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Joseph Bankman
Stanford University

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THE POLITICS OF THE INCOME TAX

*Joseph Bankman**

DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX, 1861-1913. By *Robert Stanley*. New York: Oxford University Press. 1993. Pp. xiv, 331. \$45.

The modern state allocates wealth through public law, direct expenditures, and administrative rulemaking. It is the power to tax, though, that offers the state its last and most promising means to affect the distribution of wealth. The state can reallocate wealth, not only through the tax rate structure, but also through tax incentives and disincentives that favor some sectors over others. In light of the pervasive distributional role of the tax law, one might expect that political theory would play an important role in tax scholarship. That, however, is not the case. Legal tax scholarship is generally written by former tax lawyers, aided by a handful of economists. Few legal tax scholars have advanced degrees or serious scholarly interests in history, political science, anthropology, or sociology. Consistent with their background and expertise, law professors who write on tax spend most of their time on two tasks. The first task is to provide intelligible descriptions of the increasingly complex tax law. The second task is to ferret out economically similar transactions that — often for no good reason — generate dissimilar tax consequences. An article written in the latter vein might point out that interest realized from money market accounts is fully taxed, while “interest in disguise” realized through other investments is taxed at low effective rates or escapes tax altogether.¹

At some level, of course, all writing is political. Legal scholars who have served in government and worked on tax legislation sometimes write of the broad political forces that affect such legislation.² Legal scholars who point out inconsistencies in the tax law often recommend ways in which the law ought to be changed, and those recommendations are often based on norms, such as efficiency or the so-

* Professor of Law and Helen L. Crocker Faculty Scholar, Stanford University. A.B. 1977, University of California, Berkeley; J.D. 1980, Yale. — Ed. The author wishes to thank Barbara Fried David and David Linges for their helpful comments and suggestions.

1. See, e.g., Daniel I. Halperin, *Interest in Disguise: Taxing the “Time Value of Money,”* 95 YALE L.J. 506 (1986).

2. See, e.g., Michael J. Graetz, *Mandating Employer Health Coverage: The Big Mistake*, 60 TAX NOTES 1765 (1993); Michael J. Graetz, *Revisiting the Income Tax vs. Consumption Tax Debate*, 57 TAX NOTES 1437 (1992) (a politically savvy policy analysis by an academic who served as Assistant Secretary of Tax Policy in the Bush administration).

called Haig-Simons definition of income, that are laden with political content. Few legal scholars, however, wish to spend time analyzing the political dimensions of those norms or addressing in other ways the politics of the income tax. The following play little or no role in legal scholarship: data on the before- and after-tax distribution of wealth or the fluidity of that distribution over the individual life cycle or across generations; the writings of Locke, Bentham, or more modern political theorists on the just distribution of wealth; and political, sociological, or anthropological studies of the attitudes of individuals toward the tax or expenditure side of government. Only recently has positive political theory, in the form of economics-influenced public choice theory, gained a serious foothold in legal tax scholarship.³

The present focus of legal scholarship is not necessarily bad. The tax law is enormously complicated, and inconsistencies within the law that are not brought to light can cost the fisc billions of dollars and distort behavior in ways that are undesirable under any political theory. Moreover, by focusing with increasing economic sophistication on the operation of the tax law, legal tax scholars are doing what they do best. One might therefore applaud a division of labor under which legal tax scholars confine themselves to the nuts and bolts of the system and leave it to those in the humanities and social sciences to provide insight into the larger political issues.

Unfortunately, the same complexity that keeps legal scholars tied up with the technical side of the tax law has discouraged other scholars from giving more than cursory attention to the tax system. In general, only economists have shown much interest in the politics of tax, and much of that interest has been evinced by the rather small

3. Compare Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913, 926-62 (1987) (employing public choice theory to develop a contractual model of the tax legislative process in order to explain the increasing role of tax reform) and Barry L. Anderson, Student Paper, *On the Likelihood of Sensible Tax Reform*, 4 AM. J. TAX POLY. 81, 90-105 (1985) (discussing both the public interest and public choice models of the legislative process and the problems posed for meaningful tax reform) with Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 64-111 (1990) (arguing that Doernberg and McChesney ignore the symbolic importance of legislation to voters, legislators' ideology, and other factors); Karla W. Simon, *Tax Simplification and Justice*, 36 TAX NOTES 93, 99-100 (1987) (noting that models of tax policy legislative processes must recognize the difficulty of drawing the line between the public interest and a special interest) and Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165, 1166 (1993) (arguing that tax subsidies are often better mechanisms than direct expenditures because tax institutions "are less susceptible to interest group capture and possess greater legitimacy").

