Marquette Law Review

Volume 18
Issue 4 *June 1934*

Article 1

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MARQUETTE
LAW REVIEW

VOLUME XVIII JUNE, 1934 NUMBER FOUR

THE CHANGING PHILOSOPHY OF TAXATION

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"IN PASSING judgment upon any tax law, the criteria of the economist differ essentially from those of the lawyer. The economist will concern himself primarily with the social policy of the measure, its probable utility, its equitable justice and matters of that nature, and in arriving at his conclusions he will usually be influenced somewhat by the possibilities of the shifting of the tax and its ultimate incidence. The lawyer, on the other hand, must approach the measure from an entirely different aspect. He cannot concern himself with its expedience or wisdom."[1]

In so many words the South Dakota Supreme Court illustrates the typical attitude of the American Bar toward economic policies and principles. Today, in the fourth decade of the twentieth century, this attitude is being challenged—not so much by human volition, as by the relentless course of economic principles.

There exists today in the United States two great schools of conflicting socio-political thought. The first school, termed "liberal," "progressive," or "radical," claims that the future welfare of the nation demands the maximum of scientific economic planning by the government or by quasi-governmental agencies;[2] the second school, termed

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[1] *State ex rel. Botkin* v. *Welsh,* (S.D., 1933) 152 N.W. 189.

[2] Cf. George Soule, "National Planning," The New Republic, p. 61, March 4, 1931; Stuart Chase, "A Ten Year Plan For America," Harper's Magazine, p. 1, June, 1931; Harold L. Ickes, quoted in "A Primer of 'New Deal' Economics," by J. George Frederick, 1933, p. 278, "The source of men's living is coming under something like a social control. Life processes, by which I mean

"conservative" or "reactionary," argues that while government regulation may be justified in times of national emergency,[3] such interference during normal periods threatens the basic democratic nature of the United States. Probably a majority of the members of the American Bar, by virtue of their environment, their training, and their reliance upon decisions rendered in the past, belong to this second school of "conservative" thought.[4]

Perhaps in few legal fields is the challenge to this "conservative" thought so vital or so emphatic as in the field of taxation. Four years of depression have taught the American people two principles of taxation, hitherto almost relatively unknown and almost completely unobserved: the first, that a system of taxation is dependent for its success upon the prosperity of a nation;[5] and the second, that the pros-

factories, farms, mines, transportation and such things, are being transformed from empires controlled by industrial and financial overlords into social enterprises in the output of which there must be a decent sharing by those who do the work, pay the bills and consume the output. Government has to go a new way because the old way is closed forever."

[3] *Wilson* v. *New,* 243 U.S. 332, 37 S.Ct. 298, 61 L.Ed. 755 (1917): "Although an emergency may not call into life a power which has never lived, nevertheless emergency may afford a reason for the exertion of a living power already enjoyed. If acts which if done, would interrupt, if not destroy, interstate commerce, may be by anticipation legislatively prevented, by the same token the power to regulate may be exercised to guard against the cessation of interstate commerce, threatened by a failure of employers and employees to agree as to the standard of wages, such standard being an essential prerequisite to the uninterrupted flow of interstate commerce." Cf. *Block* v. *Hirsh,* 256 U.S. 135, 154, 41 S.Ct. 458, 65 L.Ed. 865, 16 A.L.R. 165 (1921); *Chastleton Corporation* v. *Sinclair,* 264 U.S. 543, 44 S.Ct 405, 68 L.Ed 841 (1924).

[4] Cf. Hon. Homer S. Cummings, Attorney General of the United States, on "Modern Tendencies and the Law," an address before the American Bar Association, Grand Rapids, Mich., 1933, reported in Vol. 58, Reports of American Bar Ass'n., p. 287: "It is but natural that some of the legal aspects and implications of what is now going forward should disturb the more "static" members of the Bar." The address of Clarence E. Martin, President of the American Bar Association for 1933, at Grand Rapids, Mich. Aug. 30—Sept. 1, 1933 on "The Growing Impotency of The States" typifies the conservative philosophy of the leaders of the Bar. Cf. Vol. 58, Reports of American Bar Ass'n., p. 236. Also notice the address of Guy A. Thompson, President of The American Bar Association for 1932, Vol. 57, Report of American Bar Ass'n. p. 263: "A government to encourage self-reliance; yet one sees an *ominously* increasing disposition on the part of individuals and industries to look to the national government for support * * * A government, the philosophy of whose founders was that it is the duty of the citizen to maintain the state; yet there is rapidly spreading the *fatal* philosophy that it is the duty of the state to maintain its citizens." (Italics by writer.)

[5] Cf. Edwin A. Seligman, "Toward a New Tax Program," The Nation, April 27, 1932, "Everywhere, indeed, the economic depression has had its fiscal repercussions. The falling off of business activities is quickly reflected in government revenues. There is comparatively little to choose in the matter of elasticity among many kinds of taxes. As business recedes, transactions diminish, consumption is cut down, wages and profits fall, and the reduced incomes are soon capitalized into lower selling values. Customs, excises, stamp duties, corporate and individual income taxes—all suffer the same fate." Cf. Roy G. Blakey, "The State Income Tax," 1932, p. 6, "Furthermore, good finance (taxation)is almost impossible in a world whose economic and social systems are subject to frequent unpredictable upheavals by war and violently fluctuating monetary and credit systems."

perity of a nation is partially dependent for its continuation upon a proper and scientific system of taxation.

It is therefore the purpose of this article to discus, not the technical steps whereby income, inheritance or estate taxes may be avoided,[6] nor the loopholes by which such taxes may be evaded,[7] but rather the importance of the interplay of economic conditions with taxation and of taxation with economic conditions.

