶ 9.31 Redemptions by Affiliated Corporations Under §304	9 - 27

CONTENTS

		<i>Page</i>
¶ 9.32	Collateral Problems Involving “Cross-Ownership” and §304	9 - 30

PART D. REDEMPTIONS TO PAY DEATH TAXES: §303

¶ 9.40	Redemptions Under §303	9 - 31
--------	------------------------------	--------

PART E. PARTIAL LIQUIDATIONS UNDER §346

¶ 9.50	Introductory	9 - 33
¶ 9.51	One of a Series of Distributions in Complete Liquidation: §346(a)(1)	9 - 34
¶ 9.52	Corporate Contractions: §346(a)(2)	9 - 37
¶ 9.53	Termination of One Out of Two or More Businesses: §346(b)	9 - 39

PART F. COLLATERAL PROBLEMS ARISING FROM PARTIAL LIQUIDATIONS AND STOCK REDEMPTIONS

¶ 9.60	Introductory	9 - 42
¶ 9.61	Computation of Shareholder’s Gain or Loss	9 - 42
¶ 9.62	The Mystery of the Disappearing Basis	9 - 44
¶ 9.63	The Basis of Distributed Property	9 - 45
¶ 9.64	Recognition of Corporate Gain or Loss on Distribution in Redemption of Stock	9 - 45
¶ 9.65	Effect of Redemption on Corporation’s Earnings and Profits	9 - 47

Chapter 10

PREFERRED STOCK BAIL-OUTS

¶ 10.01	Introductory	10 - 1
¶ 10.02	Bail-Outs Under the 1954 Code: §306	10 - 2
¶ 10.03	The Definition of Section 306 Stock	10 - 3
¶ 10.04	Dispositions of Section 306 Stock	10 - 5
¶ 10.05	Exceptions to §306(a)	10 - 7
¶ 10.06	Uses of Section 306 Stock	10 - 9
¶ 10.07	Is §306 the Exclusive Remedy for Attempted Bail-Outs?	10 - 9

CONTENTS

Chapter 11

COMPLETE LIQUIDATIONS AND RELATED PROBLEMS

PART A. THE GENERAL RULE OF §331(a)(1)

	<i>Page</i>
¶ 11.01 Introductory	11 - 1
¶ 11.02 Meaning of “Complete Liquidation”	11 - 3
¶ 11.03 Liquidating Distributions and Shareholder Gain or Loss	11 - 4
¶ 11.04 Basis of Property Received in Complete Liquidation	11 - 9
¶ 11.05 Liquidation Followed by Reincorporation	11 - 10

PART B. NONRECOGNITION OF SHAREHOLDER GAIN IN ELECTIVE ONE-MONTH LIQUIDATIONS UNDER §333

¶ 11.20 Introductory	11 - 11
¶ 11.21 Nonrecognition of Gain Under §333	11 - 11
¶ 11.22 Basis of Property Received	11 - 13
¶ 11.23 The Election and Other Conditions of §333	11 - 14

PART C. NONRECOGNITION OF PARENT CORPORATION'S GAIN OR LOSS ON LIQUIDATING A SUBSIDIARY: §332

¶ 11.40 Introductory	11 - 16
¶ 11.41 Conditions of §332	11 - 18
¶ 11.42 Effect of Subsidiary Indebtedness to Its Parent	11 - 22
¶ 11.43 Minority Shareholders	11 - 23
¶ 11.44 Basis of Property Received by Parent Corporation: §334(b)	11 - 24
¶ 11.45 Special Problems of §334(b)(2) Liquidations	11 - 28

PART D. THE LIQUIDATING CORPORATION'S INCOME AND LOSS

¶ 11.60 Introductory	11 - 33
¶ 11.61 Effect of the Distribution Itself: §336	11 - 34
¶ 11.62 Income of the Liquidating Corporation: “Timely” Liquidations and Related Problems	11 - 35
¶ 11.63 The <i>Court Holding Co.</i> Doctrine and Its Limitations ..	11 - 39
¶ 11.64 Section 337: The “ <i>Anti-Court Holding Co.</i> ” Provision	11 - 43
¶ 11.65 Section 337: Nonqualifying Assets and Dispositions	11 - 47