For works examining problems with tax reform written prior to the popular rise of public choice scholarship in law, see generally JOSEPH A. PECHMAN, *FEDERAL TAX POLICY* (1977); and Stanley S. Surrey, *The Congress and the Tax Lobbyist — How Special Tax Provisions Get Enacted*, 70 HARV. L. REV. 1145 (1957).

For a discussion and critique of public choice theory, see generally Daniel A. Farber & Philip P. Frickey, *The Jurisprudence of Public Choice*, 65 TEXAS L. REV. 873 (1987); *Symposium on the Theory of Public Choice*, 74 VA. L. REV. 167 (1988).

group of economists who have served in government and worked on tax legislation.⁴ Excluding the contributions of this group and a smattering of works produced by policy institutions such as the Brookings Institute, it is perhaps fair to say that the politics of the income tax has been the subject of only one modern book-length study — John F. Witte's *The Politics and Development of the Federal Income Tax*.⁵ Witte provides in a single book much of what one might mean by the political study of the income tax. Witte reviews prescriptive theories of taxation, the changing public attitudes toward tax, the probable economic effect that income tax has on the distribution of wealth, and the politics leading up to major developments in the tax law.

Witte concludes — contrary to the findings of more cynical public choice theorists — that our tax system reflects popular will, or at least popular will as shaped by the pressures of pluralist politics. According to Witte, legislative deviations from a neutral income tax (tax expenditures) seldom inure to narrowly defined, wealthy special interest groups. Instead, “in terms of revenue, the tax expenditures that count are those with widely endorsed and solid justifications, long histories, and large potential constituencies,” such as the nontaxation of employer-provided health insurance.⁶ As far as the effects of the tax law on the distribution of wealth, Witte finds that the law is about as progressive as public opinion polls show the voters desire.⁷

Given the paucity of writing in this area, one welcomes the addition of a new, full-length book on the politics of the income tax: Robert Stanley's *Dimensions of Law in the Service of Order: Origins of the Federal Income Tax, 1861-1913*,⁸ published last year by Oxford University Press. Stanley's book mirrors the structure of Witte's: both books examine the cause and effects of tax legislation and offer perspectives on the state of current tax law. In tone and substance, however, it is hard to imagine two more dissimilar scholarly efforts.

Stanley is both a lawyer and a historian, and his work shows the mark of scholarship in both fields. In law, Stanley has been influenced by the critical legal studies movement, and he takes from that move-

4. In general, the scholarship produced by this group of policymaking economists has been quite good. See, e.g., DAVID F. BRADFORD, *UNTANGLING THE INCOME TAX* (1986); C. EUGENE STEUERLE, *THE TAX DECADE* (1992).

5. JOHN F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* (1985).

6. *Id.* at 285-88.

7. *Id.* at 360. The fact that the law mirrors public desire does not mean, to Witte, that all is well with the income tax. The political sway of large, organized constituencies precludes the type of “pure” income tax Witte himself favors — a broad-based comprehensive income tax with few or no exceptions. Witte sees in the present tax a patchwork of exceptions that threatens the ability of the government to raise revenue, raises compliance costs, and retards any hopes that the law may be used to redistribute significant amounts of wealth someday. *Id.* at 59-63, 369-79.

8. Robert Stanley is Associate Professor of Political Science, California State University, Chico.

ment the belief that the function of legal doctrine and reform is often symbolic rather than substantive. Stanley does not subscribe to other beliefs often associated with critical legal studies, such as the belief that law is radically indeterminate. In history, Stanley follows in the path of Gabriel Kolko, James Weinstein, Theda Skocpol, and others who offer a revisionist — though by now somewhat established — view that the ostensible reforms of the Progressive Era had little substance and are best described as shields used to deflect attacks on the prevailing order.⁹

Stanley argues at the outset of *Law in the Service of Order* that the few scholars who write on the income tax have taken a Panglossian view of their subject (p. 3). By and large, Stanley argues, the income tax has been seen as the electorate's civic-minded attempt to bring about a modicum of economic justice. For the generation of scholars writing before 1950, that view was part of a broader conception of Progressive-Era politics as a triumph of reform over plutocracy. For a more recent generation of pluralist scholars, that view represents an exception to the conception of the state as a "bumptious set" of contending special interest groups (p. 8).