Four years of economic dislocation have struck with paralyzing force against the two great systems of American taxation.[9] The sources of both the income and the property tax have suffered severe curtailment. On one hand, the national income of the United States dropped from $81,040,000,000 in 1929 to less than $49,000,000,000 in 1932.[10] On the other hand, the national wealth of the United States, including the value of real and personal property, fell from $361,800,000,000 in 1929 to $247,300,000,000 in 1932.[11]

But while the sources of government revenue dried up, demands for government expenditures multipled, with the result that the expenditures of the Federal Government increased from $3,848,463,190 in 1929 to $5,006,590,305 in 1932.[12] The National Debt rose from $16,-185,308,299 in 1930 to more than $22,500,000,000 in 1933.[13] The program of the present administration, however, calls for a total expendi-

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6 Cf. Jay M. Lee, "Minimizing Taxes;" Joseph J. Robinson, "Saving Taxes in Drafting Wills and Trusts."

7 Income taxes can be evaded through investment in tax-exempt government securities, through the creation of personal holding companies, through the sale of stocks and bonds to establish large capital losses, through gifts to members of the family. Cf. Harold M. Groves, "Recovery Through Taxation," Current History, March, 1934, p. 666: "The income tax is frequently avoided by the creation of personal holding companies which receive dividends that would otherwise go to individuals and be taxed under the surtax. Dividends received by the holding company are reinvested for the individual and escape the surtax. The main purpose of the personal holding company is to avoid taxes; it has no important economic function and should be prohibited or taxed out of existence." Much of the legislation of the 1934 Congress is directed toward the blocking up of tax loopholes.

9 The income and the general property tax are the two chief tax systems of the United States. Thus in 1929 the national government collected $2,331,274,429 from income and profit taxes, the total revenue of the government being only $3,848,463,190. Cf. William J. Schultz, "American Public Finance and Taxation," 1931, p. 403, "The general property tax and the special property taxes which are related to it are the major source of revenue for the state and local governments. In 1928 property taxes accounted for $4,801,122,000 out of a total of $6,148,396,000 of state and local tax revenue. In some states they are almost the sole source of tax revenue for the state and local governments. The great dependence placed upon property taxes as a source of state and local revenue magnifies all the difficulties involved in this form of taxation."

10 National Bureau of Economic Research, Bulletin 49, Jan. 26, 1934.

11 Unofficial estimate made by The National Industrial Conference Board in 1934.

12 Official report of the United States Department of the Treasury.

13 Ibid.

ture of more than $11,000,000,000 in 1934[14] resulting in a planned public indebtedness of $31,834,000,000 for June 30, 1935.[15] These statistics disclose the alarming fact that the United States Government is being financed today, not by means of its tax revenues,[16] but rather by means of charges against the public credit.[17] Yet, in spite of the failure of present tax systems to maintain the nation's budget, all taxes,—local, state, and nation, rose from 11.6% of the national income in 1929[18] to 15% of this income in 1930[19] and to almost 33% in 1933.[20]

At this point it might be argued that the reliance of the Federal Government upon the income tax is the basic cause for this marked fluctuation in Federal receipts.[21] However, in refutation to this charge it should be pointed out that those state and local governments which relied chiefly upon the "stable" property tax have fared no better than the National Government.[22] To quote from the recent case of *Home Building & Loan Association* v. *John H. Blaisdell*,[22a] the United States Supreme Court paid particular attention to the following argument of the Attorney General of Minnesota:

"Because of the increased burden on the state and its political subdivisions which resulted from the depression, taxes on lands, which provide by far the major portions of the taxes in this state, were increased to such an extent that in many cases they became confiscatory. Tax delinquencies were alarmingly great, rising as high as 78% in one county of the state. In seven counties of the state the tax delinquency was over 50%. Because of these delinquencies many towns, school dis-

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[14] National City Bank Bulletin, February, 1934, p. 20, "Briefly, the President estimates that for the fiscal year ending June 30 next, the ordinary cost of running the Government, including the usual provision for amortization, will amount to $3,534,000,000. Emergency expenditures are estimated at $6,357,-000,000. These, plus a supplementary sum of $1,166,000,000 not included in the budget, but which the President believes will be needed to provide adequate relief, make a total expenditure of $11,057,000,000."

[15] Ibid, p. 21.

[16] In 1932 all the receipts of the Federal Government amounted to only $2,121,-228,006 according to the report of the United States Department of the Treasury. Income tax receipts for 1933 totaled $746,791,404.

[17] National City Bank Bulletin, February, 1934, p. 23, "the Treasury faces the task of finding a market for $10,000,000,000 of Government securities in the six months from January through June."

[18] The National Industrial Conference Board, "Cost of Government in the United States, 1928-1929" p. 67.

[19] The National Industrial Conference Board, Vol. VIII, No. 4, April 20, 1934.

[20] J. George Frederick, "A Primer of 'New Deal' Economics," 1933, p. 55.

[21] United States Department of the Treasury Report, 1934: In 1929 the receipts from income and profit taxes were three times as great as they were in 1933.

[22] Harold M. Groves, "Recovery Through Taxation," Current History, March 1934, p. 662, "Nearly 2,000 rural schools in 24 states failed to open in the fall of 1933. One out of every four cities has shortened its school term; 715 rural schools are expected to run less than three months. One out of every four teachers in the United States is now teaching on a salary of less than $750 a year, only slightly above what the blanket code allows an unskilled factory laborer."

[22a] 78 L.Ed. (adv. 255), 54 S.Ct. 231, 88 A.L.R. 1487 (1934).

tricts, villages and cities were practically bankrupt. In many of these political subdivisions of the state local government would have ceased to function and would have collapsed had it not been for loans from the state."