CONTENTS

		<i>Page</i>
¶ 11.66	Section 337: Nonqualified Liquidations	11 - 52
¶ 11.67	Section 337 and Reincorporations or Other Reorganizations	11 - 54
¶ 11.68	The Liquidating Corporation's Deductions	11 - 55
¶ 11.69	The Liquidating Corporation's Indebtedness	11 - 58
¶ 11.70	Earnings and Profits of the Liquidating Corporation	11 - 59
¶ 11.71	Bootstrap Acquisitions and the Liquidating Corporation	11 - 59

Chapter 12

COLLAPSIBLE CORPORATIONS

¶ 12.01	Introductory	12 - 1
¶ 12.02	The Framework of §341	12 - 2
¶ 12.03	The Definition of Collapsible Corporation	12 - 4
¶ 12.04	The Rebuttable Presumption of Collapsibility: §341(c)	12 - 10
¶ 12.05	The Statutory Limitations of §341(d)	12 - 11
¶ 12.06	The Amnesty of §341(e)	12 - 14
¶ 12.07	Avoidance of §341 by a §341(f) Consent	12 - 21

Chapter 13

CORPORATE DIVISIONS

¶ 13.01	Introductory	13 - 1
¶ 13.02	Divisive Reorganizations Before 1954	13 - 3
¶ 13.03	The 1954 Legislation: §355 in Outline	13 - 7
¶ 13.04	The Active Business Requirement in General: §355(b)	13 - 9
¶ 13.05	The Five-Year Rule: Predistribution Business History	13 - 16
¶ 13.06	The "Device" Restriction: §355(a)(1)(B)	13 - 20
¶ 13.07	Distribution of All Stock and Securities in Controlled Corporations	13 - 24
¶ 13.08	Non Pro Rata Distributions	13 - 25
¶ 13.09	Judicial Limitations on Tax-Free Corporate Divisions	13 - 27
¶ 13.10	"Boot" Under §355	13 - 29
¶ 13.11	Basis, Holding Period, Earnings and Profits, etc.	13 - 31
¶ 13.12	The Monopoly of §355	13 - 33
¶ 13.13	Nonqualifying Corporate Divisions	13 - 34

CONTENTS

Chapter 14

CORPORATE REORGANIZATIONS

PART A. GENERAL CONSIDERATIONS

	<i>Page</i>
¶ 14.01 Introductory	14 - 1
¶ 14.02 The Statutory Pattern	14 - 4
¶ 14.03 Judicial Limitations: In General	14 - 6
¶ 14.04 Relation to Other Acquisition Techniques	14 - 7
¶ 14.05 Other General Considerations	14 - 9

PART B. "REORGANIZATION" DEFINED

¶ 14.10 Introductory	14 - 10
¶ 14.11 Continuity of Proprietary Interest and Plan of Reorganization	14 - 11
¶ 14.12 Statutory Mergers and Consolidations (Type A)	14 - 19
¶ 14.13 Acquisitions of Stock for Voting Stock (Type B)	14 - 23
¶ 14.14 Acquisitions of Property for Voting Stock (Type C)	14 - 29
¶ 14.15 Merger With Controlled Subsidiary (Hybrid Type A)	14 - 37
¶ 14.16 Transfer of Assets to Controlled Corporations (Type D)	14 - 41
¶ 14.17 Recapitalizations (Type E)	14 - 44
¶ 14.18 Changes in Identity, Form, or Place of Organization (Type F)	14 - 53
¶ 14.19 Transactions Involving Investment Companies	14 - 55