Stanley's own view of the income tax is considerably darker. The central thesis of *Law in the Service of Order* is that the income tax was adopted to shore up the position of statist or centrist capitalists — a loose, and unfortunately ill-defined, group consisting at its core of the wealthy and of members of an activist state. The purpose of the tax was to sap the strength of the left with the rhetoric rather than the reality of economic justice, and in that purpose the tax was successful (pp. 13-14).

Stanley's book is organized chronologically around the major developments during the period of his study. In support of his thesis, Stanley presents substantial evidence that the income tax was the brainchild of the establishment. The tax was introduced and — after various setbacks — reintroduced by centrist politicians. Unlike the inheritance tax, the income tax was not a major goal of the left.¹⁰ Indeed, at one point the tax was most vociferously supported by conservative political economists, who saw a single-rate income tax as a benign alternative to the constant state intermeddling inherent in the complex and ever-changing tariff system. Consistent with his belief

9. See GABRIEL KOLKO, *THE TRIUMPH OF CONSERVATISM* (1963); JAMES WEINSTEIN, *THE CORPORATE IDEAL IN THE LIBERAL STATE* (1968); Theda Skocpol, *Bringing the State Back in: Strategies of Analysis in Current Research*, in *BRINGING THE STATE BACK IN 3* (Peter B. Evans et al. eds., 1985); Theda Skocpol, *The Limits of the New Deal Systems and the Roots of Contemporary Welfare Dilemmas*, in *THE POLITICS OF SOCIAL POLICY IN THE UNITED STATES* 293 (Margaret Weir et al. eds., 1988). See generally Daniel T. Rodgers, *In Search of Progressivism*, *REVIEWS AM. HIST.*, Dec. 1982, at 113.

10. For a contrary view of the importance placed on the income tax by the left, see JAMES T. KLOPPENBERG, *UNCERTAIN VICTORY: SOCIAL DEMOCRACY AND PROGRESSIVISM IN EUROPEAN AND AMERICAN THOUGHT, 1870-1920*, at 355 (1986).

that it is the rhetoric, rather than the actual effect, of the tax that is significant, Stanley focuses considerable attention on the language used by participants in the tax debates and the way in which the tax was portrayed in the popular media. *Law in the Service of Order* is studded with quotations from speeches and writings of nineteenth-century politicians and commentators. This, together with the ambitious nature of Stanley's enterprise and the counterintuitive nature of some of the facts he has unearthed, makes *Law in the Service of Order* a good read.

Unfortunately, Stanley is ultimately unsuccessful in persuading at least this reader of the merit of his central thesis: that the political history of the income tax is best understood as the wealthy co-opting both the left and the less-privileged classes through the rhetoric of reform. Stanley's account persuasively establishes that the federal income tax at most effected, and effects, a moderate redistribution of wealth — a description few would dispute. But whether, as Stanley claims, there is a huge gap between that "incarnate historical reality" and the "apparently democratic promise of income taxation" (p. 4) that needs explaining depends, in the first instance, on what one takes that "apparent democratic promise" to be. Stanley's own answer — resting on a complicated set of factual and normative premises not always well developed — is that the tax ought to have been, and ought to be, progressive enough to alter significantly the distribution of wealth; that the left and the masses shared that position; and that the rhetoric of the tax's supporters deliberately misled them into believing that the tax would achieve the goal of equitable distribution (pp. 13-14). Granting his premises, it is hardly surprising that Stanley concludes the tax was, and is, little more than a sham to distract the non-privileged classes from their true goals.

Each of those premises is, however, at best debatable. Consider, for example, the first modern income tax, adopted in 1862 and allowed to expire a decade later. Stanley begins his analysis of this tax with a long excerpt of a speech given by one of its chief supporters, Senate Finance Committee Chairman John Sherman. In the typical grandiloquent style of the age, Sherman argued that the tax was necessary to redress the injustice of the regressive tariff system:

We tax the tea, the coffee, the sugar, the spices the poor man uses. We tax every little thing that is imported from abroad, together with the whiskey that makes him drunk and the beer that cheers him and the tobacco that consoles him. Everything that he consumes we call a luxury and tax it; yet we are afraid to touch the income of Mr. Astor. Is there any justice in that?¹¹

Sherman went on to give other justifications for the tax. It was supported by historical precedent, did not seriously threaten the sys-