Melvin Traylor, President of the First National Bank of Chicago, writing in the "Bankers Magazine" for April, 1932 states: "One million acres of land in a Middle Western state are taken over by the counties of that state for unpaid taxes. Another state has an $18,000,000 deficit; still another state with $10,000,000 in signed contracts for certain projects is unable to raise a single dollar to carry on these projects. Delinquent taxes are at least as great as in 1930, and the percentage is as high as 60, 70, and 80 per cent in certain communities. Schools are closed, bond issues are in default, hundreds of communities are tax bankrupt. Those are the basic facts which we cannot, must not, dare not evade."[23]

In the case of the Federal income tax, the burden of meeting public expenses was shifted from the people to the "Government" as such. Loss of income to the individual carried with it freedom from the liability of paying a tax. The problem of raising national funds was transferred to a body which thus far has proven capable of shouldering its new responsibilities.[24] But in the case of the state property tax, the burden of financing increased state and local expenditures remained with the property owner. He could not shift it; he could not dodge it. The fact that his income had ceased, the fact that the value of his property had declined by as much as 50%, the fact that he was financially unable to pay this annual levy, all counted for nothing. The state or the municipality needed the money; the law required the property owner to pay it; and his failure to meet his assessments within the statutory period resulted in the public sale of his property.[25]

And thus, did the economic difficulties of the depression create scores of new social problems.[26] The strict enforcement of an anti-

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[23] According to the United States Statistical Abstract for 1933 the debts of state and local governments increased from $2,144,332,000 in 1928 to $2,666,070,000 in 1931. Change in the ownership of farms due to forced sales and related defaults increased from 19.5 per 1,000 in 1929 to 52.5 per 1,000 in 1932. United States Agriculture Yearbook, 1933, p. 733.

[24] As an example of the success of United States Government finance, cf. National City Bank Bulletin, May, 1934, p. 77: "In April the Government carried through another major conversion operation in effecting an exchange of approximately $1,000,000,000 of new 3¼% bonds due in 1946 for $815,000,000 of Liberty 4¼% bonds called for payment April 15, and $234,000,000 of Treasury notes due May 2."

[25] Cf. Wisconsin Statutes, 1933, Chapter 75.

[26] Cf. William Raymond Green, "The Theory and Practice of Modern Taxation," 1933, p. 225: "Farm taxes in 1930 rose to 266 per cent of, or more than two and one-half times, the pre-war level, and even before the present depression farm taxes were absorbing a very large percentage of farm returns. In 1926, taxes took 32.6 per cent of the rentals on Colorado farms; 29.8 per cent of the

quated system of property taxation carried with it a toll of human misery and suffering seldom before paralleled in American history.[27] And so insecure did the ownership of private real property become in the United States, that the following words of Chief Justice Marshall acquired a new and sinister significance: "That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; * * * are propositions not to be denied."[28] The rusty machinery which the states and municipalities had erected for the purpose of collecting property taxes proved to be a veritable Frankenstein, a monster which not only threatened to wipe out the private ownership of property in hundreds of counties, but also endangered the very existence of these local governments by bringing in delinquencies instead of dollars. Behind the proposed loan of $462,000,000 to the state governments by the Reconstruction Finance Corporation,[29] lies the dismal financial record of the property tax system for the years of 1930 to 1933.[30]

The various state legislative bodies have not been unaware of this problem. In 1933, forty-seven states passed more than 1,000 tax laws.[31] Generally, these laws can be divided into two rough groups: the first, consisting of attempts to secure revenue from sources other than the property tax; and the second, consisting of measures seeking to aid the property taxpayer. Within the first group can be included the following measures: the adoption of liquor taxes by thirty-three states;[32] gross income or sale taxes by thirteen states;[33] horse racing taxes by

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rentals on South Dakota farms; and 20 per cent in Virginia. In 1925, they took 54.3 per cent in Michigan; in 1922, 41 per cent in Ohio; and in 1927, 27 percent in Iowa. The total tax burden of the farmers is estimated at more than a billion dollars annually, and taking into consideration the fact that little if any of this can be passed on or shifted it is probable that no other industry in the United States sustains such a heavy burden of taxation as that of agriculture."

[27] It is significant that the most violent uprisings of the present depression occurred in those farm communities where homes were being put on the block for failure to pay either mortgages or back taxes.

[28] *McCulloch* v. *Maryland,* 4 Wheat. 316, 4 L.Ed. 579 (1819).

[29] National City Bank Bulletin, February, 1934, p. 21.

[30] Cf. Professor Simon E. Leland, "Tax Problems and a Tax Program for Real Estate," in The National Tax Association Bulletin, April-May, 1930, p. 200-3, 234-43: "That tax (the general property tax) has been so completely discredited from the standpoint of theory and of fact that it must be completely abandoned."

[31] Cf. Raymond E. Manning, "State Tax Legislation, 1933," The Tax Magazine, February, 1934, p. 63.

[32] Cf. ibid, p. 68.

[33] Arizona, Ch. 90, held unconstitutional in *Cox* v. *Stults Eagle Drug Co.,* Arizona, May 4, 1933, 21 P. (2nd) 914. California, Ch. 1020; Illinois, p. 938, p. 924, held unconstitutional in *Winter* v. *Barrett,* 352 Ill. 441, 186 N.E. 113 (1933); Indiana, Ch. 50; Michigan, H.B. 184; New Mexico, Ch. 73; New York, Ch. 281; North Carolina, Ch. 445; North Dakota, Ch. 261, rejected on referendum; Oklahoma, 1st Ex. H.B. 2; Oregon, Ch. 400, rejected on referendum, South Dakota, Ch. 184; Utah, Ch. 63, 2nd Ex. Ch. 20; Vermont, No. 240; Washington, Ch. 191; Minnesota, Ch. 213; Wisconsin, Ch. 470; West Virginia, 1st Ex. S.B. 1.

eleven states;[34] chain store taxes by seven states;[35] personal income taxes by six states;[36] corporate income taxes by five states;[37] gift taxes by two states;[38] oleomargarine taxes by two state;[39] boxing and wrestling taxes by two states;[40] and cigarette taxes by two states.[41]

Measures seeking to aid the property taxpayer take the form of provisions for the payment of delinquent taxes in installments,[42] the reduction or waiver of penalties and interest on taxes now delinquent,[43] the extension of time for the payment of current taxes,[44] and moratoria postponing sales for taxes.[45]

It was but natural that many of these laws, especially those providing for moratoria postponing sales for taxes, or extending the period of redemption, should have been attacked on the ground that they violated the contract clauses of the Federal and State constitutions. Thus, the West Virginia Supreme Court in the case of *Milkint* v. *McNeely*,[46] held that an act of 1932, extending the period of redemption of property sold for taxes for 1929, 1930, and 1931, impaired the obligation of contracts as against an individual purchaser at a tax sale, and therefore violated the contract clauses of the United States and West Vir-

[34] California, Ch. 101; Maryland, Ch. 324; New Hampshire, Ch. 62; Oregon, Ch. 397; Washington, Ch. 55; New Mexico, Ch. 55; Ohio, S.B., 372; South Dakota, Ex. Ch. 9; Texas, 1st Ex. H.B. 12; Michigan, No. 199; Delaware, S.B. 160; North Carolina, Ch. 373, 511, 545, 563.