PART C. TREATMENT OF PARTIES TO A REORGANIZATION

¶ 14.30 Introductory	14 - 56
¶ 14.31 Stock or Securities vs. Boot: In General	14 - 57
¶ 14.32 Treatment of Corporate Transferor: §§361, 357, and 358	14 - 61
¶ 14.33 Treatment of Corporate Transferee: §§1032 and 362 ..	14 - 64
¶ 14.34 Treatment of Shareholders and Security Holders: §§354, 356, and 358	14 - 67
¶ 14.35 Section 306 Stock Received in Corporate Reorganizations	14 - 73
¶ 14.36 Reorganizations of Foreign Corporations: §367	14 - 74

PART D. SPECIAL PROBLEMS IN REORGANIZATIONS

¶ 14.50 Introductory	14 - 75
----------------------------	---------

CONTENTS

	<i>Page</i>
¶ 14.51 Judicial Doctrines and Limitations: Business Purpose, Continuity of Business Enterprise, and Step Transactions	14 - 75
¶ 14.52 Disposition of Unwanted Assets in Connection With a Reorganization	14 - 79
¶ 14.53 Affiliated Corporations: Special Acquisition Problems and Techniques	14 - 85
¶ 14.54 Reincorporations: Liquidation vs. Reorganization	14 - 94
¶ 14.55 Assumption of Liabilities: Effect on Reorganization Status	14 - 103
¶ 14.56 Contingent Consideration Acquisitions and Related Problems	14 - 106

Chapter 15

AFFILIATED CORPORATIONS

PART A. MULTIPLE CORPORATIONS

¶ 15.01 Section 482: In General	15 - 1
¶ 15.02 Allocation of Income and Deductions Under §482	15 - 2
¶ 15.03 Other Weapons Against Multiple Corporations	15 - 13
¶ 15.04 Basic Income and Deduction Principles in the Multiple Corporation Context	15 - 16
¶ 15.05 Historic Benefits of Multiple Corporations	15 - 21

PART B. CONSOLIDATED RETURNS

¶ 15.20 Introductory	15 - 25
¶ 15.21 Eligibility to File Consolidated Returns	15 - 26
¶ 15.22 The Election to File a Consolidated Return	15 - 28
¶ 15.23 Computation of Consolidated Taxable Income and of Tax Liability: In General	15 - 29
¶ 15.24 Limitations on Application of Consolidated Return Principles	15 - 37

Chapter 16

CORPORATE TAX ATTRIBUTES: SURVIVAL AND TRANSFER

PART A. BACKGROUND AND INTRODUCTION

¶ 16.01 Corporate Tax Attributes: In General	16 - 1
¶ 16.02 Acquisition of Tax Benefits: A Chronology of Major Developments	16 - 4
¶ 16.03 Statutory and Transactional Patterns: In General	16 - 7

CONTENTS

PART B. CARRYOVERS AND §381

	<i>Page</i>
¶ 16.10 In General	16 - 10
¶ 16.11 Section 381(a) Transactions	16 - 11
¶ 16.12 Special Operating Rules: §381(b)	16 - 13
¶ 16.13 Carryover Items and Computation Mechanics: §381(c)	16 - 13
¶ 16.14 Non-§381(a) Transactions and Non-§381(c) Items	16 - 18

PART C. LIMITATIONS ON ENJOYMENT OF CORPORATE TAX ATTRIBUTES

¶ 16.20 Introductory	16 - 19
¶ 16.21 Acquisitions to Evade or Avoid Income Tax: §269	16 - 20
¶ 16.22 Disallowance of Net Operating Loss Carryovers Because of Change of Ownership and Abandonment of Business: §382(a)	16 - 28
¶ 16.23 Restriction of Net Operating Loss Carryovers Because of Change of Ownership Resulting From Reorganiza- tion: §382(b)	16 - 34
¶ 16.24 Section 382 as Amended by the Tax Reform Act of 1976	16 - 37
¶ 16.25 The <i>Libson Shops</i> Doctrine and Its Radiations	16 - 42
¶ 16.26 Other Limitations on Survival of Corporate Tax Attributes	16 - 46