11. P. 19 (citing CONG. GLOBE, 41st Cong., 2d Sess. 4715 (1870)).

tem of private property, and, finally, was necessary to quiet the masses: “[Y]ou will hear clamor coming from the mass of the people who will complain of injustice and wrong, and their voice, although not often heard in the way of petitions, when it comes to you is more mighty than the waves of the sea.”¹²

In his exegesis of the passage, in a chapter entitled “Forestalling the ‘Popular Clamor,’” Stanley concludes that it is the last of Sherman’s two arguments that captures the true purpose behind the adoption of the tax: to quiet dissent without relinquishing the privileges of the existing order (pp. 15-58). As an exercise in internal textual interpretation, Stanley’s reading seems at least contestable. Perhaps in using a metaphor in the close of his speech, to link the voice of the masses to the swelling of the sea, Sherman meant to imbue the position of the former group with the majesty of the latter force and to suggest that the injustice of the existing law constituted a sin against nature. More importantly, there is no obvious internal reason to privilege the last part of the speech, whatever its interpretation, over the first part of the speech, in which Sherman offered a seemingly heartfelt description of the need to relieve the poor of excessive taxation. Stanley offers no other significant evidence as to Sherman’s motivation and virtually no evidence as to the motivation of anyone other than Sherman.

Stanley shows that the Civil War tax did not appreciably change the distribution of wealth. High exemption levels removed tax liability for all but about one percent of the population (p. 40), the tax rate never exceeded ten percent (p. 41), and the tax never raised more than nineteen percent of revenue (p. 42). Given the more limited goals set forth by Sherman, however, the tax was successful: by raising additional revenue through an income tax paid only by the very wealthy rather than a regressive tariff, the tax significantly changed the progressivity of the tax system.

A key element of Stanley’s thesis is that the rhetoric rather than substance of the income tax helped forestall dissent. Stanley presents no evidence, however, to suggest that the public perceived the income tax to be anything other than it was. Congress passed the tax during the Civil War as a means of funding the war. It seems unlikely that the masses saw redistribution of wealth as an intended purpose or probable effect of the tax.

For the most part, Stanley’s analysis of the role of the income tax during the half century following the Civil War is subject to the same criticism. The tax measures passed in 1894 and 1913 never seriously affected the distribution of private wealth; however, again due to high exemption levels, the taxes were quite progressive and were large enough, relative to other taxes, to alter the distribution of the aggre-

12. P. 22 (citing CONG. GLOBE, 41st Cong., 2d Sess. 4716 (1870)).

gate tax burden. Again, Stanley presents relatively little evidence of legislative intent or the way in which the taxes were perceived by the left or the poor.

As its subtitle suggests, *Law in the Service of Order* concentrates on the development of the income tax prior to World War I. In the last chapter, however, Stanley brings his analysis up to the present day (pp. 248-57). Stanley acknowledges that, during this century, the income tax has grown to have an increasingly large economic impact and a smaller symbolic or rhetorical role. However, Stanley still finds the tax law insufficiently redistributive, and, once again, he places the blame on the influence of centrism. According to Stanley, "the course of the modern tax reflects the same processes that originated it: the centrist use . . . to preserve, rather than to change, the conditions of power" (p. 256). "[T]he best explanation of modern income taxation and its relationship to the organization of wealth and opportunity," writes Stanley, "is not that an apparently pluralist system has consistently failed in its efforts toward long-term reform, but, rather, that a genuinely centrist system has consistently succeeded in preventing it" (p. 257).

It is difficult, from these and other statements, to understand the method by which Stanley believes centrism has succeeded in thwarting reform. Perhaps Stanley believes the rhetorical dimension in tax, while diminished, is still present and that this dimension misleads voters and prevents reform. If this is Stanley's argument, one wonders what he makes of the evidence, cited by Witte,¹³ that the tax law reflects public desires and that the law is as progressive in actual effect as the public wishes. At one point, Stanley suggests that the public understands and approves of the present tax law, but only because it has been misled into doing so.¹⁴ The tax law, in other words, is now the product rather than the cause of false consciousness. Unfortunately, Stanley does not develop this argument in any detail.