[35] Florida, S.B. 171; Idaho, Ch. 113; Indiana, Ch. 271; Maine, Ch. 260; Maryland, Ch. 542; Michigan, H.B. 128; Minnesota, Ch. 213; Montana, Ch. 155; North Carolina, Ch. 445; West Virginia, H.B. 12; Wisconsin, Ch. 470.

[36] Alabama, No. 125; Montana, Ch. 83; Alabama, No. 169; Arizona, 1st Ex. Ch. 8; Kansas, Ch. 320; Minnesota, Ch. 405; Montana, Ch. 181; New Mexico, Ch. 85.

[37] Alabama, No. 169; Arizona, 1st Ex. Ch. 8; Kansas, Ch. 320; Minnesota, Ch. 405; New Mexico, Ch. 85.

[38] Oregon, Ch. 427; Wisconsin, Ch. 363

[39] Colorado, H.B. 337; Kansas, Ch. 321; Minnesota, Ch. 175.

[40] Texas, Ch. 241; Washington, Ch. 184.

[41] Arizona, 1st Ex. Ch. 18; Oklahoma, H.B. 299.

[42] Cf. Raymond E. Manning, "State Tax Legislation, 1933," National Tax Association Bulletin, Vol. XVIII, No. 7, April, 1933, p. 203: "Payment of delinquent taxes in installments is provided for in Arizona, Oregon, and South Dakota, and installment payment of current taxes is to be allowed in Arizona, North Dakota, Oregon, Vermont, Washington, and West Virginia." Cf. Minnesota, Ch. 121; New Jersey, Ch. 109; North Dakota, S.B. 328; Ohio, S.B. 42.

[43] Cf. Raymond E. Manning, ibid. "Penalties and interest on taxes now delinquent are waived or reduced in Kansas, Minnesota, North Dakota, Oklahoma, Oregon, South Dakota, and Washington."

[44] Cf. Roymond E. Manning, "State Tax Legislation, 1933," National Tax Association Bulletin, Vol. XVIII, No. 9, p. 261: "Extensions of time for paying taxes due during 1933 are granted by California, Ch. 100, Ch. 103; Florida, S.B. 1; Nebraska, H.R. 604; and by a South Carolina Act."

[45] Cf. Raymond E. Manning, ibid. "A moratorium postponing sales for taxes has been enacted by Minnesota, Ch. 98, and Ch. 337. By a Pennsylvania Act, courts are given power to stay writs of execution for the sale of real estate for taxes during the period ending March 31, 1935." Moratoria postponing sales for taxes have been enacted by Iowa, S.F. 90; Kansas, H.J.R. 18; and Washington, Ch. 53. Wisconsin Ch. 16 permits local units to extend the time for paying 1932 taxes.

[46] (W. Va. 1933) 169 S.E. 790.

ginia Constitutions. In the case of *Thompson* v. *Auditor General*,[47] the Supreme Court of Michigan held that a statute postponing tax sales was unconstitutional because it impaired the obligation of contract of holders of notes issued under a statute contemplating loans against delinquent taxes and creating a sinking fund consisting in part of the proceeds of tax sales.[48]

However, judicial notice was taken of emergency conditions by the Washington Supreme Court in the case of *State ex rel. Stiner* v. *Yelle*,[49] when the Court said: "The state is facing stark necessity. The legislature has earnestly endeavored to meet this critical situation. This law is perhaps not perfect. No tax law yet devised has been entirely fair and just to all in its practical workings. This is an emergency measure limited by its terms to a two year period. If it works injustice to some, it will be but temporary, and such temporary injustice, if any, must be borne for the common good."

A similar attitude was taken by the Minnesota Supreme Court in the famous mortgage moratorium case of *John H. Blaisdell* v. *Home Building & Loan Association*.[50] The following words indicate the stand of the Court: "Not only they, (the legislature) but the courts, must be guided by what is common knowledge. It is common knowledge that in the last few years land values have shrunk enormously. Loans made a few years ago upon the basis of the then going values cannot possibly be replaced on the basis of present values." And in a concurring opinion, Mr. Chief Justice Wilson states: "It follows that it is detrimental to the public interest for our people to lose their valuable lands, improved or unimproved, at a time when the banks are closed and when it is impossible to find any one who will make a mortgage loan."[51]

Sharp disagreement with this stand was taken by the South Dakota Supreme Court in the case of *State ex rel. Botkin* v. *Welsh*.[52] Refer-

[47] 261 Mich. 624, 247 N.W. 360 (1933). But see Raymond E. Manning, National Tax Association Bulletin, Vol. XVIII, No. 7, p. 203: "It may be of interest to note that the Michigan act referred to in last month's summary has been before the courts. On March 1, 1933, the Supreme Court of Michigan in *Thompson* v. *Auditor General*, held that the law impaired the obligation of contract and granted a writ of mandamus to compel publication of delinquent tax land notices. On March 2, 1933, the previous holding was reversed and the writ refused." The bank difficulties in Michigan during those hectic March days, might be assigned as a reason for this reversal.

[48] See *Lingo Lumber Co.* v. *Hayes*, (Tex. Civ. App., 1933) 64 S.W. (2d) 835 to the effect that the authority of legislature in exercise of its police power cannot be restricted by contracts between individuals or corporations or between individuals and municipal corporations.

[49] (Wash. 1933) 25 Pac. (2d) 91.

[50] (Minn. 1933) 249 N.W. 334, 86 A.L.R. 1507.