Chapter 17

FOREIGN CORPORATIONS AND FOREIGN-SOURCE INCOME

PART A. TAXATION OF FOREIGN CORPORATIONS: IN GENERAL

¶ 17.01 Introductory	17 - 1
¶ 17.02 Basic Definitions	17 - 2
¶ 17.03 Foreign Corporations Not Engaged in United States Business: §881	17 - 9
¶ 17.04 Foreign Corporations Engaged in United States Business: §882	17 - 11
¶ 17.05 Special-Purpose Foreign Corporations	17 - 13

CONTENTS

PART B. DOMESTIC CORPORATIONS WITH FOREIGN-SOURCE INCOME

	<i>Page</i>
¶ 17.10 Introductory	17 - 14
¶ 17.11 Foreign Tax Credit	17 - 15
¶ 17.12 Possessions Corporations: §§931 and 936	17 - 23
¶ 17.13 Domestic International Sales Corporations: §§991-997	17 - 24
¶ 17.14 International Boycotts: §999	17 - 28

PART C. FOREIGN PERSONAL HOLDING COMPANIES AND FOREIGN INVESTMENT COMPANIES

¶ 17.20 Introductory	17 - 28
¶ 17.21 Foreign Personal Holding Companies: Definition	17 - 29
¶ 17.22 Taxation of Foreign Personal Holding Company Income to Shareholders: §551	17 - 29

PART D. CONTROLLED FOREIGN CORPORATIONS

¶ 17.30 Introductory	17 - 30
¶ 17.31 The "Controlled Foreign Corporation"	17 - 32
¶ 17.32 Income Attributed to Shareholders of Controlled Foreign Corporations	17 - 34
¶ 17.33 Sale or Liquidation of Controlled Foreign Corporations: §1248	17 - 38

PART E. ORGANIZATION, LIQUIDATION, AND REORGANIZATION OF FOREIGN CORPORATIONS: §367

¶ 17.40 Introductory: Background and Scope of §367	17 - 39
¶ 17.41 Tax Reform Act of 1976 Amendments to §§367 and 1491: In General	17 - 44

Table of Parallel Case Report Citations	TP - 1
Table of Cases	T - 1
Table of Revenue Rulings, Revenue Procedures, and Other IRS Releases	T - 11
Index	I - 1

CHAPTER 1

Introductory

¶ 1.01 THE CORPORATE INCOME TAX

The federal government has taxed the income of corporations continuously since the Payne-Aldrich Tariff Act of 1909, which antedated the adoption of the Sixteenth Amendment by four years. The 1909 Act was levied “with respect to the carrying on or doing business” by corporations (as well as joint stock companies, associations, and insurance companies); this approach led the Supreme Court, in *Flint v. Stone Tracy Co.*,¹ to find that what Congress had imposed was not a “direct” tax but an “excise” or “indirect” tax upon “the exercise of the privilege of doing business in a corporate capacity.” Since the tax was not a “direct” tax, the Constitution did not require it to be apportioned according to population.² The Court then went on to hold that corporate activities were subject to federal taxation even though carried on under a state charter; that the tax was “uniform throughout the United States” as required by the Constitution even though individual proprietors and partnerships were not taxed; that the tax was not a “direct” tax merely because it reached income from municipal bonds and other nontaxable securities; and that various other constitutional objections were equally invalid.

¹ *Flint v. Stone Tracy Co.*, 220 US 107 (1911).

² The principal constitutional provisions regarding taxation are:

Article I, Section 8, Clause 1: “The Congress shall have Power 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; but all Duties, Imposts and Excises shall be uniform throughout the United States.”

Article I, Section 9, Clause 4: “No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.”

Amendment XVI: “The 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.”