Stanley's book is animated in part by his belief that the tax law ought to have been and ought now to be more progressive than it is. At no point in his book, though, does Stanley explicitly argue the merits of that animating belief. Instead, *Law in the Service of Order* supports the goal of greater redistribution indirectly, by impugning the process by which we arrived at our present rate structure. One can hardly blame Stanley for using the tools at his disposal to address the issue. Ultimately, though, one suspects that the case for a more redistributive tax-transfer system is better argued as a matter of policy rather than process. Such an argument might begin with a portrait of the existing distribution of wealth. One could not hope to provide

13. See WITTE, *supra* note 5, at 339-64.

14. Pp. 250-57 (suggesting that the modern income tax has lost much of its symbolic function and that federal entitlement programs have assumed that role).

such a portrait without taking sides in numerous debates within the relevant literature. There is no debate, however, over the proposition that, as an absolute measure and relative to other developed nations, there is a wide gap between the wealthy and the poor in this country.¹⁵ Moreover, there is no significant trend in the past fifteen years toward a more equal distribution of national wealth.¹⁶

One might then attempt to articulate more formally the moral theories or intuitions that underlie our unease with the present distribution of wealth. In the past, those who have argued for redistribution, including this reviewer, have relied on welfarist theories of justice.¹⁷ These theories assume a dollar is more valuable to the poor than the wealthy; they assume redistribution reduces the misery of the poor and, notwithstanding the fact that the wealthy are worse off, increases social welfare. One might instead approach the issue through various equality-based theories of justice, focusing perhaps on the relationship between the distribution of wealth and the desiderate of equal opportunity or equal access to basic goods.¹⁸

Finally, one might examine the role of the tax system in redistributing wealth. High tax rates reduce savings and work effort, though commentators often overstate the extent of this reduction.¹⁹ It may be better, perhaps, to have healthy but proportionate taxes and transfer programs aimed directly at the poor than to return to the days of high progressive rates.²⁰

No single scholar could hope to do original work on the three rather disparate elements of the argument outlined above, and it is foolish to think that Stanley should have defined his enterprise to include any of those arguments. Until the question of progressivity is addressed head on, however, indirect attacks on the present system, no matter how well documented, are unlikely to have much effect, even by the attenuated standards by which one measures the effect of scholarly works.

Notwithstanding its somewhat peculiar take on the issue and the evident problems with its thesis, *Law in the Service of Order* is a valuable contribution to the literature. Stanley has a good story to tell and

15. See generally AMARTYA SEN, *INEQUALITY REEXAMINED* (1992); *UNEVEN TIDES: RISING INEQUALITY IN AMERICA* (Sheldon Danziger & Peter Gottschalk eds., 1993).

16. Indeed, most scholars have found the opposite to be the case. See *supra* note 15. For a slightly more optimistic view of recent trends, see David Wessel, *The Outlook: Rise in Inequality Shows Signs of Slowing*, WALL ST. J., Oct. 19, 1992, at A1.

17. See Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 905 (1987).

18. See, e.g., JOHN RAWLS, *A THEORY OF JUSTICE* 83-95 (1971) (arguing that principles of fair equality of opportunity and pure procedural justice demand that all individuals maintain equal access to certain "primary social goods").

19. See Bankman & Griffith, *supra* note 17, at 1919-25 (discussing studies of labor elasticity).

20. *Id.* at 1966-67 (advocating a combination of flat marginal rates and transfer payments).

tells it well. One is continually struck by the author's erudition and intelligence. Finally, in emphasizing the importance of rhetoric in the politics of tax, Stanley has hit upon a subject ripe for analysis. One does not have to agree with Stanley that the public is fooled by the rhetoric of tax to think it useful to examine the political discourse surrounding the tax law. Suppose, instead, one adopts Witte's more benign vision that politicians offer the public what they believe the public wants. In that case, the rhetoric of tax can serve as a window from which to view the public attitude toward the creation and allocation of wealth. One thinks in this connection of the most recent presidential election. All three candidates made tax reform a central part of their campaign and then proceeded to release tax proposals that could not possibly accomplish their stated objectives and struck many knowledgeable observers as preposterous.²¹ What the proposals had in common was their high symbolic content and their appeal to popular myth and prejudice. Recall the attention given to enterprise or empowerment zones or the claims made concerning tax evasion by foreign companies operating in the United States. Careful analysis of the rhetoric of the campaign might give us some insight into the current tax law. In any event, given the lack of substance in today's political discourse, what else can one study but the rhetoric of the debate?

21. See, e.g., Alan Murray, *Clintonomics: Democrat's Plan Relies on Public Spending to Spur Investment*, WALL ST. J., Oct. 19, 1991, at A1 (detailing the reactions of various economists and policymakers to the tax reform proposals of Clinton, Bush, and Perot).