[51] Cf. *In Suring State Bank* v. *Giese*, 210 Wis. 489, 246 N.W. 556, 85 A.L.R. 1477 (1933), in which the Wisconsin Supreme Court said: "The court takes judicial notice of the fact that the present economic depression has not merely resulted in a serious dislocation of the value of real estate, but also in the almost complete absence of a market for real estate."

[52] (S.D. 1933) 251 N.W. 189.

ring specifically to the Stiner and the Blaisdell cases, supra, the Court said: "In another recent case an inference appears justifiable, from the language used, that economic emergency may render legislative action constitutional which, but for such emergency would not be constitutional. Manifestly, where the constitutional criterion of the validity of a legislative act is whether such act is reasonable or arbitrary, a fact question is invoked, and the social and economic situation becomes material. If the cases above mentioned mean to go further than this, however, and intend their language to give rise to an inference that legislative action which the Constitution clearly and definitely forbids may nevertheless be valid, if there is or seems temporarily to be a sufficiently urgent social need for that type of legislation, then, and to that extent, they promulgate a doctrine with which we cannot agree."

The stand of the Minnesota Supreme Court in the Blaisdell case was, however, affirmed and fully clarified by the United States Supreme Court in the case of *Home Building & Loan Association* v. *Blaisdell*.[53] The following words of Mr. Chief Justice Hughes are of special significance: "The states retain adequate power to protect the public health against the maintenance of nuisances despite insistence upon existing contracts * * * Legislation to protect the public safety comes within the same category of reserved power.[54] * * * The economic interests of the State may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts."[55]

And while a distinction may be drawn between tax moratorium cases and mortgage moratorium cases, the principles underlying both are so similar, that the decisions applying to the latter can with equal force be used as precedent for the former. And thus, have not only the various state legislatures taken cognizance of the desperate plight of the real property tax payers, but also the various courts of the land, including the highest, the United States Supreme Court.

It is quite clear that the basic American systems of taxation are inherently dependent upon the prosperity of the nation for their success, and that as the nation's economic structure breaks down,

[53] 78 L.Ed. (adv. 255), 54 S.Ct. 231, 88 A.L.R. 1487 (1934).

[54] Cf. *Chicago, B. & Q. R. Co.* v. *Nebraska,* 170 U.S. 57, 42 L.Ed. 948, 18 S.Ct. 513 (1898); *Texas & N. O. R. Co.* v. *Miller,* 221 U.S. 408, 55 L.Ed. 789, 31 S.Ct. 534 (1911); *Atlantic Coast Line R. Co.* v. *Goldsboro,* 232 U.S. 548, 58 L.Ed. 721, 34 S.Ct. 364 (1914).

[55] Also see *Grieb* v *National Bank of Kentucky's Receiver,* 252 Ky. 753, 68 S.W. (2d) 21 (1934). *Sewer Improvement Dist. No. 1 of Wynne* v. *Delinquent Lands,* (Ark. 1934) 68 S.W. (2d) 80 (1934), where it was held that constitutional provisions inhibiting impairment of obligation of contracts were not all inclusive, and arose no higher than the reserve power in the people. In *Milner* v. *Gibson,* 249 Ky. 594, 61 S.W. (2d) 273 (1933), the court held that legislation enacted under the police power is not invalid merely because of its incidental effect on contract.

the systems of taxation cease to function properly. This is true not only of the income tax, but of the real property tax, and as has been shown in the case of the latter, all efforts to collect revenue from those who lack the ability to pay, merely serve to accelerate the downward movement of business, and to result in increased poverty and insecurity. It therefore follows that all attempts toward the solution of modern tax evils must concern themselves with the problem of business cycles and depressions. For if the fluctuation of incomes, and of real estate values can be eliminated, the basic weakness of the income and the property tax will disappear.

With this conclusion, the statement of the second principle of modern taxation achieves a new importance and a deep significance. For if it is true that the prosperity of a nation is dependent for its continuation upon a proper and scientific system of taxation,[56] then it necessarily follows that a tax system in order to be successful must safeguard the smooth operation of the economic structure of the nation. Scientific taxation implies not merely the collection of revenue, but rather the guarantee that there will be a national income from which such revenue can be collected.

The problem confronting the tax expert thus becomes: "How can the smooth operation of the economic machinery of the nation be safeguarded?" And to solve this problem it is imperative to analyze the causes of economic dislocation. It is generally conceded today that among the fundamental causes for the present depression were: first, the failure of purchasing power to keep pace with producing power;[57] and second, the uncontrolled over-capitalization of American industry.[58] To quote at length from that excellent dissent of Mr. Justice Brandeis in the case of *New State Ice Co.* v. *Liebmann*:[59]

[56] This is the second new principle of taxation as indicated in the first paragraph of this article.

[57] Cf. Arthur B. Adams, "Trend of Business," 1932, p. 45; "In so far as this depression was brought about by a shortage of consumers' money income to purchase the goods which were produced, there was a general over-production in the sense that the public could not buy at prevailing prices all the goods which were produced. In other words, general over-production is purely a question of maldistribution of money income among the different economic classes of society." Cf. Henry Pratt Fairchild, "Profits or Prosperity," 1932, p. 83, "Discover the way to restore purchasing power and you have discovered the remedy for the existing depression. Find out how to maintain purchasing power and you have found out how to prevent depressions in the future."

[58] Cf. William Trufant Foster and Waddill Catchings, "Profits," 1925, p. 399: "As business expands and profits are thus realized, approximately half the profits are used to produce more goods. In fact, it is the established, approved, and under the present system the necessary, practice of the various industries to distribute only part of the realized profits and to use the rest, in one way or another, to increase capital. Thus the flow of goods which consumers must buy if business is to prosper increases more rapidly than the flow of money to consumers."

[59] 285 U.S. 262, 76 L.Ed. 747, 52 S.Ct. 371 (1932).

"The people of the United States are now confronted with an emergency more serious than war. Misery is wide-spread, in a time, not of scarcity, but of over-abundance. The long continued depression has brought unprecedented unemployment, a catastrophic fall in commodity prices and a volume of economic losses which threatens our financial institutions. Some people believe that the existing conditions threaten even the stability of the capitalistic system. Economists are searching for the causes of this disorder and are re-examining the basis of our industrial structure. Business men are seeking possible remedies. *Most of them realize that failure to distribute widely the profits of industry has been a prime cause of our present plight.* But rightly or wrongly, many persons think that one of the major contributing causes has been unbridled competition. *Increasingly, doubt is expressed whether it is economically wise, or morally right, that men should be permitted to add to the producing facilities of an industry which is already suffering from over-capacity. In justification of that doubt, men point to the excess capacity of our productive facilities resulting from their vast expansion without corresponding increase in the consumptive capacity of the people.* They assert that through improved methods of manufacture, made possible by advances in science and invention and vast accumulation of capital, our industries had become capable of producing from 30 to 100 per cent more than was consumed even in day of vaunted prosperity; and that the present capacity will, for a long time, exceed the needs of business. *All agree that irregularity in unemployment—the greatest of our evils—cannot be overcome unless production and consumption are more nearly balanced.* Many insist there must be some form of economic control." (Italics by writer.)

In agreement with this view is that of President Roosevelt when he writes:

"I believe that we are at the threshold of a fundamental change in our economic thought. I believe that in the future we are going to think less about the producer and more about the consumer. Do what we may to inject health into our ailing economic order, we cannot make it endure for long unless we bring about a wiser, more equitable distribution of the national income."[60]

The relationship between national purchasing power and national prosperity should be quite obvious. The modern industrial structure, based upon the system of mass production, is dependent upon steady markets for smooth continuous operation.[61] In the case of the United States, these markets are predominantly domestic, for not even in the boom period of 1928 did foreign consumers purchase more than 7%

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[60] "In Looking Forward," the Chapter on "Need for Economic Planning." Cf. J. George Frederick, "A Primer of 'New Deal' Economics," p. 272, 1933.

[61] Cf. Ralph Borsodi, "The Distribution Age," p. 22, 1927. "Today it (marketing) is a problem which exceeds in importance that of production. The greater part of the average manufacturer's thought is engrossed with this problem, and a considerable portion of the manufacturer's total expenditures is today devoted to marketing his production."

of the total production of the United States.[62] However, because of an inequitable distribution of national income, domestic consumers were not able to dispose of national production over any long period of time, as the following figures will show. In 1929 the national income *produced* was $83,037,000,000. In the same year the national income *paid out* was only $81,040,000,000.[63] Thus, in this year alone, had all income earners spent all their income in purchasing goods, a surplus of almost $2,000,000,000 in unpurchased goods would have remained.

But the important point is that income earners do not spend all their income in purchasing goods. For example, in 1929, more than 12% of the national income was distributed to less than 100,000 people.[64] A purchasing power of $9,547,000,000 was given to approximately 0.08% of the population of the United States. The lowest income in this group was $25,000.[65] It is at once obvious that people getting incomes in excess of $25,000 do not spend all of this money in the purchase of the necessities or luxuries of life. In fact, it is doubtful whether even $5,000,000,000 of this amount was used as purchasing power. The balance of $4,547,000,000 was probably invested in new industries, buildings, or government securities. In other words, this inequitable distribution of income not only increased the unpurchased surplus of goods by about $4,500,000,000, but also increased the amount of capital available for investment in excess productive machinery. Purchasing power was thus severely curtailed; producing power was unnecessarily increased.

These statistics, however, refer only to personal incomes in excess of $25,000. They do not apply to corporate incomes or savings. It is significant to note that annual corporate savings for 1929 were estimated as being $2,320,000,000.[66] All told, it is highly probable that the amount of national income in 1929 which was not used for purchasing

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62 In 1928 exports reached the total of $5,128,356,000. Cf. United States Department of Commerce, Report for 1930. Cf. "Recent Economic Changes in the United States," Volume II, Chapter XI, p. 749, 1929: "The value of our visible exports makes up approximately 10% of our domestic production of *exportable commodities.* Of our total production, the percentage is much less."

63 Report of The National Bureau of Economic Research, Inc., Jan. 26, 1934. The discrepancy of almost $2,000,000,000 between produced and paid out income is explained by the fact that this amount was not distributed or withdrawn from productive employment, but remained as an increase of productive capacity.

64 National Industrial Conference Board, Vol. 60, p. 480-1, Dec. 20, 1931.

65 Cf. ibid. In 1929, 63,404 people received incomes of $25,000 to $50,000, the total being $2,582,000,000. 23, 949 received incomes of $50,000 to $100,000, the total being $1,948,000,000. 6,340 received incomes of $100,000 to $150,000, the total being $912,000,000. 5,268 received incomes of $150,000 to $300,000, the total being $1,267,000,000. 1,622 received incomes of $300,000 to $500,000, the total being $720,000,000. And 1,471 received incomes in excess of $500,000, the total being $2,118,000,000.

66 Frederick C. Mills, "Economic Tendencies in the United States," 1932, p. 425.

power, but rather was reinvested in producing power was in excess of \$10,000,000,000, or more than 12% of the national income.[67]

American industry was thus placed in the position where it had to find new markets for its growing surplus of unpurchased goods. To increase domestic purchasing power, industry hit upon the device of installment selling, little realizing that it but mortgaged the purchasing power of tomorrow to increase the sales of today. Installment selling expanded and swelled until in 1925 the total volume of retail installment sales was over \$5,000,000,000.[68] And although statistics are lacking for the total volume of installment sales in the halcyon days of 1928-29, it is probable that new high totals were reached before the crash. Installment selling was a temporary measure; it served to postpone the depression; but it also served to make it more severe.

In addition, American industry sought to conquer foreign markets. But success in this field was merely illusory for although in the period from 1922 to 1929 America enjoyed a favorable balance of trade amounting to more than \$7,000,000,000, yet during that same period it was necessary for American bankers to invest more than \$8,000,000,000 in foreign lands in order to supply foreigners with a sufficient purchasing power to buy American made goods.[69] Today, it is highly doubtful whether more than a fraction of this amount will be repaid; and with the increasing nationalism and the expanding productive capacities of various foreign lands it is becoming quite clear to American exporters that the golden days of foreign trade have definitely passed.

At this point, the question will arise: how can the scientific use of a system of taxation provide an adequate market for the American producer? And in answering this question, the writer will seek to show first, how the unscientific use of taxation systems in the past decreased American purchasing power, and second, how the scientific use of these same systems can increase domestic purchasing power.

Perhaps few tax systems have shown less regard for the importance of domestic purchasing power than the general property tax. William Raymond Green, in "The Theory and Practice of Modern Taxation," 1933, p. 233 writes:

"In imposing the tax on real property the question of ability to pay is not taken into consideration, nor is there any practical way of fixing the tax upon that basis as long as it is measured by the value of the

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[67] Cf. ibid, p. 427.

[68] "Recent Economic Changes in the United States," 1929, Vol. I, p. 390.

[69] Cf. Arthur B. Adams, op. cit., p. 13. "The eight billion dollars of private loans which were made through American bankers to foreign governments and foreign citizens from 1922 to 1929 supported our large favorable balance of trade after 1921. This huge favorable balance of trade provided a market for a large part of the surplus goods which America was able to produce."

property. The real property taxed may not only produce no revenue but may actually be from year to year decreasing in value and causing a steady loss to the owner from the price he paid for it. If the property is a laborer's cottage, except in the few States which provide some exemptions in cases of this kind, and the owner is barely able to make a meager living for himself and family, it is heavily taxed just the same and the social as well as the economic effect is bad * * *

"The tax on farm land therefore, so far as the farmer is concerned, must come out of the farmer's income without in any way being proportioned to it. Statistics show that in most States it takes from 30 to 50 per cent of his net income from the land taxed, and in instances where there has been a partial or nearly complete failure of crops, it has been known to take all of his net income or more to pay the tax."

Nor is the effect of the sales tax any better. It is agreed by most economists, that the incidence of this tax is invariably shifted upon the ultimate consumer,[70] and in view of the growing popularity of the sales tax in the United States, it is most important to realize, that of all systems of taxation, the sales tax is the one which most drastically strikes at the purchasing power of the people. Robert Murray Haig, Professor of Political Economy at Columbia University, writing in the National Tax Association Bulletin for November, 1932, Vol. XVIII, No. 2, p. 34, voices the reaction of the scientific economist when he states: "So far as I am aware serious students of public finance are unanimous in the opinion that sales taxes are regressive rather than progressive in their tendency and effect * * * To propose the substitution of general sales taxes for taxes on real estate as a measure of relief for the small man is an insult to intelligence and an affront to common sense."

The income tax, therefore, remains as the one system of taxation which can be utilized to increase domestic purchasing power. But its value as a measure of social control was never properly appreciated until the present depression. As a matter of fact the National Administrations of 1921 to 1932 were blind to the possibilities of the income tax. President Coolidge, in his Lincoln Day address at New York, February 12, 1924, said:

"I agree perfectly with those who wish to relieve the small taxpayer by getting the largest possible contribution from the people with large

[70] William J. Shultz, "American Public Finance and Taxation," 1931, p. 297: "The effect of a general tax on sales, then, is to introduce an element of acceleration into the decrease of purchases of each commodity over and above what would be indicated by the elasticity of the original demand for that commodity." Cf. William Raymond Green, "The Theory and Practice of Modern Taxation," 1933, p. 130, "One of the principal arguments against a general sales tax is that it is not based upon ability to pay, but on the contrary levied largely upon those that are least able to pay. It is also asserted that the tax is shifted or passed on as a general rule to the consuming public and therefore is a tax on consumption."

incomes. *But if the rates on large incomes are so high that they disappear, the small taxpayer will be left to bear the entire burden.* If, on the other hand, the rates are placed where they will produce the most revenue from large incomes, then the small taxpayer will be relieved. The experience of the Treasury Department and the opinion of the best experts place the rate which will collect most from the people of great wealth, thus giving the largest relief to people of moderate wealth, at not over 25 per cent." (Italics by writer.)

And in accordance with this view, tax rates on high incomes were slashed to the lowest possible standards. Quoting from William Raymond Green, supra,[71]

"By the revenue bills of 1926 and 1928 the taxes of all those who were still left upon the lists were greatly reduced through a plan under which those in the higher brackets received much the greater amount of reduction in tax, although those in the lower brackets generally received a greater proportionate reduction * * *[72] The average income tax paid in 1918 by the individuals having an income of $1,000,000 and over was $1,326,645.51. In 1928, the average was $362,309.61."

Thus whereas the Act of 1918 imposed a maximum normal tax of 12% and a surtax of 65%, the Act of 1926 fixed the maximum normal tax at 5% and the maximum surtax at 20%. And while the policy of the National Government in freeing the small income earner of his burden of taxation was sound and scientific economics,[73] there is no doubt but that its action in reducing the tax rates on huge incomes merely served to accelerate the inequitable distribution of national wealth. However, since 1930, due to an increased demand for Federal expenditures, and due to the decreasing Federal receipts, income tax rates were brought to higher levels. By the Act of 1932, the maximum normal tax was fixed at 8% and the maximum surtax at 55% upon incomes in excess of $1,000,000. Under the provisions of the new 1934 Act, the rates on incomes of less than $30,000 are being slightly reduced, while the rates on incomes of more than $30,000 are being slightly increased. A proposed 10% emergency super-income tax sponsored by Senators La Follette of Wisconsin and Couzens of Michigan, was rejected by an overwhelming majority of 282 to 77 in the lower House.

At the present time, the Roosevelt Administration has recognized to a limited degree the possibilities of increasing national purchasing power by Federal taxation and Federal programs. True, while the in-

[71] Ibid, p. 51.

[72] Thus the average rate of tax on incomes from $2,000 to $3,000 was 0.98% in 1918, and 0.21% in 1928; on incomes of $1,000,000 and over it was 64.65% in 1918, and 16.70% in 1928.

[73] By the Act of 1924, Congress removed nearly 2,000,000 small taxpayers from the rolls.

come tax has not been increased to the extent that certain liberals would desire, nevertheless the Federal emergency expenditures of $6,-357,000,000 outlined for 1934,[74] indicate that the Roosevelt Administration intends to utilize this method of social control to a greater degree than ever before practiced.

The comparatively mild use of the income tax to readjust the inequitable distribution of national income, may be explained by the fact that the Federal Government is relying upon private industry to accomplish this necessary readjustment by its own voluntary action. The very spirit of the National Industrial Recovery Act is that of cooperation with private industry, rather than that of compulsion by the Federal Government.[75] Today, many regard the use of Federal expenditures to increase purchasing power, as being a temporary expedient.[76] However, expected improvements in economic conditions have not been realized. At the time of this writing, the number of unemployed is estimated as being anywhere from 8,000,000 to 10,000,000.[77] Wage increases have been followed by price increases, which in many cases were greater than the original wage increases justified.[78] And it is being charged by a growing number of critics that the cost of living is advancing more rapidly than the purchasing power of the masses of people. Moreover, it is claimed that the technical improvements made in the technique of production have been so great since 1930, that even if prosperity were to return, at least 7,000,000 men would remain unemployed.[79]

The following quotation from The National City Bank Bulletin of

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[74] Cf. National City Bank Bulletin, February, 1934, p. 20, 21.

[75] Cf. President Roosevelt, Message to Congress, accompanying Industrial Recovery Bill, May, 1933: "My first request is that the Congress provide for the machinery necessary for a great cooperative movement throughout all industry in order to obtain wide re-employment, to shorten the work week, to pay a decent wage for the shorter week and to prevent unfair competition and disastrous overproduction."

[76] Cf. National City Bank Bulletin, February, 1934, p. 17: "Of course, the effect of public expenditures upon trade can only be in the nature of a temporary stimulus or stopgap. When the time comes, as it must, to discontinue them, the trade situation will depend once more upon the purchasing power created by the production and exchange of goods; and the important question then will be whether sound economic adjustments have been made, and price relationships that will promote production and exchange restored."

[77] Cf. National City Bank Bulletin, May, 1934, p. 71: "There are still other workers, 8,000,000 or more in number, largely in the capital goods and service industries, who have little employment or none at all and are living upon the slender resources of governmental assistance." The American Federation of Labor estimates that approximately 10,000,000 men are still unemployed.

[78] Cf. National City Bank Bulletin, November, 1933, p. 166: "it has been necessary to take into account that these increases in money income have been offset in part by the reduced purchasing power of the money, due to the higher prices for the goods bought; and that consumers whose incomes have not had any compensating increase have had their purchasing power diminished."

[79] Automatic factories, typified by the A. O. Smith Plant of Milwaukee, have multiplied during the last three years.

April, 1934 is typical of the attitude of modern business men and discloses the fallacy in their approach to the problem before them:

"Business men know, however, that increased wages and shorter hours mean higher prices, and they are fearful of the effect of price advances upon consumption in the present state of the markets and of reduced buying power."

Apparently, these men do not realize that the only way to increase buying power is by raising wages and cutting hours *without increasing prices*. They fail to understand that the only scientific way to recovery is by means of a policy which takes profits and converts these profits into purchasing power, rather than into producing power.

Consequently, the following tax program is suggested as a means whereby that portion of national income which formerly was used to increase producing power, can be converted into a source for new purchasing power:

First: a new heavy tax upon all *unspent* income of more than $25,000. The income earner would be given the choice either of spending this income upon articles of consumption, or else of forfeiting a major part of it to the National government, in the form of a tax. The income earner would not be permitted to invest this income in productive capital, except in certain necessary instances.

Second: the Federal Government would establish a permanent public works program capable of employing anywhere from 10,000,000 to 15,000,000 people. This program would be financed by the receipts from the new heavy income tax. During periods of prosperity, as private profits and private incomes would swell, this Federal program would increase accordingly, thereby giving to the American people the necessary increase in purchasing power. It would be the basic purpose of this program to accomplish, first, the proper distribution of purchasing power among the American people, and second, the construction of non-productive necessary public improvements.

The effect of the first provision above stated would be either the increase of purchasing by the wealthy income classes, or else the flight of much of the income affected to tax-exempt government securities. If the demand for these tax-exempt securities became too great, the Government could convert old issues into new ones bearing much lower interest rates, thereby greatly reducing one field of National expenditure. Furthermore, the Goverment could use these securities to finance public works programs in the event the receipts from the new taxes should prove insufficient. And finally, the Government would discourage investment in new productive enterprises, at the same time gaining control over such amounts of capital as to encourage the establishment of those new industries considered necessary for the welfare of the nation.

The effect of the second provision above stated would be to supply a permanent ever-expanding domestic market for American industry. And this guarantee of steady markets would afford industry a security which it cannot enjoy under the present system, and would to a large extent, remove the necessity for building up huge reserves with which to weather depressions.

In conclusion, it my be stated, that a survey of the present system of taxation discloses the absence of any major attempt to use taxation as a means of effecting a proper redistribution of purchasing power. The millionaire who is forced to pay over a large portion of his income to the government is given no assurance that by such action he is safeguarding his own welfare. For all he knows, adverse business conditions may wipe out his entire capital within the next twelve months. And therefore, because he desires security, because he fails to see where his payment of taxes will give him this security, he employs skilled attorneys to find loopholes in the Federal and state tax laws.

Consequently, it is obvious that what is needed is a system whereby the payment of huge income taxes will guarantee, to a reasonable extent, the receipt of large incomes in coming years. Taxpayers must be given the assurance that the funds they pay into the National Treasury are to be used to maintain a high level of prosperity in the United States. Taxpayers must be made to feel that the payment of taxes is a form of individual as well as national insurance, and that tax evasion is not only a crime against society, but also a crime against self.

The present situation throws a challenge to the modern lawyer-economist—a challenge to escape from the present muddle of depression leading to tax-evasion, and tax-evasion leading to depression; a challenge to erect a new, efficient, and scientific structure of taxation, which by its own operation will automatically safeguard the operation of the modern industrial machine, a system of taxation which will offer such apparent benefits to the individual, as to cause him to work for the welfare of society.